CERTIFIED TRANSCRIPT

NATIONAL FEDERAL MILK MARKETING ORDER

PRICING FORMULA HEARING

DOCKET NO.: 23-J-0067; AMS-DA-23-0031

Before the Honorable Channing D. Strother, Judge

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Carmel, Indiana

September 12, 2023

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(Please note: Appearances for all parties are subject to change daily, and may not be reported or listed on subsequent days' transcripts.)

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TUESDAY, SEPTEMBER 12, 2023 - - MORNING SESSION

THE COURT: Okay. Let's get started.

Raise your right hand.

JEFF LYON,

Being first duly sworn, was examined and testified as follows:

THE COURT: Thank you.

Your witness.

DIRECT EXAMINATION

BY MS. HANCOCK:

Q. Good morning, Mr. Lyon. Would you mind stating and spelling your name for the record?

A. Jeff Lyon, J-E-F-F, L-Y-O-N.

Q. And what is your business address?

A. Business address is 4001 Nakoosa Trail, Suite 100, Madison, Wisconsin.

Q. How do you spell Nakoosa?

A. N-A-K-O-O-S-A.

Q. Did you prepare NMPF-22 in preparation for your testimony today?

A. Yes, I did.

MS. HANCOCK: Your Honor, if we could mark that as our next exhibit?

THE COURT: Yes. I have the next number as 174. So marked.

(Thereafter, Exhibit Number 174 was marked for identification.)

MS. HANCOCK: Thank you.

BY MS. HANCOCK:

Q. Mr. Lyon, would you proceed with your testimony, please? And then just a reminder to be mindful of your speed because of the -- we want to make sure that we get a good transcript.

A. Yes. I was listening the other day, and one of my fellow Wisconsinites was told to slow down. And that is kind of the nature of some of us Upper Midwesterners, we crank it out a little fast, so I will try.

My name is Jeff Lyon, and this testimony is presented in support of Proposal 7, increase in Make Allowances in the component price formulas to the following levels: Brother, $0.21 per pound; nonfat dry milk, $0.21 per pound; cheese, $0.24 per pound; dry whey, $0.23 per pound.

My background and experience -- my testimony is presented on behalf of FarmFirst Dairy Cooperative, which is a longtime member of National Milk Producers Federation. My time in the dairy industry covers more than 30 years working directly for dairy farmers.

As General Manager for FarmFirst, I have the overall responsibility for all our divisions and departments. With respect to our milk marketing division, Family Dairies USA, I am involved with setting the monthly milk price, pooling/de-pooling decisions, and Federal Order issues. I represent the cooperative in dairy policy discussions individually, through NMPF, and the Midwest Dairy Coalition. I am a member of the Central Milk

Producers Cooperative board of directors.

I got my start working on dairy policy issues in July 1985 as an agriculture legislative assistant for former Wisconsin Congressman Steve Gunderson in his Washington DC office. Mr. Gunderson was the ranking member on the Dairy subcommittee, within the House agriculture committee. And I worked on the 1985 Farm Bill, which included the whole herd buyout program and increasing Class I price differentials.

In the spring of 1986 through March 1988, I served as assistant director for the National Commission on Dairy Policy, a federal commission created by Congress in the 1985 Farm Bill to evaluate U.S. dairy policy. That report was submitted to Congress.

For 22 years I worked for the Wisconsin Farm Bureau Federation. In my first four years and last seven years with Farm Bureau, I coordinated the national affairs program and also lobbied on state legislative and regulatory issues.

I was the lead staff person for our Dairy Advisory Committee. I lobbied on dairy issues in Washington DC individually, with the Farm Bureau president, the Board of Directors, and young farmers.

I prepared testimony for my president and a farmer member for a Federal Order hearing in the early 1990s. For the other 11 years, I led the member relations division and was responsible for coordinating the organization's membership procurement and retention

efforts. While not involved daily in dairy policy I had a thorough understanding of our position on dairy issues.

Before joining FarmFirst, I served seven years as the Deputy Secretary at the Wisconsin Department of Agriculture, Trade, and Consumer Protection. At DATCP, my primary responsibilities included the implementation of policy and rules affecting DATCP, assisting in the management of 600-plus employees, programs, and operations and representing DATCP in relations with other persons, foreign delegations, and stakeholders including the legislature and the Governor.

FarmFirst has been a member of National Milk since 2013, when three Wisconsin based cooperatives merged to form FarmFirst. I have served on the National Milk's Board of Directors for six years. I have also been a member of National Milk's Economic Policy Committee for six years. I have been a member of National Milk's Federal Order Task Force, which for almost two years has studied, evaluated, and proposed the NMPF proposals being heard at this national Federal Order hearing.

And I would like to thank the Secretary of Agriculture for holding this national hearing to consider NMPF proposals. FarmFirst believes the adoption of National Milk's proposals will benefit the entire dairy industry.

FarmFirst has nearly 2600 dairy farmer members in seven Upper Midwestern states, which include Illinois, Indiana, Iowa, Michigan, Minnesota, South Dakota, and

Wisconsin. Their milk is pooled under Federal Orders 30, 32, and 33.

We are a diverse cooperative that provides milk test verification services, markets milk, and owns a milk testing laboratory. We provide milk test verification services for our members that ship their milk to proprietary milk processors, which is the vast majority of our 2600 members. Our members ship milk to 52 processors that are predominantly cheese plants. These plants range from some of the largest to the smallest in the Upper Midwest.

Our membership includes all sizes of dairy farms, small, medium, and large, with the largest concentration of our members in Wisconsin. Our members and their farms are critical to the local economy and infrastructure in their communities with their purchases of products and services, including but not limited to banking, equipment dealers, veterinarians, and feed and fertilizer dealers.

Through our milk marketing division, Family Dairies USA, we sell nearly 600 million pounds of milk annually to 20 to 25 milk proprietary processors of products in all four classes of milk on behalf of our 135 Family Dairies USA patrons. FarmFirst markets all of its milk in Federal Milk Marketing Order 30.

We advocate for our members on policy issues based on positions adopted by our delegates at our annual meeting. Our ten-person Board of Directors, all of which are dairy farmers, and staff are responsible for advancing

member positions on issues.

FarmFirst represents nearly 7.7 billion pounds of milk production annually. In 2022, Hoard's Dairymen ranked FarmFirst as the seventh largest cooperative with respect to milk volume and the second largest cooperative with respect to the number of members.

FarmFirst does not own or operate a processing facility to convert milk into a finished product. However, FarmFirst has an intake/reload facility that allows us to store milk for short periods of time to balance the milk going to processors, keeping the milk fresh until delivery.

FarmFirst sells milk through negotiated annual supply agreements with our buyers and through "spot" loads that are sold to plants that we do not have a supply agreement with. Our milk buyers pay a premium (a negotiated amount above the Class Ill price), which we are able to return to our patron members.

In exchange, our buyers are guaranteed a regular supply of high-quality milk when they need it. We also work with our buyers on a weekly basis and adjust our milk deliveries based on the demand from their customers. We also source organic, A2 milk, and grass-fed milk for our milk buyers when requested.

Our customers rely on FarmFirst to handle milk in excess of their needs annually, seasonally, monthly, weekly, or a daily basis. These balancing serves are costly for FarmFirst member owners.

Since FarmFirst does not operate a processing facility, my testimony will address the effect that current Make Allowances have had on my members and why FarmFirst supports the National Milk proposal.

Over the last few years, FarmFirst has experienced a significant decrease in the premiums we have received for our milk due in large part to outdated Make Allowances.

Current Make Allowances have compressed margins at processing plants, which in turn have been passed on to producers in the form of lower premiums so processing plants can manage their margins. Make Allowances need to be updated in the long-term interest of processor reinvestment in their plants.

In situations as we are in right now with an oversupply of milk -- and when I wrote this, we were very much in that, tightened up here a little bit recently -- but it makes the situation worse for producers. Milk gets dumped or sold well below the Class price.

From January 2020 through July 2023, we experienced a 24% decrease in the average negotiated premium paid per pound of milk, which resulted in approximately $2.7 million or about $0.16 cents per hundredweight on average that we were not able to pay our Family Dairies USA producers. The $2.7 million does not include milk sold under the Class Ill price.

For our members that FarmFirst provides milk test verification services, I do not have the manufacturing

cost data for the proprietary plants, which is considered confidential information, but the situation is similar with negative Producer Price Differentials and the prices received by our farmer members.

Manufacturing costs, or "Make Allowances," are an integral part of the determining milk prices, and Product Price Formulas do not work as intended when Make Allowances are set below the actual cost of commodity manufacturing.

As National Milk stated in their petition, "Under Federal Order Reform, Product Price Formulas replaced the previous direct survey of prices paid for manufacturing milk. PPFs moved the process of establishing the basis for Federal Order pricing up the marketing chain one step to survey unregulated buying and selling of wholesale, spot, commodity style, dairy products.

"Those dairy product prices became the foundation, working backward via economic formulas, to determine the minimum price of milk used to make those commodity dairy products. Adjusting their prices by subtracting the non-milk costs of manufacturing these products and applying appropriate yield factors determines an implied value for the components of milk used to produce them.

"Having accurate and updated plant processing costs, or 'Make Allowances,' and appropriate product yield factors are critical for this indirect method of determining milk prices, which is a principal function of the Federal Order Program. Yet a regular and systematic

method of ensuring that these critical PPFs remain accurate and current has not been established."

There is no question that manufacturing costs have increased since they were last updated in 2008. During our deliberations on the National Milk Federal Order Task Force, members were concerned that the while the 2018 Make Allowance Study commissioned by USDA and conducted by University of Wisconsin-Madison dairy economist Dr. Mark Stephenson provided valuable information on manufacturing costs, there were inconsistencies in his methodology compared to previous Make Allowance surveys, due in large part to the voluntary nature of the survey that disincentivized those plants with a less of a cost increase to respond to the survey.

The National Milk proposal makes modest increases to Make Allowances to partially alleviate problems that have led to the disorderly marketing of milk. The National Milk proposal balances producer and processor interests. It is generally understood that increasing the Make Allowance will have a negative effect on producer prices, at least in the short-term.

Due to the lack of agreed upon comprehensive, industry-wide data on costs, yields and plant volumes, and the impact on producer margins, it is imperative that Make Allowances only be increased to the levels being proposed by National Milk.

Larger increases in Make Allowances that are being proposed by other organizations would only compound the

problem and would narrow margins even further to levels that would negatively impact the profitability of producers, thus jeopardize milk production needed for future dairy demands.

The impact of even modest increases in Make Allowances will be an additional negative on producer margins when one considers the low projected milk price for the remainder of 2023 and into 2024 and already narrow margins due to high feed costs, and increased labor, fuel, and equipment costs.

A perfect example of the tight margins being experienced by producers are the payments received by producers since 2018 through the Dairy Margin Coverage Program, the safety net program that was included in the 2018 Farm Bill.

The DMC program is a voluntary risk management program for dairy producers that offers protection to dairy producers when the difference between the all-milk price and the average feed price falls below a certain dollar amount selected by the producer. The DMC offsets some of the costs being incurred by producers but not all.

I have a table of the payments that have been made in 2019, total payments were just under 452 million. In 2020, payments just under 234 million. In 2021, 1.187 billion. In 2022, 83, almost 84 million. And in 2023, through August 15th, it was at 610 million. And those numbers that I got from USDA, from public numbers.

With respect to processors, Make Allowances were

never intended to guarantee processors a profit on the products they produce but to determine a value for the components of milk.

While not part of this national hearing, National Milk is actively pursuing legislative authority and funding for USDA to conduct regular, mandatory, auditable plant processing cost studies to use to update Make Allowances. If this can be accomplished, the dairy industry will be able to use accurate and more reliable information in updating Make Allowances.

In closing, the industry did not get into the Make Allowance situation overnight and USDA should not expect to get out of this situation entirely on the backs of producers. The modest increases to Make Allowances included within the National Milk proposal is a good first step to balance the interests of both producers and processors.

More importantly, when USDA is given the authorization and funding to conduct mandatory cost surveys as National Milk is also proposing, this will ensure necessary Make Allowance modifications will be made in the future. This will also ensure such Make Allowance changes are conducted on a regular basis.

Once USDA's releases their mandatory plant cost results, then the industry can decide whether to petition for a hearing. This enables the industry to go through the normal hearing process which includes changes being voted on by dairy farmers since Federal Milk Marketing

Orders are a program for dairy farmers. Going through this formal process ensures markets will be corrected, which results in market stability and orderly marketing.

Thank you.

Q. Thank you, Mr. Lyon.

MS. HANCOCK: Your Honor, we would make him available for cross-examination.

THE COURT: Examination of this witness?

Mr. Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Steve Rosenbaum for the International Dairy Foods Association. Good morning, Mr. Lyon.

My first question, really, just one of clarification, if you can turn to page 3 of your statement.

You -- you first talk about 2600 dairy farmers, whose milk is pooled under Orders 30, 32 and 33.

A. Uh-huh.

Q. And then later you talk about a milk marketing division within your cooperative that sells 600 million pounds of milk, all of which is marked in Federal Milk Marketing Order 30.

Can you explain what the difference is between those two --

A. Sure.

Q. -- undertakings?

A. Sure. The -- like I said, the vast majority of my

2600 members in all those Upper Midwestern states, we do test verification services for them. Through the Federal Order system, we need to be a member of a cooperative, like I said, so we do those services for them. These are people that are selling their milk to proprietary dairy processors. So as I said, we do those kind of services for them. My staff regularly checks for components to make sure they are paid properly for components, volumes, those kinds of things. And then -- so that's our function there that we provide for them. And then obviously advocacy efforts as well for them.

Q. So you don't take title to the milk?

A. No. I have nothing to do with their --they are paid by whoever they are shipping their milk to. Like I said, we're the third party group that evaluates their test verification services.

Q. Okay.

A. The other portion, the Family Dairies USA, that's my milk marketing division. And that's where I have 135 processors, and we pick up milk from the Upper Peninsula of Michigan and the Eastern side of Wisconsin and sell that milk to 20 to 25 processors.

Q. Okay. And is that milk, milk of members of your co-op?

A. Yes. They will be the Family Dairies members. Correct.

Q. Okay. And so in that case, you do take title to their milk, and you are the one who is selling it?

A. Yeah. Yeah. We're selling the milk, right. Correct.

Q. All right. So appreciate the clarification.

The -- on page 4, you talk about how there is an oversupply of milk resulting in milk getting dumped; is that correct?

A. There's been a lot of that this past spring. Our -- we're used to demand being slower, you know, during the holiday period, but -- not necessarily a joke, but the comments have been made that Christmas lasted until July this year. It's been very difficult selling milk.

Q. And when you say milk has been dumped, do you have some quantification of that from your own experience and how much?

A. I don't know how much, but it's public record that milk has been dumped, and there was a story in the Milwaukee Journal Sentinel of milk that was going into a sewer treatment facility. But the rest would be anecdotal. We, fortunately, at Family Dairies have not had to dump milk. We've been able to sell ours. Not at prices we always like, but we have been able to sell it.

Q. Okay. And you -- you calculate -- you mentioned that there is a negotiated premium paid --

A. Correct.

Q. -- for milk from January -- correct?

A. Yes. We enter supply agreements with people that we sell milk to, and we work to, you know, sell that milk at class price and something above for the services that

we provide, and making sure that they have the milk, when they want it and in a timely fashion. And then, as I said in my testimony, take care of any, you know, changes they might have. You know, their demand changes, and so sometimes they want more milk, sometimes they want less, and we have to work with them to take care of their needs.

Q. Okay. So you are aware that the minimum milk price -- I'm maybe oversimplifying slightly -- but the minimum milk price that a regulated handler has to pay is essentially the market price for their finished product, let's say cheese as an example, minus the Make Allowance, what's left becomes the minimum milk price --

A. Uh-huh.

Q. -- is that correct?

A. Right. Yeah.

Q. Are you saying "yes"? I'm sorry.

A. Yeah. The price -- I mean, like I said, that's the -- yeah, the price is, you know, set, you know, whatever the price is going to be.

Q. Well, I'm just trying to get to the minimum milk price that's set by regulation. So just the basic concept and approach of the Federal Milk Order system since 2000 has been to survey what the price is for --

A. Correct.

Q. -- for example, commodity cheddar cheese --

A. Correct.

Q. -- to be sold out and --

A. Correct. We sell --

Q. Let me just finish.

-- deduct from that the Make Allowance, which today is roughly $0.20 for cheese, and then the remainder becomes the minimum price that the processor has to pay for their milk, correct?

A. Uh-huh.

Q. Now -- but the fact that you -- you typically try to negotiate a premium over that --

A. Absolutely.

Q. -- correct?

And the fact that you say you have experienced a decrease in the negotiated premium necessarily means you have, in fact, been able to negotiate some level of premium, correct?

A. Correct. And so we have been able to get some. But like I said, that number has decreased due to the fact that the Make Allowance numbers are not accurate. So what's the plant going to do? They are going to cover their costs, and so they are not going to pay as much for the milk, so that's why they pay us --

Q. Right. But I mean --

A. -- less.

Q. -- the fact of the matter is that processors are not necessarily able to hang on to the entire Make Allowance, because some of that money ends up being paid to the farmers in the form of an over-order premium, correct?

A. In some cases, yes.

Q. You have been successful in achieving that, correct?

A. Somewhat.

Q. Okay.

A. My members would like us to be more successful.

Q. Doubtlessly. But, I mean, it's fair to say Make Allowances do not constitute a guarantee for the processors as to how much money they actually get to keep; is that fair?

A. Say that again, sir?

Q. Yeah. That under the order system it's a minimum milk price. The minimum milk price takes away from the processor everything but the Make Allowance from what they have been able to sell the commodity product for. But farmers are still free to and, in fact, succeed in negotiating additional payments in the form of over-order premiums.

Isn't that how the system has worked as a practical matter?

A. It does work, but what I'm referring to in my testimony is that those numbers have gone down considerably, which means a lot less milk -- or a lot less money that I can pay my producers.

Q. And believe me, we're trying to increase those Make Allowances too. But I'm just trying to establish the fundamental point that Make Allowances -- the amount of money reflected in the Make Allowance is not something that a processor is guaranteed to be able to hang on to,

and, in fact, you have been successful, historically, in negotiating over-order premiums --

A. On the Family Dairies side, yes.

Q. Okay. So does your cooperative engage in base/excess plans or other mechanisms to limit the growth in production by your farmer --

A. We --

Q. I know I can tell you know where my questions are going, but for the court reporter it's very challenging if you don't let me finish my question.

A. All right.

Q. So go ahead, please.

A. Go ahead, finish.

Q. No, I finished.

A. Yes. So within our cooperative we have discussed a base/excess plan. It's gone through our milk advisory committee. We have had one ready to go. We have not put it in place. But, you know, we have all the numbers that we could -- we could put in place.

The thought was -- and, quite honestly, go back to 2020 when COVID hit that first Monday, when all the plants were saying they didn't need my milk, I thought we were going to have to dump, and that's when we really started talking and thinking about it. But my members were concerned about, one, how you treat the members. One, they did not want to cut back production because we'd need something different, a smaller herd versus a larger herd. So we looked at it, you know, for, you know, limiting the

growth. But we have not implemented as of yet, but we are certainly ready to go if we need to.

Q. And I take it you don't have direct information as to cost of manufacture since you don't know anything --

A. No, I don't.

Q. Now, are you aware that the kind of survey information, for example, performed by Dr. Stephenson represents the kind of information that has been used by USDA to set Make Allowances since they were first put in place in 2000?

A. Correct. Yes.

Q. And are you aware that, in fact, in putting those Make Allowances into effect in 2000, when it first began, USDA relied in part upon surveys by Dr. Stephenson himself?

A. Correct. Yes.

Q. Okay. Okay. In terms of the Dairy Margin Coverage Program, the farmers have to pay something in order to get that coverage?

A. Yeah. You pay a premium to basically -- it is like an insurance policy. You pay a premium for it.

Q. And do you know how much the payments made by the federal government have exceeded the premiums received?

A. No, I don't. That's a question for USDA.

MR. ROSENBAUM: That's all I have. Thank you.

THE COURT: Further cross?

CROSS-EXAMINATION

BY MS. VULIN:

Q. Good morning, Mr. Lyon.
A. Good morning.
Q. My name is Ashley Vulin. I'm an attorney for the Milk Innovation Group, a group of fluid milk processors.
A. Okay.
Q. Thanks for being here with us this morning.
A. Yep.
Q. I wanted to start by following up on the milk dumping that you described.
You said that that occurred quite a bit this last spring?
A. Yes.
Q. And you said not, though, within your organization, but you were aware of it happening in -- with other producers?
A. We were very fortunate. But anecdotally, yes, we knew that there was milk dumping going on by other companies.
Q. And was that just in Wisconsin or in other places in the country?
A. I only know of it in Wisconsin, not any other parts of the country.
Q. And this past spring when you heard about this milk dumping happening in Wisconsin, was that the first time you had ever heard about milk being dumped?
A. No.
Q. Can you tell me, historically, when you have heard about it happening at other times?

A. Well, most recently would have been when the COVID-19 pandemic hit, and like I said, everything was in disarray, and markets went completely -- there was a lot of milk dumped early then. But it changed very quickly as well when we -- the industry figured out what was going to happen.

Q. And how about prior to that, because I know that was a very singular moment in time, prior to the COVID-19 pandemic happening, were you aware of any milk being dumped in Wisconsin or elsewhere?

A. Oh, there could have been. I can't recall. But different times there would always -- you know, within supply and demand for milk, you know, there's going to be times when somebody doesn't have a home for that milk, so -- but I can't recall any specific dates or times.

Q. And in Wisconsin specifically, can you identify for me in the last ten years any moments where milk supplies were particularly tight, other than the kind of evening out of the COVID-19 pandemic situation?

A. Well, it all -- it all flows. I mean, it is, like I said, just here recently we have had, you know, extremely low prices. We have had soft demand domestically and internationally, and so we had more than sufficient milk supply. But here in recent times, it -- our milk buyers have wanted as much milk as we can give them and things have tightened up. So it is a very cyclical type thing that happens.

Q. And you said that you source organic, A2 milk, and

grass-fed milk for your buyers?

A. Correct.

Q. And do you sell that milk at a premium above what you would sell for other milk?

A. Yeah, we -- we -- what we try to get is -- on that is get some kind of payment just for our service for doing the work for helping this milk buyer out, that we're doing all the work getting the milk to them, so there's a cost for us to do that. So we try to get some money out of it, but it's -- it's not a lot.

Q. More like a brokerage fee?

A. It just -- yeah, just a fee, and it keeps our relationship with those people that we're supplying milk because we're providing them services that they can count on us to help them out with other situations.

Q. And when you -- when you arrange for the sourcing of that organic, A2, and grass-fed milk, do you help negotiate the sale price?

A. Yeah, we'll -- we talk -- yeah, we'll talk back and forth with both buyer and seller on that as to, you know, what they are going to agree upon for that. But that's mostly between the processors buying -- who is going to be the making the cheese, you know, and -- and the customer -- you know, the customer that they have because they want to -- you know, they got to figure out the price that they can actually sell the product at, so --

Q. And for organic milk particularly, are you aware

if the prices being negotiated are significantly higher than non-organic milk?

A. Oh, organic milk is generally higher priced.

Q. And you mentioned that it is important to have accurate and updated processing costs in order to develop the Make Allowances, correct?

A. Yes.

Q. And you -- you testified that your members have been negatively impacted by low Make Allowances because it has impacted the over-order premiums that you were able to negotiate?

A. Correct.

Q. So even though your cooperative doesn't own any processing facilities, you would be better off if Make Allowances were set at an accurate level?

A. That's -- in this whole discussion has been very interesting and -- for me, within our cooperative, because you're correct, I do not have processing facilities. So I could take the easy way out and say, don't make any changes because it's going to be a negative on the producer pay, you know or -- if we raise it, I could just say, leave them the same.

But if I do that, we're still taking -- you know, the farmers are still getting hit because the plants are going to take care of their marginal costs, you know, for running -- operating their plants. And if you go to the high levels that are being proposed by some other groups, farmers are still going to get hit with that because

that's going to -- you know, as I said in my testimony, at least in the short run, that's going to affect them as well. So that's partly why I come in here.

Like I said, I don't operate a facility, but I sell to plants that are experiencing this, and I want those plants to be able to reinvest, whether it is proprietary, co-ops, whoever it happens to be, because that's what my farmers need. If they're not reinvesting, you know, we go down the drain. And we saw that in Wisconsin years ago where we didn't have reinvestment in or plants.

MS. VULIN: Thank you. No further questions.

THE COURT: Further cross?

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good morning, Mr. Lyon.

A. Good morning.

Q. My name is Ryan Miltner. I represent Select Milk Producers.

On page 3 of your testimony, in the middle of the page, you talk about the importance of your members' dairy farms to the local economy. And I wondered if you could comment a little bit more about that, about how important a strong dairy farming community is to the community as a whole.

A. Well, in Wisconsin we still have -- I'll use Wisconsin as my example because that's where I have lived all my formative years. My father -- my family's been

involved in agriculture in Wisconsin for a long time.

And what you see if you look around communities, that when rural communities, when they lose livestock agriculture as a whole, dairy primarily in Wisconsin, but other places where you lose livestock agriculture, you see small towns drying up. And enough people around here know that that happens because the livestock industry, dairy industry requires a lot of services from a lot of different groups, different people as I said in my testimony, that -- so that the dollars get spent very much in our rural communities.

Q. So my -- Select Milk Producers has members in New Mexico, among other states.

A. Sure.

Q. And New Mexico state issued an analysis of the industry suggesting that for every 100 cows, there's a job in the community that is supported, not just on the farm but in the allied industry as you know.

A. Correct.

Q. Are you aware of any similar data for Wisconsin or --

A. Wisconsin is about 45 and a half billion dollar industry for the state of Wisconsin, and that -- and I don't have the numbers of jobs, but the Dairy Farmers of Wisconsin motion would have all those things. But the number of jobs both in on-farm and in processing are considerable.

Q. On page 1 you make a reference to Central Milk

Producers Cooperative.

Can you explain what -- what Central Milk Producers Cooperative is?

A. Central Milk Producers Cooperative was formed in the mid '60s, and it was cooperatives basically working together with respect to -- on the fluid market side of things -- to try to enhance and get the premiums for milk going into the Chicago market.

Q. Is it what might be called a marketing agency in common?

A. Yeah. Right. It's a group of cooperatives together, right.

Q. Does CMPC still set any over-order premiums?

A. The CMPC this past summer made the decision to dissolve their -- we're in that process right now.

Q. With the dissolution of CMPC, do you expect that the Upper Midwest will have significant Class I premiums?

A. That's hard to say where that will all fall out here in the future.

Q. Mr. Rosenbaum asked you some questions about the distinctions between FarmFirst and Family Dairies, and I wanted to follow up on a few of those if I could.

A. Sure.

Q. Where you state that our members ship milk to 52 processors that are predominantly cheese plants.

That -- when you refer to "52 processors," is that for the entire 2600 farms within FarmFirst?

A. Minus the 135 that are Family Dairies people,

so --

Q. Okay. And so do each of those 2500 members or so --

A. Uh-huh.

Q. -- negotiate their own agreement with a processor?

A. They are patrons of whoever they happen to be selling their milk to. So the price that they receive for their milk is between them and the processor. I don't get involved in any way on determining their -- prices for them. That's between them and the processor.

Q. Do you know if, except for instances of price inversions and the like, whether that milk is typically pooled?

A. Well, it all depends upon in the Upper Midwest Order, all depends where -- where all the numbers are at with respect to Class III, Class IV price, so you are going to make a decision as to whether you want to pool or depool your milk. So it's -- it depend upon -- you know, each month you are going to make a decision as to how much you are going to pool or depool based on where Class III Class IV and -- and the formula we use now for the Class I mover.

Q. And when you say you make a decision to pool or depool, for those 2500 farmers or so, is that a decision typically made by their milk buyer?

A. By their milk buyer, yeah. So that's them.

Q. Do you -- do you know as I guess a rule of thumb or what typically happens, whether the benefits of that

depooling are passed through to those 2500 members or not?

A. It's difficult to say because each of those plants are in a different position depending upon, you know, their size, their newness, all those different kinds of things, have they done an expansion. So they may be passing that on; they may not be passing it on. Just -- you know, might guess, I don't know, referring back to 2020, the COVID pandemic, when the milk price, you know -- or price got high, Class III price was, you know, in the 23, 24, something like that. I got calls from my members saying, Jeff, how come I -- my buyer only gave me 19 bucks a hundredweight? How is that when the price is at 23?

And so I had to do my explanation on what depooling means and those kinds of activities. And I said, that's -- you know, that's their decision as to whether they want to give you the 23 or the 19, but they are not part of the Federal Order, so they can pay what they want.

Q. So in an instant like that, you were -- you were giving advice to that -- that patron, correct?

A. I was trying to explain negative producer price differentials, yes.

Q. As part of the services that FarmFirst provides, if there's a dispute between a member and a handler, will you serve as an intermediary or advocate for your producer in that situation?

A. We -- we do not intervene as far as, you know, on what they are paying -- you know, what a processor is

paying the farmer, because like I said, that is their -- that's their business. Like I said, we don't get involved with that. The only time we intervene would be, as I said, on the test verification side of things, if we saw some inaccuracies with respect to component values, that might be where we would get -- you know, if they're not being paid properly for their components, as I said, I have staff that check those regularly, and we also do, you know, tank calibrations and those kinds of things. So it could be on the farmer side or -- or the processor side, you know, are we paying for too much or not enough milk, that kind of thing, so --

Q. At least in my experience, I have seen contracts with cheese plants come in two general varieties: One where the cheese plant will pay a Class III price plus a premium, and some where the pay price is actually based on a formula tied to what that plant manufactures.

Do you have any insight as to what types of contracts exist in Wisconsin in your area?

A. No, I do not.

Q. Are you aware of any -- any contracts between a producer and a cheese plant that is based on an end product formula?

A. I am not.

Q. Moving on to page 4, and you are describing both the services that you provide for your owners and for your customers. It's the second paragraph there.

When you're -- when you are -- when you're

describing those balancing challenges, you say, "Our customers rely on FarmFirst to handle milk in excess of their needs."

Is that --

A. That -- that -- to correct that, that would be -- that would be more accurate to say Family Dairies, my director of milk marketing, not FarmFirst.

Q. Okay. That was my question.

A. Correct.

Q. So then in the next sentence where it says, "These balancing services are costly for FarmFirst member-owners," is that -- should that also be --

A. Family Dairies --

Q. -- Family Dairies?

A. -- correct. Yes. Apologies for the confusion.

Q. No need to apologize.

A. Kind of interchangeable in my world.

Q. So for the member of FarmFirst who has a contract with a cheese plant, that cheese plant has -- do they have to balance all of their own milk needs?

A. I am not quite following your question.

Q. Okay. Well, does FarmFirst -- let me start over here.

We have got a producer. Okay? Who is a member of FarmFirst but not Family Dairies.

A. Correct.

Q. And the cheese plant that is buying milk from that producer, who is responsible for balancing the milk

requirements of that cheese plant?

A. The cheese plant that's buying it. I mean, if they have enough milk from all their patrons, then they are balanced and it works out for them, and different times when they need to -- a plant like that may need additional milk, they are going to go to another source for additional supplies of milk and -- and we're one of those sources and -- sources.

Q. So unless you get a call from that cheese plant that says, "I need some more milk," you -- you -- FarmFirst does not get involved in the balancing for that plant?

A. Well, the -- it's always very interesting because it -- in -- when you are -- let me try to explain a week in my director of milk marketing's life.

Does the scheduling on a Thursday. So we start asking all our buyers, how much milk are they going to need, you know, and you would have a general idea of what it is going to be. But then they might say, we don't need as much, you know, demand's down, we are going to shut down the plant because we have to do maintenance on it, so we're not going to be taking milk on a certain day, so we need less milk.

So then we find out from our current customers how much milk they need, and then when you know that, then you know how much milk that you are going to have to make phone calls. So that's when you get around and you start to calling people to find out who needs milk. And it is a

situation where there's lot of phone calls going back and forth from lots of different people, you know, who needs milk, who has milk. Those conversations happen all the time to -- to take care of everyone's needs.

Q. Let me approach this a little bit differently because I think we're thinking of a couple different things.

A. All right.

Q. Probably because I'm not phrasing my questions perfectly.

A. All right.

Q. For the producer who sells directly to a cheese plant, is that agreement to sell all of the milk production from that farm, generally?

A. Yes.

Q. Now, if we -- if we look now at Family Dairies --

A. Uh-huh.

Q. -- and you testified that the balancing services are costly for those Family Dairies members, correct?

A. Correct.

Q. Okay. Those balancing services provided by Family -- by Family Dairies, are those costs shared among all 2600 members?

A. No.

Q. They are not?

A. No, that -- they are separate entities. The Family Dairies and the FarmFirst are separate entities. So when I say costly and balancing, depending upon time of

year, depending on demand, and let's say, you know, demand from our buyers is down, and we have several spot loads of milk that we have to sell, then -- you know, then we got get on and sell those -- sell those loads of milk. And, obviously, perishability, we don't -- not having a processing plant, we have to sell that milk. I don't have a -- the ability to make 40-pound blocks of cheddar and sell some other time, so we have to sell that. So depending upon time of year, those -- those loads of milk can be sold at the stretch price. But we are also balancing the needs of some other plants, too.

Q. So really you have a small proportion of your cooperative bearing all the balancing costs for 2600 members?

A. No.

Q. "No"?

A. As I said in my statement, they are totally separate entities. My milk marketing division Family Dairies operates separately. That's 135 farms, 600 million pounds of milk that we sell. We do our pooling, do all the different things and work with that.

The members -- your earlier question on the 26 -- the less than 2600 that we do the test verification services, those are farmers that sell to proprietary plants that have agreements with the people that they are selling their milk to.

Q. Can you -- can you help me understand a little more, how the adoption of Proposal 7 will alleviate some

of those balancing costs that you now have to incur?

A. Well, the -- you know, in our review with the National Milk and looking at the Federal Orders, you know, and looking at Dr. Stephenson's and the numbers that came out, and as I said in my testimony, there was -- you know, you know, just the entire industry, you know, because of some inconsistencies in how things were done, everyone agreed that the numbers, you know, where we're at right now, you know, that costs have increased. And it was our thought, you know, looking at it and our -- I think questions have been asked of our members who have testified already about, you know, their own numbers and how we came up with the numbers. But that was, you know, our best estimate that, you know, this is where we should start with these because, as I said, we're trying to balance both the processor and farmer interests in this -- in getting to where we need to be in the future.

Q. Thank you.

Further down on page 4 you are describing the decrease in negotiated premiums. And are you talking about premiums overall or are those just Class III premiums you are discussing?

A. They would be over the Class III price that we try to negotiate.

Q. So you note that they have declined by about $0.16 per hundredweight, correct?

A. Correct. Yep.

Q. And that that's a 24% decrease, correct?

A. In that timeframe, yes.
Q. So if I take 16 and I divide by .24, I get about $0.66. Does that -- would that be about the Class III premium you were starting at in January 2020?
A. They all vary. It would depend upon the customers.
Q. So in Order 30 it's not a uniform Class III premium, it is negotiated customer by customer?
A. Correct.
Q. Different from like what CMPC would do for the Class I market?
A. Correct.
Q. On page 6 you talk about the Dairy Margin Coverage Program. And that program has like two tiers to it, correct?
A. Yes.
Q. And the first tier covers up to I think it's now 5 million pounds of annual production. Does that sound about right?
A. That's correct.
Q. Of all of your members, and I mean all 2600 or so, do you have an estimate as to how many of them exceed that Tier 1 limit?
A. I -- no, I couldn't tell you how many exceed. I would have to -- I would have to dig into my numbers because, like I said, I -- on the test verification side, it would just be looking at the amount that comes in for a test, our revenue that we get from them, so I can do the

calculation. But the majority would probably be at the 5 million or under. But there's -- there's normal size herds are going to be above that, so --

MR. MILTNER: Thank you very much for your answers. I don't have any other questions.

THE WITNESS: Yep.

THE COURT: Further examination? Other than AMS? Seeing none, AMS, Ms. Taylor.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good morning.

A. Good morning.

Q. Thanks for coming to testify today.

I was wondering if you could give us a little more detail on your farmer members, particularly if they would meet the Small Business definition, which is $3.75 million in annual gross revenue a year on a whole farm basis. There's been discussion at the hearing that that's around 400 cows or so.

A. The majority would fall the 400 cows or under.

Q. And could you speak at all to whether your members use any types of -- other than DMC, use any types of risk management tools available to them?

A. A few years ago, about three, four years ago, we did a survey of our Family Dairies patrons to just find out about their risk management. And as you might expect -- and I'm glad we -- because we encourage, but they are participating in DMC, because that's been a very

good program. We offer forward contracting through the cooperative. We have some members that do take advantage of that. And then other members indicated that they do LGM and DRP as well. That would be the majority.

Q. Okay. Thank you.

Under the premiums you discuss on page 4, I believe that these -- this -- it doesn't say specifically. So to be clear, these are premiums for your family dairy's milk?

A. That is correct.

Q. Okay. And I -- and I think you just answered some of the questions I had with Mr. Miltner about they are negotiated customer by customer.

A. Absolutely.

Q. And are they typically done annually?

A. Annually, and, you know, we'll have, depending upon the buyer, we have annual contracts, and we might certain types of year have, you know, for several months, that kind of thing, so --

Q. Okay. And have you seen -- you talk about the decrease in 2020 to 2023. So has it just kind of been a steady decline as you move through that period?

A. I wouldn't say -- I wouldn't say steady, but, you know, like I said, it comes up from time to time from our buyers saying, hey, we want to talk about this, and so then we have to have that discussion.

Q. Uh-huh. So how would you expect the premiums to be impacted if the Make Allowances are increased?

A. I think over time that the premiums would increase. I mean, theoretically, that's what would happen is that if you go back, you know, several years when Make Allowances were more in line, you know, the premiums were, you know, significant in the Upper Midwest that we were able to get for that milk. So one would, you know, assume reason that they would go up over time. But I wouldn't -- I would never say that they are going to go up real fast.

Q. Okay. On the bottom of page 5 when you are discussing the National Milk proposal specifically, you talk about how it's a modest increase and will partially alleviate the problems that have led to the disorderly marketing of milk.

My first question is, can you talk a little bit about the disorder you are citing there? What do you see as disorderly marketing?

A. Well, thinking about that last night as to what, you know, the definition of disorderly means. If your -- if your definition is, you know, as far as moving milk, that's, you know, one definition. But disorderly, if we're talking about a program that's for farmers and -- and we're not -- you know, I'm not taking care of them through, you know, the Federal Order program or whatever, disorderly becomes people exiting the business. That's -- that can be disorderly as well, too, so --

Q. And would you say the decrease in, I guess, premiums and the Federal Order prices, or the overall

price your farmers get, is something that is leading farms to exit the industry, then?

A. There's lots of reasons why people exit the industry.

Q. But you believe Make Allowances is one of those reasons.

A. Absolutely. If you are getting less for your milk, and you got high costs of production, you make decisions in life.

Q. So another question that arises, then, is -- and you talk a little bit about trying to find the right balance, but why are the modest increases appropriate if they don't fully alleviate the problems related to the formulas not working as intended?

A. Well, I tried to answer that question, I think, from one of the other people. That if we -- if you do nothing and we just would stay where we're at, you are going to continue on the course we're at right now where plants are going to make sure that they cover their margins on it, because you're not -- we're not making any changes. If you make those changes too drastically and raise it up too high too fast, farmers are still going to take it with respect to the price as far as receiving a lower price.

I mean, it's -- it's been recognized, you know, any of the economists that would tell you that at least, as I said in my testimony, in the short-term, you are going to see a decrease in prices to farmers.

So that's why -- why National Milk came with the idea of let's go after it with a modest increase with it. And the real problem has been is because it's taken so long since the last survey that was done, that's why -- not in part of the order hearing, but legislative to give USDA the authority and funding to be able to do these on a regular basis so we don't end up in the situation that we're at right now.

So, you know, to me, it's a very real economic decision, both to assist the processors and the producers, and that's why I think the numbers that National Milk is proposing are where they should be.

MS. TAYLOR: That's it from AMS. Thank you.

THE WITNESS: You're welcome.

THE COURT: Dr. Bozic.

CROSS-EXAMINATION

BY DR. BOZIC:

Q. Marin Bozic for Edge Dairy Farmer Cooperative.

Good morning, Mr. Lyon.

A. Good morning.

Q. I think I heard you say something, and I wanted to confirm that I heard correctly. Did you say that outdated Make Allowances are increasing farm exits?

A. I said there's lot of reasons why farmers exit the industry.

Q. Is -- are outdated Make Allowances one of those reasons?

A. Well, I don't know if outdated Make Allowances

directly, but the fact that the plants are covering their costs and farmers get in a lower price would be the reason. But necessarily, you know, but the Make Allowance is part of that.

Q. Well, differently, would increasing Make Allowances help arrest or reduce farm exits, in your opinion?

A. I can't -- I can't answer that. Like, as I said before, there's lots of reasons why people enter and exit the business.

Q. The other thing I think I heard you say is that over-order premiums, you expect them to come back at a higher level if Make Allowances are increased; is that --

A. I would hope so.

Q. Yeah, me too.

But -- but I think I also heard you say that you would not expect them to come back instantly or immediately. Is that a fair statement?

A. That's a fair statement, because I have -- the prices never go up faster than they go down, and it always seems like it takes a long time for them to get back up. So that would -- if history is any indicator, I would expect that it would go slow.

Q. So then would it follow that for a period of time we could sort of have a double whammy, where protein price, regulated protein price, is lower because of higher Make Allowance, but the over-order premiums are slow to react, so net-net, or producers actually get even lower

price?

A. Say that again? I'm sorry.

Q. So if over-order premiums would take time to -- to get back, then on day one, when we get higher Make Allowance, would the net effect of higher Make Allowance and slow-to-react over-order premiums be even lower farm price?

A. I would have -- you would have to take that to someone -- an economist or something, and tell me what is going to happen with that. And you would be one of the people that could run those numbers, along with other people.

Q. Yeah. So I was just trying to tease out the logical consequences of your expectations regarding the slow-reverting over-order premiums, and -- in face of increasing Make Allowances.

The other thing that I'm -- just want to confirm. When -- when we were cross-examining several witnesses yesterday who are representing cooperatives, several of them -- or at least one of them that I cross-examined, stated that they do not anticipate that the cash flow to their cooperative directly would change -- or in any significant way, change because of change in Make Allowances. In other words, they have to reblend right now because their costs are high. If the Make Allowances are increased, they just wouldn't have to reblend as much, but the amount of money they received every month as a sum of the sales proceeds from their

products and the draws from the pool, that -- that sum wouldn't change. So, in other words, their producers would not feel the increase in Make Allowances, a lower paycheck that they take home every month.

Would you anticipate that as a consequence of higher Make Allowances, your members that sell to proprietary farms would also be held harmless immediately after the Make Allowances are increased?

A. I don't -- there's a lot to that question if you are going to be held harmlessly, because a lot depends upon any -- on whether it's a proprietary or a cooperative, whether, you know, on the Make Allowances and, you know, whether you are going to be pooling or depooling, and all the different other aspects that go into those decisions. Because, you know, you can -- you know, the proprietary plant, if you are -- you know, you're not pooled or whatever, you can pay -- you know, as I said earlier, you pay, you know, whatever you want to, you know, to make sure that you have milk to process products.

So, you know, it's very difficult. I can't answer -- to whoever you talked to, whoever was on yesterday. But that's -- what's interesting and difficult about it, is that all the plants are so different in what their option, what their needs are as far as modernization, expansions, you know, what they happen to be doing, you know, and just how they want to treat their farmers, too.

Q. But in some sense it doesn't have to be that complicated, so let's try to tease this out.

Do you have -- are you -- are your members currently shipping to some proprietary plants that are currently pooled on Order 30?

A. Yes. If I looked at the USDA, you know, there would be people that would pool.

Q. That would be pooling?

A. Yeah, they'd be pooling. Sure.

Q. So if they are pooled today, that means that they are paying at least the minimum regulated prices today.

A. Correct.

Q. And if the minimum regulated price goes down as a consequence of Make Allowance, and those proprietary plants cannot reblend, would it not be logical to expect that then the farm price would also tend to go down, at least until the time that over-order premiums adjust?

A. Uh-huh.

Q. I just hope that doesn't lead to farm exits while the over-order premiums --

A. Absolutely.

DR. BOZIC: Thank you very much.

THE COURT: Anything further?

Redirect.

MS. HANCOCK: Your Honor, that's all we have for Mr. Lyon. We would move to admit Exhibit 174.

THE COURT: Objections?

Seeing none, Exhibit 174 is admitted into the

record.

(Thereafter, Exhibit Number 174 was received into evidence.)

THE COURT: Thank you, sir.

Let's break for ten minutes. Come back at 9:25.

(Whereupon, a break was taken.)

THE COURT: On the record.

Raise your right hand.

ED GALLAGHER,

Being first duly sworn, was examined and testified as follows:

THE COURT: Your witness.

DIRECT EXAMINATION

BY MS. HANCOCK:

Q. Good morning, Mr. Gallagher.

A. Good morning.

Q. Welcome back to the stand and back to Indianapolis. I want to have you, I guess --

MS. HANCOCK: I can't remember, are we having them restate their name and address?

THE COURT: Let's not. Unless somebody's got an objection. We're trying to -- it seems like -- thank you. Good suggestion.

BY MS. HANCOCK:

Q. Mr. Gallagher, did you prepare Exhibit NMPF-24 in support of your testimony today?

A. I did.

Q. And that's testimony in support of National Milk's

Make Allowance proposal?

A. That's correct.

MS. HANCOCK: Your Honor, if we would mark that as the next exhibit?

THE COURT: NMPF-4 will be marked --

MS. TAYLOR: 24.

THE COURT: What's that?

MS. TAYLOR: NMPF-24.

THE COURT: 24. 175.

(Thereafter, Exhibit Number 175 was marked for identification.)

BY MS. HANCOCK:

Q. Mr. Gallagher, if you could go ahead and present us with your testimony in Exhibit 175.

A. Yes, thank you.

I'm going to skip around a bit and sort of hit the highlights. I am going to -- a little bit different than I did for the milk composition, I'm going to spend a little bit more time reading some of my testimony.

I'm curious, how many of you read my testimony already?

All right. Thank you. Because I put a lot of work into this, so thank you for reading it. I appreciate it.

Okay. So I'm going to start on page 2, the first full paragraph.

I'm hear to present evidence about the need to limit the Make Allowance changes to those levels proposed

by NMPF. My testimony will cover the existence of significant farm input price inflation, high milk cost of production, and thin dairy profit margins that could lead to a disorderly marketing condition of a substantial loss of raw milk production if a structural change to Federal Order class prices leads to a significant reduction in farm milk prices.

The existence of high feed prices and other inflated dairy production costs and longer-term low dairy farmer profit margins provide strong evidence for the need to be responsive to the impacts Make Allowance changes will have on dairy farmer profitability.

Aggressive Make Allowance increases, whether or not evidence of higher manufacturing costs exist, will harm dairy farmer profitability, negatively impacting the milk supply and lead to a potentially troubling disorderly marketing condition that risks the ability for U.S. dairy farmers to adequately supply the market's need for milk.

DFA and the NMPF member cooperatives have carefully and thoughtfully approached the issue about updating Federal Order Make Allowances. There is no doubt that dairy plant input prices have increased since 2006, the last time the data was included in a Federal Order hearing considering adjustments to Make Allowances.

There is also no doubt that dairy plants are more efficient in converting loads of milk into manufacturing, dairy products, and there is no doubt that dairy -- the dairy manufacturing industry has expanded with newer and

more efficient technology and larger plant sizes.

But the changes to non-milk input prices at the processing level must be balanced against what would happen at the farm level of the dairy supply chain if a Federal Order price formula change led to a significant decrease in milk prices.

An increase in Make Allowances reduces class prices in dairy farmer milk prices and shifts that revenue to a credit to those manufacturing dairy products. Since a Make Allowance increase directly reduces milk prices impacting dairy farmer milk checks, we believe a strong burden of proof backed by strong and credible data are absolutely necessary to justify a large Make Allowance increase.

The dairy farmer side of the industry has data confidence issues with the survey data in the public domain, that in prior proceedings of this nature, were used to adjust dairy farmer milk prices, via Make Allowance change.

I go no further than pointing to the work of the International Dairy Foods Association, and others, to utilize input price changes in equations to update manufacturing costs that were established with the technology in manufacturing infrastructure that existed 17 years ago, as an example of evidence of the concerns about the survey's data.

If adequate survey data existed, there would be no need to perform these mathematical calculations in an

attempt to determine the changes in the manufacturing costs of production or to prove them out. Dairy manufacturing factors of productivity have increased over those 17 years, which cannot be seen by a review of input prices alone or by adjusting an equation by some mathematical exercise to include some other industry's factors of productivity.

Dairy farmers across the country are concerned about a wealth transfer from their families' businesses, manufacturing plant operators through their milk checks by federal fiat. We are faced with a looming crisis of confidence from dairy producers.

You will hear resounding support from the dairy farming community for the NMPF Make Allowance proposal that balances the recognition of manufacturing plant input price increases against the impact on dairy farmer milk prices and dairy farmer profitability, and in so doing, recognizes the data issues that undermine the confidence of dairy farmers wanting a fair and balanced outcome.

DFA, NMPF, American Farm Bureau, IDFA, and others, are working with Congress to establish a procedure for the federal government to survey dairy plant manufacturers about their input prices, costs yields, and other factors, to develop a dataset that has the entire industry's confidence and that can be used as meaningful input in future Federal Order hearings about Make Allowances. Unfortunately, at this point in time, we do not have the data that leads to industry-wide confidence.

The NMPF member cooperatives have developed a fair and balanced Make Allowance proposal that provides cost relief to manufacturing plants. Cooperatives are hopeful that this balanced approach will maintain the confidence in and support of the Federal Order program by dairy farmers across this country. DFA and NMPF strongly urges the Secretary of Agriculture to adopt the NMPF Make Allowance proposal.

DFA and NMPF will be sharing today data that compares farm input prices, dairy farm costs, and costs of production per hundredweight of milk, and dairy farm profitability in the U.S. and for various regions over time.

We will provide data from USDA and private accounting firms as evidence. This evidence will show that there has been significant price inflation on dairy farms. Their costs and cost of production have increased substantially. And the average profitability over time is highly variable and averages less than $1 per hundredweight of milk produced in some areas of the United States.

Although you will have information on the record that may show that manufacturing input prices have increased substantially and total costs of production have increased at various milk plants across the United States, beyond $0.04 a pound since 2006, it is important to note that dairy farmers' input prices and costs have increased as well, and their profitability will be substantially

harmed if there is a significant increase in Make Allowances.

A significant change in the structural basis of U.S. milk prices coming from a significant increase in Federal Order Make Allowances will result in a loss of profitability of dairy farms, more rapid consolidation in the producers sector, reduced milk production than would otherwise occur, which in turn could likely create disorderly marketing conditions relative to the supply of milk to meet the needs of consumers.

I begin by presenting farm input price inflation. I expect much to be discussed about farm input price inflation. Manufacturing side, we believe it's important for the Secretary of Agriculture to consider price inflation on farms as well.

The U.S. Constitution equivalent of the Federal Order Program, the Agricultural Marketing Agreement Act of 1937, as amended, does not reference Make Allowances or manufacturers' input price inflation in the determination of minimum milk prices. It does instruct the Secretary of Agriculture to consider issues related to the price of livestock feed and the ability to adequately supply milk to the marketplace.

USDA's National Agricultural Statistical Service administers monthly surveys of agricultural prices received and paid by farmers. Their survey results are presented in their monthly publication, Agriculture Prices. The prices paid section provides relevant

information on several farm production inputs, and tracked over time, can show inflationary or deflationary prices faced by farmers across the United States.

DFA and National Milk request official notice be taken of the Ag Prices monthly publications from December 1999 to the present.

The Ag Prices feed price index is telling of the situation faced by farmers. I show that, page 5, the graph on page 5.

It provides general pricing information for the U.S. marketplace where dairy farmers purchase livestock feed inputs in competition with other livestock farmers, ethanol plants, and other businesses using feed stuffs in their manufacturing process.

It can also show pressures from overseas buyers that import U.S. grown feed grains. Livestock feed often represents 50% or more of the cost of production on a dairy farm, so inflationary or deflationary aspects of feed are an important factor in the cost of producing milk.

The chart on the top of page 5 was produced at DFA using Ag Prices data. We adjusted the base year to be 2000 to coincide with the implementation of the Federal Order Reform pricing provisions. We also included producer -- Federal Bureau of Labor Statistics producer price index, or PPI. That statistic, also surveyed and reported monthly, is a common measurement of inflation impacting producers of goods and services across the U.S.

It surveys the price that was received for selling the input produced by the manufacturers or service providers.

The statistics change over time and provide indications of general inflation or deflation facing businesses, as they raise or lower their selling prices to either pass along higher input prices or pass along deflating input prices. It is for this reason that the Federal Reserve uses this statistic as a guide in making inflationary-based decisions about adjustments to the federal funds rate.

DFA and National Milk request official notice be taken of monthly PPI publications from December 1999 to the present.

Q. Mr. Gallagher, while you have this pulled up, I'm just wondering if you can zoom in so that we can see just the chart in a larger image.

A. The chart, using the Ag Prices information for livestock feed, shows that feed prices are inflationary and deflationary, but tend to be much more inflationary over time than the PPI, which also has been included in the bottom line. This can be seen that the feed index PPI is 3.25 times higher than it was in 2000, while the PPI is about 1.8 times higher.

It can also be seen that feed and general PPI inflation ran approximately parallel in 2007 when the two price surveys have seen increasingly larger divergences. Impacting feed prices has been the Federal government's

supported use of feed stuffs to produce ethanol and other biofuels, droughts, growing U.S. feed grain export sales, and, most recently, the Russia-Ukraine conflict.

But I would note where it jumps, the market jumped, is when ethanol really took off in the United States, and significant quantities of livestock feed were used to produce ethanol. It raised the cost of producing milk to dairy farms across the country by a significant amount.

That is my next chart. Unsurprising to you, it would be the DFA risk management has a feed index to help our farmer-owners manage their feed cost index -- or feed cost -- feed costs, and we combine it with our milk price-forward contracting program to help them manage a milk feed margin.

This is our index. The variables in the index are corn and soybean meal, both using futures market settlements from the CME Group. Those are the only variables in this -- in our formula.

And you can see that our index would suggest from 2000 to 2006, other than one spike, that the average cost of feed on a milk per hundredweight basis, using our index, was $4 per hundredweight of milk.

Ethanol then took hold. We had some really crazy markets. And as it settled out over time, and if you look at 2015 through 2019, it settled out not at $4 per hundredweight of milk, but at $8 per hundredweight of milk. It doubled. And it's gone up since for other

reasons, most notably, most recently, including the Ukraine-Russian conflict.

Dairy farmers have been faced with significant feed price inflation that has led to changes in profitability. Federal Order milk pricing formulas and blend price pools do not include a factor to help dairy farmers recover their costs relating to feeding more expensive feed to their herds.

The existence of inflated livestock feed prices and the significant impact on dairy farmers' cost of production needs to be measured against a structural change to Federal Order milk prices. With higher feed costs, a significant decline in Federal Order milk prices will harm dairy farmer profitability, leading to reduced milk production that otherwise would occur, threatening the ability to adequately supply the market its milk needs, leading to a potentially supply-induced disorderly marketing condition.

The DFA encourages the Secretary of Agriculture to consider the significantly inflated prices for livestock feed when making his decision about changes to Federal Order Make Allowance and use it as evidence to support the NMPF Make Allowance adjustment proposal, even if there's credible evidence of the existence of higher manufacturing costs of production.

The next section is about the Dairy Margin Coverage Program. I would say the Dairy Margin Coverage Program is the single best risk management tool that

exists. And I appreciate its continuance, and we hope we can strengthen it over time.

I'm going to skip to page 8, and I want to show the chart at the top of page 8. This is data that I received from the National Milk Producers Federation, and they received this data from USDA. And it shows for 2022, the year 2022, the number of operations by milk production size that participated in the Dairy Margin Coverage Program. And I'll come back to some of that data here in a minute.

For calendar year 2022, U.S. dairy -- I'll do it right now -- U.S. dairy farmers produced 226.5 billion pounds of milk. Of this production, 48.8 billion, or 21.5%, had meaningful coverage under the DMC Tier 1 coverage and some measure of protection against livestock feed.

I'm going to back up. And the chart on page 7 shows the Tier 1 and Tier 2 premiums. And so, in essence, every -- it's silly for a dairy farmer not to be covered by Dairy Margin Coverage. Fortunately some are. Every dairy farmer that has coverage should have as much covered under Tier 1 as they can. The larger farms are limited to how much they can get covered under Tier 1. And generally, though, then, what they will do is they will cover the rest of their milk under Tier -- under Tier 2 at $4 per hundredweight because there's no cost.

I don't believe there's very much coverage beyond that. We never thought in the history of the world that

they would ever get a margin payment at the $4 level, but I think this most recent month they are receiving a payment on the -- on the margin, because the margin is less than $4 a hundredweight. Go figure. Crazy world we live in.

So the other -- so we have 26 -- 21.5% of the milk that has some meaningful coverage under DMC to protect them against feed price changes. The other 78.5% of U.S. milk production did not have that type of meaningful protection under this program.

The existence of the DMC program does not produce enough benefit on the super majority of the U.S. milk production to be considered an offset against the need to recognize livestock feed price inflation in determining the appropriate limitation on the degree of Make Allowance -- appropriate Make Allowance increase.

Now I'm going to talk about the chart at the bottom of page 8.

This chart was developed from the Ag Prices data and portrays changes in farm input prices for a variety of inputs. The chart shows significant price inflation since 2006, and like everyone else, every manufacturing business in the United States, and around the world, significant price inflation since 2021.

The Ag Prices data publication has its own version of an index that would be similar to a PPI. It's called the Prices Paid By Farmers For Commodity Services, Interest, Taxes, and Wage Rates, and it is referred to as

PPITW.

This chart on page 9 tracks that against the PPI. The red bars at the bottom identify the divergence between the two.

Of importance in this proceeding, every business faced steep inflation over the last two years. This includes dairy farmers. However, unlike the request from the milk plant operators in IDFA and the Wisconsin Cheese Makers Association, if dairy farmers cover the manufacturers' increased inflationary input prices, dairy farmers do not have the opportunity to recover their inflationary costs via federal edict. Dairy farmers' inflated cost of production need to be considered when determining the decree of increase to Make Allowance in this proceeding.

DFA presents for the record information about dairy farmer costs of production and profit margins. We present data from USDA and the two accounting firms.

I would like to take official notice of USDA's milk cost of production documents and include all their information dating back to 1999 in the record.

The following table was compiled by me from USDA Economic Research Service Milk Cost of Production Estimates, using 2010, 2016, and 2021 as the base years. I have presented the data for all sizes of dairy farms. They have data that breaks out costs of production and returns over time, by different sizes of dairy farms. But in this chart, it is the average for all dairies in the

United States, across all regions, all states.

I have made an adjustment from their data. So I copied the data into an Excel spreadsheet and created this chart. I have made adjustments to their total costs listed values by subtracting from the cost the opportunity cost of labor and the opportunity cost of land. I do this to make the data more comparable to the information from the two accounting firms that have previously appeared and included their information in the hearing record.

I have adjusted the total cost in the row I call "cost less opportunity cost of unpaid labor and land." I recomputed profitability by subtracting that value and total gross value of production, and the recomputed profitability value is the last row in the chart called "adjusted net profit."

This chart that is on page 11 was produced from the data that I have presented on page 10. It charts the total feed cost row, identified in the chart as feed, the cost less operating cost unpaid labor and land, row identified in the chart as total, and the milk sold row, which represents the average milk price identified in the chart as milk sold. It shows that dairy farmers have been under cost pressure.

So we can see that the total cost in almost every year is greater than milk sold. It also shows how feed costs change, but how they have gone up over time. And as you get into 2021 and 2022, you can look at the difference between the feed bar and the total bar and you can see

that the difference between the two is increasing to show that there are other inflationary pressures also impacting dairy farmer productivity.

As I mentioned, USDA also identifies costs of production for various farm sizes. So I created the chart on page 12 to identify two different farm sizes. And I do these two different farm sizes because they are more similar to the data that would be included in the Frazer accounting firm data and the Nietzke Faupel accounting firm data, since those two datasets generally incorporate information from larger-sized farms.

From 2012 through 2014, the largest size category that was listed in the -- in the data was 1,000 cows or more. In 2016, they also then started showing 2,000 cows or more. And so I would have gone -- I have got in my data, I pulled the data from the USDA that would have looked like this, except for it was for those two size categories. I recomputed the numbers like I did here, and I looked at their adjusted net profit, and I have listed that in this chart for each year.

I do note that from 2012 through 2015, because I -- they don't have 2,000 or more cow data, I just used whatever they had for the 1,000 or more for that column. I also then also on the third column listed the all sizes, so the average size for all dairy farmers throughout the United States.

And you can see in that data, very clearly, red is loss, black is profit. And across time there are years

when dairy farmers make money and there are years when dairy farmers lose money. Even the largest of the large lose money.

What I think is very instructive is what the average is. 2022 was a really good year. Most dairy farmers made money, and they did okay. But 2022, unfortunately, is an anomaly that doesn't occur very often. In the interim, there are a lot of hard times.

So I think what's important is to look at the average profitability over time, and you can see the -- if you go all the way to the right, the all sizes, and you can pick your average and the data is there, and you can -- you know, whoever wants to, USDA, I rely on you to sort this however you think is appropriate.

But on average, dairy farmers lose money across the United States. But the larger farms on average make money, but they make a lot less than you would think.

So, on the 1,000 to 2,000 cow farms, they make somewhere between, on average, $0.70 to $1.00 a hundredweight. And then the even larger farms make, on average, somewhere from $1.20 to $1.45. You got to take this into consideration.

By year four of the implementation of the IDFA and the Wisconsin Cheese Makers Association, the structural change in the milk price of their Make Allowance increase would be about $1.45-ish. And you guys can use all -- you guys can recompute what that means, and I'll accept your computation, USDA. But at $1.45, it wipes out the average

profitability of pretty much everybody in the dairy industry.

So I think there's a milk supply issue if that happens, and I think that creates a disorderly marketing condition. And despite information that would have been included in prior decisions on hearings about Class III and IV prices, largely from the Bush Administration, but certainly not from the Biden Administration, I think you absolutely have to take the impacts on dairy farmer profitability and their costs of production into account in this situation.

I do explain how I got to my calculations. If you look on -- and I'm open to correction on any of this, but it's not going to be much different. But I have shown in this chart, on page 13, the impact to the Class III and IV price on the -- based on the National Milk proposal. And I have looked at the cumulative impact by year of the IDFA and Wisconsin Cheese Makers Association proposal. You can see my estimate on the all-milk price is pretty significantly more, almost a dollar a hundredweight larger -- more of a decrease in farm milk prices from the IDFA and the Wisconsin Cheese Makers Association.

And I describe above that the utilizations I used. And I'm open to anybody using the utilizations, but the net impact isn't going to change that much from my calculations. There's serious, serious risk to dairy farmer profitability if you go much above the National Milk proposal.

Picking up on page 13, right under the -- picking up my testimony right under the chart.

The IDFA proposed change is greater than the average profitability of the average U.S. dairy farm and the two largest sized dairy farm groups based on the USDA information.

For the two largest sized dairy farm groups, about seven or eight years out of 11, the net farm income averaged less than $1.45 per hundredweight. For the all size groups, it occurred in ten of 11 years. It is DFA's view that the implementation of the IDFA proposal would result in a much more rapid consolidation of the U.S. dairy farming sector and threaten the financial stability of the largest U.S. dairy farms producing most of the milk and create credit-related issues with feed companies and the agricultural lending industry. It would be a wreck.

The implementation of the IDFA proposal will lead to severe disorderly marketing conditions that could undermine the ability to adequately supply consumers with fresh fluid milk and it must be rejected by USDA.

We provided information from two accounting firms. Leland Kootstra, a partner in Frazer, LLP, presented information already at the hearing, and Jeff Bushey, a partner at Nietzke Faupel also presented information. The information that I'm going to use in my charts can be found in these publications.

The reported dairy farm cost of production in these reports, by region, show for 2006 to 2022

significant increases. Southern California, up 84%; San Joaquin Valley, up 53%; and so on. The Nietzke Faupel data is Michigan and Ohio, it is up 46%. There's significant cost inflation on dairy farms across the country, even the largest dairy farms.

This following chart would show the net income equivalent line on the data sets over the years, and you can see there's a lot of -- there's a lot of red. Highly variable profitability on dairy farms across the country.

This chart that says -- I'm showing now looks at some of the data from the above chart. So, to show -- to explain it, for the Southern California data, which is "So CA," which say as reported of the average loss on the Frazer LLP customers that are included, eight years they show average losses. The number of years where profits were $1.45 or less were 15 years. So the additional years of losses, if there's a $1.45 per hundredweight decline in the milk price because of a structural change in class prices, it would increase by seven, there's 20 years of data, 15 years of losses, 75% of the time there would be losses, on average, on the farm surveyed in the -- in Southern California, by the Frazer firm.

And that data -- the rest of that data is similar. My Michigan and Ohio, MI and OH, is from the Nietzke Faupel data.

The chart at the top of page 17 looks at average profitability. And, again, I take two different time periods. I'll let USDA determine what they think is the

appropriate time period to look at. I'm suggesting a couple.

And you can see that for most of those regions, the average profitability in most of those regions is less than a dollar. And some may be a little bit more than a $1.45, but if you took a $1.45 out of that profitability, you would be taking away most of their profitability.

You have to think about that. Dairy farms are businesses. They are investing in their business to get a return. If you do something that somebody's -- they are pretty profitable. Maybe this says that in the Northwest they have $1.80 average profitability, so they can withstand it. I would say, I think you have to think about, will they still stay in business, because they are expecting a certain return on their investment. And right now that return on their investment when they make that kind of profitability keeps them in the dairy industry. If you take most of that profitability away, I'm not so sure it -- it will encourage them to stay in the dairy industry. You have some significant challenges to ponder over what this means, what these proposals mean on dairy farmer profitability.

Too often the view of structural changes to milk prices that emanate from Make Allowance increases are viewed against the milk price. Dairy farm milk price of $20 may seem to be able to support a structural decrease of $1.45 per hundredweight as the change represents about 7% of the milk price. This belies the true economic

impact of importance, the impact on a dairy farmer's profitability. In this context, the most important context, $1.45 per hundredweight milk price change, at worst, wipes out the long-term average profitability on many dairy farms across the United States, and at best, for some of the larger dairies, as for example the Michigan and Ohio dairies, who would show a profitability from 2012 to 2022 of about $1.88, it reduces that average profitability by 77%.

We believe that the impact on average profitability is compelling. It needs to be a factor in the decision by the Secretary of Agriculture that he makes relative to the structural changes to Federal Order milk prices stemming from an increase in Make Allowances. DFA and the National Milk Producers Federation believe this information is sufficient for you to limit any Make Allowance changes to those proposed by the National Milk Producers Federation.

I make a distinction in all this between pricing cost and average cost of production. Price is the value of the good or service, can be measured over time to identify price increases or decreases. Increases are commonly referred to as inflation.

The producer price index series is an example of a survey of prices, and from it, there can be representations made about price inflation over time.

Prices and costs are different. For example, the wage rate or price of the labor input may increase;

however, that is not a representation of how a business's cost of labor is changing. For example, as wage rates increase, the hours worked may decrease. This simple example identifies how businesses change their input usage as prices change.

The two of these aspects together can be viewed to look at the total cost of labor. However, since there can be input substitution, this would mean that the cost of labor would change differently over time than the price of labor.

Furthermore, businesses may, at the same time, change their output. Example, less labor may be used due to increased mechanization that leads to increased output. Cost is a combination of price, input usage, and output, and it's this combination that represents the average cost of production. It is the average cost of production that is relevant at this hearing.

We appreciate Dr. Stephenson's interactions with the dairy industry and his participation in surveying dairy manufacturing plants to provide some information for us to think about. He's done as good of a job as he can with the data that's been made available to him.

Despite that, we do have -- we do not have confidence in the average manufacturing cost of production that will be presented in this hearing from the private surveys. We believe USDA needs to discount these costs. The widespread requests by industry participants to have Congress legislate authority to USDA to survey these costs

is ample evidence of the lack of universal confidence in the private data surveys. It just is.

More importantly, what is more relevant is average profitability, which combines revenue with cost. And sorely lacking from the analysis, manufacturing input costs, is a review of profitability at manufacturing plants. We have provided historical dairy farmer profitability information collected by USDA and accounting firms using generally accepted accounting principles, we believe this data to be highly credible and important for USDA to utilize in determining the appropriate Make Allowance changes.

Over the last few years, we have seen new cheddar cheese plants built in Michigan, Wisconsin, Texas, production expansion in South Dakota. Additionally, new cheese plants are being built in Kansas and New York. All of these plants were built or planned based on the current Make Allowances used to determine Federal Order milk prices. It is self-evident in economics that all of these milk plants were built based on an expected profitable return.

This would suggest that the large, efficient, and modern cheese manufacturing facilities have developed means of profitability despite a fixed cheese Make Allowance dating back to 2008. Increases in Make Allowance will greatly benefit the profitability of the largest and most efficient milk plants that operate at the lowest cost of production.

Really large Make Allowance increases will shift income from dairy farmers to large and efficient milk plants that do not need that kind of financial support provided to them by dairy farmers.

2023 has been a rough year in the dairy industry. There are extreme losses on just about every dairy farm right now. The milk price, has been testified to by a number of dairy farmer witnesses, has decreased substantially, and their costs have not.

My model -- I'm not presenting my model here -- but my model would suggest these losses are 4 or $5 a hundredweight on average right now. I don't expect those losses to zero out. For most of this year, maybe by the fourth quarter, as prices -- if the prices on the CME futures market hold in the prices for milk, and the prices for new crop livestock feed stay at about the level that the CME Group futures price are expecting, we may see, on average, farm returns return to maybe a break-even. And as I look out into 2024, and the model that I run and I use, using the CME Group futures prices would suggest maybe, without other wild changes, that maybe it might be a break-even year, but not a very good year.

Going to page 19, I have some testimony on negative other solids prices, and I would just suggest to look at that. The proposal by the Wisconsin Cheese Makers and IDFA would result in significantly increased occurrences of negative other solids prices.

Okay. I'm about done.

There's some historical precedent. Federal Order Make Allowances -- I'm going to adjust this because I know Mr. Rosenbaum is going to correct me, so hopefully I can get this in the right -- there's been three occurrences when we have looked at Class III and IV milk price formulas, and/or Make Allowances, since Federal Order Reform. There was 2000, I believe 2004, and then again in 2007.

So during those proceedings, data from multiple sources was used to determine Federal Order Make Allowances, in each proceeding. Additionally, the time between the hearings was relatively short, and price inflation was relatively tame.

The resulting changes from these hearings had modest changes in Federal Order milk prices. I believe the biggest changes to milk prices occurred from the 2007 hearing that were implemented in 2008. The Class III price declined by $0.34, and the Class IV price declined by $0.25.

In 2004, that hearing -- if it was 2005, I'm open to correction on the years -- the Class III price declined by $0.25, and the Class IV price declined by $0.17. And I believe that in the 2000 hearing Class III and IV prices modestly increased as a result of that hearing. I'm open to stand corrected on any of that, but I'm pretty close to being right.

So the changes were modest. We're not talking about modest changes here, even -- I would say even the

National Milk proposal, but certainly not the IDFA or Wisconsin Cheese Makers Association.

For each of those proceedings USDA relied on multiple sources of data, principally a USDA cost of manufacturing study, a/k/a Charlie Lying study -- studies. The California's audited data from their state Milk Marketing Orders also.

I may have this wrong, and I stand for correction, because I'm not sure when Mr. Stephenson's study first started, if it was in 2004 or 2006. But we also relied on the Cornell survey information. Cornell at the time, Wisconsin now, in each case -- and so in each of those cases -- and there was also -- there was also data submitted by individual plants and cooperatives, so there was a rich source of information that was on the record, for USDA to use to determine Make Allowance changes.

These rich sources of information provided USDA with a relevant set of cost data to form the basis of their decision. No prior case, no prior case, did USDA rely solely on a non-government source of information or on changes in input price relationships developed from the Federal Bureau of Labor Statistics.

Unfortunately, we don't have all this data anymore. We now have a significant problem in the dairy farmers' and their cooperatives' confidence in the data available to consider a Make Allowance adjustment. No longer do we have the USDA study and an analysis, nor do we have the California information.

We are limited to two private surveys from the University of Wisconsin, one supported by USDA, but that had limited cheese manufacturing participation, especially with the larger cheese plants, and then a cost allocation that we weren't quite sure about at butter/powder plants.

And another one, sponsored by IDFA, who has a biased interest in a significant increase in the Make Allowance, and that was administered during the peak of the U.S. and global price environment. In efforts to buttress the obvious shortfalls of the data, my good friend, Mr. Schiek, looked at some input price indexes, used those to estimate production costs.

I believe these efforts have their own credibility issues since input consumption and production are fixed at those factors that existed years ago, so assuming there are no economies of scale or size from larger milk plants built over the last few years, no capital investments made at plants to reduce input uses or improve in production efficiencies. And, I think I said this, none of the plants hedged their input prices.

It is for this reason that NMPF and its member cooperatives, the American Farm Bureau, IDFA, and others, are requesting Congressional action to provide federal authority to USDA to conduct relevant dairy manufacturing plant surveys to identify input prices, input utilizations, capital investments, production yields, and other factors, and audit the information, to provide the dairy industry reliable and unbiased information to use

when considering changes to dairy producer milk prices.

In conclusion, there is no doubt that plant input prices are higher today than they were in 2006. There is no doubt that the conversion of milk to manufacture products yields more than occurred in 2006. There is no doubt that a larger proportion of manufacturing output is produced by modern and more cost efficient manufacturing plants than occurred in 2006.

Despite this knowledge there is significant doubt of the conversion of those factors into a reliable and accepted cost of production statistic. Additionally, there's doubt about the relevancy of observations that should be used to determine this value: Should it be only large efficient plants? All plants surveyed? All plants but high and low cost outliers? Or other combinations? The dairy industry has not debated these factors.

National Milk Producers Federation member cooperatives represent all relevant segments of the U.S. dairy industry. Its members operate significant manufacturing businesses across all cheese categories, butter, and powder. Its members produce a clear majority of the butter and powder manufactured in the United States. Additionally, its member cooperatives market the milk and write the milk checks for their farmer-owners, which collectively represents more than 75% of the U.S. milk production. 75% of the U.S. milk production.

The NMPF member cooperatives are uniquely invested in a manner that allows them to see all sides of these

issues around Make Allowances and class price formulas.

The National Milk Producers Federation member cooperatives have meticulously deliberated over the weighty and important issues surrounding an appropriate Make Allowance change. You have heard from many of us. You have heard from many of us.

We agree that the average cost of manufacturing dairy products have gone up since 2006. That's undisputed. However, we struggle with knowing how much these costs have gone up due to the lack of credible and reliable information.

Despite the best efforts of many in the dairy industry, credible and reliable information that culminates in reducing dairy farmer milk prices does not exist. Dairy farmers see this and understand this. To make an aggressive Make Allowance change using this flawed data will undermine the confidence dairy farmers have in the Federal Order system. If that information existed, and it suggested a Make Allowance change of more than a few cents per pound, we would be restrained from advocating for the full implementation of the change due to the impact on milk prices and profitability for our farmer-owners.

Again, no prior class price formula or Make Allowance has impacted farmer milk checks, I have by more than $0.35. It's probably by more than $0.30 when you do the actual utilizations of the changes from the 2008 hearing.

To maintain dairy farmer confidence in the credibility of the administrative process of changing the Make Allowance, and in the absence of robust, credible, and audited manufacturing cost information from a federal government source, we believe that the implementation of the National Milk Producers Federation proposed Make Allowance increases are the appropriate adjusted -- adjustments to make all things considered. Our suggested changes will lower farmer milk prices by about $0.50 per hundredweight, which we believe to be an acceptable balance between the milk price and profitability impact and the manufacturers' cost recovery.

Appendix 1, which is pages 22 through 24, is the data from the Frazer and the Nietzke Faupel surveys, which is all contained in the information that they provided in the exhibits when they were here to testify.

With that, I will end my formal presentation. Thank you.

Q. Thank you, Mr. Gallagher. I just have a few questions that I want to make sure that we expand upon before we turn you over for your cross-examination.

On page 20 of your testimony, in your conclusion, and then previously in your testimony, you referred to the process that National Milk went through in order to come up with its numbers for Make Allowance that's in its proposal. And we have heard testimony from other National Milk task force members where they have talked about a compromise, and I think some of the questioning has led

this into a position to suggest that they were somewhat made up.

And I want to -- you were involved in that process, and you provided some of the information here that led you to your position on Make Allowance. I wondered if you could talk about whether or not you believe that National Milk's proposed numbers are a compromise in a way that suggests that they are made up numbers.

A. Yeah. Very good. Thank you.

They are not made up numbers. We went through a very diligent and robust process to look at and deliberate over what we thought we would propose for Make Allowance changes.

We looked at each member cooperative, looked at their own manufacturing costs of production. We looked at price changes and spent time looking at price indexes, but rejected those because the faults -- fault -- faultiness of index changes when you can't take into account productivity changes. So we rejected those fairly quickly. And then we thought about what would be the impact on milk prices for farmer-owners into their profitability.

So everything I talked about in here, we deliberated on, and we took a long time. We started this process in January of 2022, and it wasn't until October that we had finally come to terms with what we thought was the best process.

We looked at all kind of costs. We included, first, the Wisconsin survey and looked at that information. We looked at old manufacturing cost studies, including the California studies. We took in a lot of information.

And at the end of the day, based on all that information, we decided that the best numbers to go with were the ones that we presented because we recognized that we couldn't ask our farmer-owners to experience a dramatic milk price decline that would erode their profitability. And yet we also recognized that all of us have higher costs at our manufacturing plants and that there is a need to provide some cost relief. And we really think we struck the right balance, all things considered, in our review.

Q. And how would you -- I think you have touched on this in your testimony. I just want to make sure that it is clear. In that analysis, you weren't -- you weren't working your analysis in a way that was designed to ensure that the process National Milk proposed was protecting just the dairy farmers' profitability, were you?

A. No. We were looking at all aspects. We looked at what -- what -- we didn't share our information, but we looked at what our -- you know, we reviewed what our costs of production would be. Had pretty robust conversations about that.

Q. And how -- how is it that you believe that the dairy farmers -- to the extent in your testimony you are

talking about dairy farmers' profitability and their ability to absorb a change -- how is it that you believe that those changes and the dairy farmers' profitability has an impact on the milk supply or the ability to continue to supply milk into the future?

A. Dairy farming is a business. As a business, in order to be successful, you have to be able to earn a profit. In too dramatic of a change in their milk price, that would be a structural change, a structural change. This isn't like Mr. Lyon's testified to demand being slower and so the price went down, eventually demand comes back, and the price goes up. That's not what we're talking about.

We're talking about, amongst that, a structural change that reduces milk prices forever. And so those changes can hit on the profitability of dairy farms, and if they're not going to be profitable, some are going to go out of business, and that's going to, you know -- and the cows may not just get shifted to another farm, because the investment for the other farms that are going to stay in business, investment returns aren't going to be strong enough for them to build bigger barns or expand their herds.

And so I -- I am significantly concerned that dairy farmers will go out of business, cows will go out of business, and the milk supply could be severely constrained.

Q. Thank you.

You just referred to Mr. Lyon's testimony, and he talked about some opportunities -- or not opportunities, I said that wrong -- he talked about some times in which there was dumping of milk. I'm wondering if you can talk about whether you have observed times in the industry when milk has had to be dumped and what was it that you observed was causing that situation.

A. Yeah. So dairy farmers and their cooperatives hate -- hate the fact that milk can't find a market and that -- but sometimes there just is no market available, and the only -- the only other option is dispose of it.

This really reared its head at the beginnings of the COVID pandemic. And so there's lots of -- lots of reasons why milk gets, quote, dumped. During the COVID pandemic, milk got dumped because plants weren't operating, or weren't operating at full capacity, and there was nothing you could do. And that happens a lot. There are plants break down, and so you -- as a marketer of raw milk, you are trying to move milk around wherever you can.

And we work -- all of us, everyone does, not just DFA, everyone does -- works really hard to figure out how can we salvage that milk. And sometimes it is you separate the cream, and you can still find somebody that will buy the cream, but nobody wants the skim, and so the skim gets dumped.

So -- and these things happen. It may not be a plant breakdown, as Mr. Lyons (sic) testified to. Some of

the issues that we have seen recently, it's just the reaction to global inflation had impacts on global demand for dairy products that backed the system up. There just weren't buyers for the milk.

And as a manufacturing plant, you may not want the milk, and so maybe they had capacity, maybe they didn't, but they didn't want the milk, so what do you do? You have to dispose of it.

You know, this isn't a Make Allowance thing. I mean, sure, go ahead -- it's not a Make Allowance thing. Milk companies, dairy cooperatives aren't going to build milk plants to assure that no milk ever gets dumped, when those milk plants probably most of the time won't even run half full. And so we're not going to lose all kinds of money building milk plants -- regardless of what the Make Allowance is, you can increase it, whatever -- we're not going to build milk plants just to scoop up all the milk that's getting dumped because it's not that much. And that would be a significant profit losing proposition to do that.

So there's lots of reasons why, you know, milk gets dumped. It's -- you know, we hate it, but it's not enough yet in any one specific area to build a milk plant about.

Q. Do you believe that we have too many dairy producers producing milk?

A. No. We don't have too many dairy producers producing milk.

Q. Do you have Class III and IV plants that take in raw milk?

A. We do.

Q. Can you tell me where they are located and what kind of products you produce?

A. We have 14. And so let me start on the West Coast. We have a plant in Turlock, California, that makes liquid whey and Italian cheese.

We have a plant in Fallon, Nevada, makes skim milk powder and whole milk powder.

We have a plant in Beaver, Utah, makes American-style cheese, condensed milk, and cream.

We have a plant in Garden City, Kansas, makes nonfat dry milk, skim milk powder, and whole milk powder.

We have a plant in Portales, New Mexico, that primarily makes nonfat dry milk and skim milk powder, but it can also make condensed and MPC.

We have a plant in Fort Morgan, Colorado, that makes condensed milk, cream, and nonfat dry milk.

We have a plant in Pollock, South Dakota, that makes hard Italian cheese and liquid whey.

We have a plant in Winthrop, Minnesota, that makes sweetened condensed milk.

We have a plant in Zumbrota, Minnesota, that makes hard Italian cheese and has recently been retooled, it can also make American-style cheese.

We have a plant in Goshen, Indiana, that makes nonfat dry milk and can condense milk and sell cream.

We have a plant in Cass City, Michigan, that is a separation plant: Condensed, milk, cream, skim milk.

We have a plant in New Wilmington, Pennsylvania, that makes Italian-style cheese and dry whey.

We have a plant in Redding, Pennsylvania, that primarily makes nonfat dry milk, but can also make condensed milk and sells cream.

We have a plant in Middlebury Center, Pennsylvania, that can make nonfat dry milk and whole milk powder, also can make condensed -- condensed milk and can sell cream, separate cream.

And we have a plant in St. Albans, Vermont, which makes nonfat dry milk and skim milk, and also can condense milk and separate cream and sell cream.

Those are our manufacturing plants that take in raw milk for Class III and IV purposes.

Q. Did DFA respond to Stephenson's study or survey?

A. The first one, yes. We participated -- so, taking a step back. Prior to 2022, I had pretty limited interactions on a lot of this stuff. I am aware that in the 2019 survey, I think that's when it was, 2019, we shared information. I am not sure what we did in the prior surveys. I don't have that historical knowledge. In the 2022 survey, we did not share our data.

Q. Is it fair to say that one -- that that becomes the basis for one of the reasons that you questioned the completeness and accuracy with Dr. Stephenson's 2022 survey?

A. One of the reasons, yes.
Q. Among others that you mentioned as well?
A. Among others, yes.
Q. Thank you.
MS. HANCOCK: Your Honor, at this time we would make Mr. Gallagher available for cross-examination.
THE COURT: We have been going a little more than an hour and a quarter, so let's take a ten-minute break. Come back at -- let's come back at 11:00.
(Whereupon, a break was taken.)
THE COURT: On the record.
I have a quick question here. This witness asked that official notice be taken of certain USDA documents, I think there's other PPI documents. I think the regs require that folks be given notice of that and the opportunity to argue to me whether they are inaccurate or otherwise that official notice should not be taken.
How do we want to handle this?
MR. HILL: I would say that we do need to get those documents as well, just as an aside, because usually, if we can have those documents sent to us in some way, because we need a way to confirm which documents they actually need on the record.
So for anyone making these requests, if we could get a copy of those documents, or at least the website for the documents, or have them sent to us, or e-mailed, that would be helpful from our perspective.
THE COURT: You can do that? Yeah. And I see the

testimony --

MR. HILL: And that would be true of everyone who has asked for those type of documents, not just obviously for this witness.

THE COURT: Sure.

MR. ROSENBAUM: Steve Rosenbaum, your Honor. We would like to see those as well, obviously, and then have the opportunity to -- to take a position whether we have any reason why they should not be subject to conditions once we have seen them.

MS. HANCOCK: That ship sailed.

THE COURT: Yes. I mean, I think we need at least a website or something. I don't want to --

THE WITNESS: Here's the website. Can you -- where's that guy -- can you put --

MS. HANCOCK: We're going to pull up what we want --

THE WITNESS: There's the website right there, "Milk Cost of Production Estimates."

THE COURT: All right. Well, let's circulate a document. Maybe we can mark it as an exhibit, something like that, or otherwise the -- somebody looking at the record doesn't have a way of getting there either.

All right. We'll take it up later. I mean, if someone's got an objection, remind me, and we'll take it up. Thank you.

Your witness, Mr. Rosenbaum.

///

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. This is Steve Rosenbaum for the International Dairy Foods Association.

Mr. Gallagher, I understood you in your testimony to talk about how it was important to have the opportunity to have data presented by companies as to their cost of manufacture.

Did I hear that correctly?

A. In the past hearings, as in this one, different entities have presented their companies' costs.

Q. And do you view that as a source of information upon which USDA can reasonably rely?

A. It's a source of information to use in making their decisions because it's reasonable to rely on it. I don't know -- I don't know what they -- I have never been -- participated in their decision-making process, so I'm not sure what kind of reasonability they associate with that information.

Q. Okay.

A. But it is information. It is data.

Q. Okay. And, I mean, you don't have any inherent objection to USDA relying upon sworn testimony by manufacturers as to what their actual costs of manufacture are?

A. The data is what the data is. They have to determine themselves what the reliability of that data is.

Q. I mean, as an example --

A. No, I can't -- I can't help them, you know.
Q. I mean, I don't know whether you were here during the testimony, but the Land O'Lakes witness presented what he asserted to be hard data, which I don't dispute, that would indicate that Land O'Lakes since 2008 has incurred a more than 70% increase in its costs of manufacturing nonfat dry milk and butter.

Do you have any reason to tell the USDA they should not rely upon that information?
A. The -- whatever Land O'Lakes witness testified to is in the record. I'm not particularly aware of that. Again, the --
Q. I mean, assuming that USDA were to find that witness to be credible, that evidence to be reliable, and that the percentage increase that Land O'Lakes says it has itself -- the increase in cost that Land O'Lakes says it has itself incurred since 2008, if that number exceeds by a comfortable amount the Make Allowance increases that are being sought by IDFA, would that provide some reason to conclude that the IDFA data is reliable notwithstanding what you see is certain shortcomings?
A. No.
Q. Okay. Really?
A. Really.
Q. So even if -- just as to the reliability of the data?
A. So -- so your -- your question to me, the last part of the question, was that if by chance the

Land O'Lakes data is reliable -- and I don't know what USDA thinks is reliable -- but it is credible data to prove the IDFA numbers out, so you are asking me to -- to -- to think that one individual business's plants can be used to verify your information?

Q. Oh, I am --

A. That's what I'm saying no to.

Q. I'm just starting --

A. Just saying no.

MS. HANCOCK: Your Honor, if we could let the witness finish the answer, please.

THE COURT: One at a time.

THE WITNESS: So the connection I'm saying no to --

MR. ROSENBAUM: All right.

THE WITNESS: -- the connection --

MR. ROSENBAUM: What --

THE WITNESS: -- that you need more than --

MS. HANCOCK: Your Honor, if we could let the witness --

THE WITNESS: -- that you need -- I'm sorry.

THE COURT: Wait a minute, everybody. One at a time. Let the witness finish --

THE WITNESS: One more thing --

THE COURT: Let the interrogator finish.

THE WITNESS: What I'm disagreeing with, Mr. Rosenbaum, is that you're asking me to -- to agree with you that one business's data corroborates the IDFA

data. That's what I'm saying. I don't believe one business's data is enough to corroborate the IDFA data.

BY MR. ROSENBAUM:

Q. What --

A. That's what I'm saying.

Q. Appreciate that. What if they were to conclude that the testimony of the AMPI witness, that they have incurred cost increases consistent with the IDFA proposal, what if USDA found that also to be credible --

A. Again --

Q. -- would that, to your mind, be reasonably relied upon to conclude that the IDFA cost to manufacture numbers, which are then incorporated into its Make Allowance proposal, is reasonable?

A. No.

Q. Okay. How about if Northwest Dairy -- I think that's the right name of it, Northwest Dairy -- similarly confirmed in testimony that it had incurred cost increases that were consistent with the IDFA proposal, at that point would the IDFA data, from your mind, reasonably be concluded to be reasonable?

A. No. Let me -- let me --

(Court Reporter clarification.)

THE WITNESS: First of all, we believe that there needs to be a federal government source collecting the data, analyzing the data, and auditing the data to make significant Make Allowance changes.

All of the witnesses that you have referenced from

the National Milk cooperatives, other than AMPI, all testified that regardless of what increases in manufacturing costs may be, we have to be careful not to reduce dairy farmer milk prices too significantly because it will too negatively impact their profitability.

And I think other than AMPI, you can go through any one of the NMPF witnesses, and I believe they all have said the same thing, that we need to limit the impact on dairy farmer profitability, even if there are additional costs in the system beyond those being in the National Milk proposal.

So -- so if you want, we can go through all the National Milk witnesses, and I'm just going to say no to all of them, but that's sort of where I'm coming from.

BY MR. ROSENBAUM:

Q. I'll do one more. California Dairies, assuming that they testified -- and I believe I have this right, but I could be corrected -- I know one of the members testified that they have incurred 80% increase in cost since 2008. Once again, would that --

A. No. No.

Q. But -- but you -- I mean, you have more than one criticism of the IDFA proposal, correct? One of them is, regardless of the veracity of the numbers, you oppose the Make Allowances being proposed because you think it has too big an effect on dairy farmers, correct? That's one of your objections, correct?

A. One of our objections is the impact on dairy

farmer milk prices and profitability of too large of a Make Allowance increase.

Q. And I -- and you just referenced that and answered a previous question of mine. We're going to get to that issue in a minute. But I'm just trying to focus on your other criticism at this point, which is that the -- you don't think the IDFA cost of manufacture data, which translates into IDFA's Make Allowance proposal, is sufficiently reliable, correct? That's another criticism you are expressing in your document, correct?

A. Yes.

Q. And I'm asking you whether you maintain that criticism, even if multiple members of National Milk have come and testified under oath, with respect to their own costs of manufacture, and a substantial number of them have testified to cost increases that are consistent with, and in some cases in excess of, the increased Make Allowances that are being sought by IDFA.

A. What's your question?

Q. Does that -- doesn't that, in fact, support the reliability of the IDFA numbers, wholly apart from the question in which you have identified is a separate question, is whether that's how we should go about setting Make Allowances?

A. So you are using a subset of the universe, a non-random subset of the universe to substantiate data in a survey, and I don't agree that there's enough information presented on the record from a subset of the

universe to substantiate any of the survey analysis, survey results.

(Court Reporter clarification.)

BY MR. ROSENBAUM:

Q. You have provided a history, in part, and I want to discuss that history for a minute.

So as I counted, USDA has previously had on five occasions set Make Allowances. Let me recite them and see if you agree.

A. Yep. Yes.

Q. Number one, they did them in 2000 in the Order Reform itself.

Number two, they did it again in late 2000. They actually were under a Congressional directive because there was concern the Make Allowances might not be accurate, so they did it again, in December 2000 as it happens.

Then they did it again in 2002.

And they did it again in 2006.

And they did it again in 2008.

Which I get to be five occasions --

A. 2002. Then what year?

Q. 2006.

A. And then 2008?

Q. 2008.

A. Well, I wasn't including 2000.

Q. Okay.

A. And if there's another one, I missed it.

Q. Okay. So -- well, we'll have some history presented when -- in our testimony, so I'm not really looking to you for the specifics, so much as an answer to the following question: Am I right that in every case, USDA set the Make Allowance based upon what it concluded was the actual cost to manufacture?

A. So I haven't reviewed that history, so I -- I don't know the answer to that.

But I'll come back to the Agricultural Marketing Agreement Act stipulates that the cost of livestock feed must be considered, as well as whether there will be an adequate supply of fluid milk. And in all prior hearings, there's never been as significant of a change requested, in light of all of the circumstances, that would so significantly impact the profitability of dairy farmers, that would have an impact on such a potential negative impact on the adequate supply of milk that's required under the law.

And so I -- I -- I don't know what they actually said. I don't remember. I didn't review it. But it's different this time by a --

Q. Well --

A. -- by a large measure.

Q. -- one difference, and there may be different reasons for this, but one difference is we simply have never waited so many years to update Make Allowances, correct?

I have given you the history --

A. Yep.
Q. -- so it's simple --
A. I can't disagree with that.
Q. Okay. So, I mean, it has been 15 years, correct?
A. Yes.
Q. And do you -- are you familiar with the fact that, although the most recent decision came out in 2008, it was actually based upon data regarding costs of manufacture in 2006 and 2007?
A. I am familiar with that, yes.
Q. So if you were to look at the gap in cost data, there's probably even an extra year you have to add in to look at how long it's been; is that --
A. Maybe. Sure. I don't know. I don't know -- I don't know -- so you're referring to a hearing record, and I don't recall what the cost information that would have been included in that hearing record. But it's, you know, around the area as far as I'm concerned, whether it's, what, one year or the next.
Q. Okay. Now, are you aware that the -- that even in times when only a couple of years had passed since the most recent prior revision to Make Allowances, there were sometimes pretty substantial increases, even over a two-year period? Have you studied that?
And I'll give you specific numbers if you want.
A. Yeah. I'd like to hear your specific numbers.
Q. Okay. So from 2006 to 2008, which is only two years, the Make Allowance for butter increased from

$0.1202 to $0.1715. That's over two years. That's a 42% increase in the Make Allowance.

Were you aware of that?

And I'm -- I'm -- let me just --

A. I'm checking my notes.

Q. Yeah, let me --

A. I'm not -- I'm not going to -- the records -- the record is what the record is. I don't know. But USDA knows, so I'm comfortable with what they know.

Q. Yeah. Just so -- the citation, I'm looking at 73 Federal Register, I believe it begins on 35306 and I'm just looking at the statement by USDA, trying to get a specific page number. It's not jumping out at me immediately. But in any event, they said, specifically the Make Allowance for butter increases from $0.1202 to $0.1715.

And were you aware that in that same decision, which only reflected a change from a 2006 decision, and now it is 2008, that the Make Allowance for cheese increased from $0.1682 to $0.2003, which represented a 19% increase just for two years?

A. Mathematically, I'm assuming you're correct. I'm confident in your mathematical ability. And I'm confident that you have probably -- and I -- I have in my notes similar Make Allowance numbers that would be similar to what you are saying.

Q. Okay. And are you aware that in 2006 -- excuse me, start that question again.

Are you aware that in 2008, the increase for dry whey was very modest, but that may, in part, reflect the fact that in 2006, USDA had increased the Make Allowance from dry whey from the 2002 number of $0.159 to $0.1956?

A. I -- I don't know the reasoning behind why the whey price only went up a nominal amount, but I would agree that your numbers for the changes in the manufacturing allowance for whey appear to be correct from the notes that I have taken.

Q. And that 2006 increase, from 15.9 to 19.56, was an increase over the price that had been set simply four years earlier in 2002?

A. Sure.

Q. That's a pretty hefty increase over just four years, correct?

A. So I believe I have correctly testified to the impact on the Class III and IV prices. Do you dispute what I testified to?

Q. I have not done those calculations. I'm not going to -- so I'm not in a position to tell you one way or the other.

A. But somebody will come back and check on that, I'm sure.

So despite those percentage increases, my information that I have found in some of the USDA documents would say that in the interim final rule for January 31st, 2007, does that sound correct, for that -- for that 2006 hearing?

Q. Okay. I can't verify that --
A. Everybody --
Q. I --
A. Everybody --
(Court Reporter clarification.)
THE WITNESS: USDA can check the numbers. They have got the data. So I would -- my data shows that from that hearing the Class III price decreased by $0.25, and the Class IV price decreased by $0.17, and stemming from the 2008 hearing the Class III price decreased by $0.34 and Class IV price by $0.25, despite whatever percentage increase you have stated for the specific Make Allowance changes. And USDA can check my information because I know they know it.
BY MR. ROSENBAUM:
Q. Now, you have done some dollar calculations regarding the dollar amount of the increase for the Make Allowances IDFA is proposing, correct?
A. Yes.
Q. Now, first of all -- I think this is clear to everyone, but we should make it clear -- you're -- you are aware that IDFA is proposing to increase Make Allowances over a four-year period. It's a staggered phase-in, correct?
A. I am aware of that, yes.
Q. And you have taken for your analyses the final number, which if our proposal were to be accepted, will not actually come into effect until 2028, correct?

A. Correct.
Q. And in addition, to state the obvious, these Make Allowances are used to set the minimum milk price, correct?
A. USDA and the Federal Order program administers a series of set of class prices that are minimum milk prices.
Q. Okay.
A. To the extent that the minimum milk prices end up being too far away from reasonable milk prices, I'm not -- you know, I'm not sure the system works very well.
Q. Well, obviously, you are aware -- deeply aware, I'm sure that -- that often processors have to pay over-order premiums to their -- to their farmers, correct?
A. Yes.
Q. And you have not attempted to analyze, at least for anything you have shared today, the extent to which over-order premiums would be achieved by farmers in a way that would make the effective milk price higher than the minimum milk price?
A. With the existence of over-order premiums, the effective milk price would be higher than the minimum milk price.
Q. Okay. And -- and I think you made reference to this previously, but historically, at least, USDA has performed an econometric study in connection with proposed revisions to Make Allowances and other provisions of the borders where its purpose has been to come up with a --

what it views as a realistic determination of what the actual effect would be on milk prices, correct?

A. I haven't testified to that.

Q. No, no, I know. But I'm just asking you if you are aware that USDA does that, that that's part of the process? Historically that's been part of the process?

A. I am aware that they have done econometric analyses of information relating to Federal Order policy changes.

Q. Sorry, related --

A. Related to Federal Order policy changes at a proceeding, such as this, a hearing to adjust Federal Order provisions.

Q. You are aware that as a -- at least as a general practice, they do in connection with a proceeding like this perform such an analysis?

A. I am familiar that -- with the documents that -- I haven't reviewed them extensively for this testimony, but I am familiar in some of the past hearings that they have presented their analysis of -- their estimates of what they think changes would be on a variety of factors, which I -- which I believe go beyond -- which go beyond the impacts on milk prices over time.

I would say, as a corollary to that, I'm not sure I have ever seen an analysis that ever got it right.

Q. But you have not offered one yourself, correct?

A. I have not.

Q. So are you aware that USDA has directly

confronted, a number of times, the question whether in setting Make Allowances it should take into account dairy farmer cost of production? Are you aware of that?

A. I think that was one of your original questions.

Q. Okay.

A. And I -- I --

Q. Asking it from a little different direction.

A. I know. So confronted sounds like it is a battle. It's a little bit what's going on here. So there is a confrontation, I guess.

So -- so I guess, I respond the same way. I didn't review the record to be able to sort of give you -- give -- put on this record what I think was all the factors that went into their decision of why they adjusted Make Allowances the way they did in prior hearings.

Q. I mean, are you aware that after the 2008 hearing, there were challenges brought to the decision that specifically contended that USDA, by basing the Make Allowances solely on manufacturer cost of production, had failed to carry out its obligation under the 37 Act, that that was the accusation made in those challenges?

A. I don't remember if it was 2008, but I'll take your word for that's what it was. But I didn't review those decisions. I vaguely remember that.

Q. And are you aware that USDA in responding to those challenges said, quote -- having summarized what they had done, quote, "It is, therefore, neither inappropriate nor surprising that while USDA considers producer cost in

fixing prices, it declined to modify the Make Allowances to account for those costs. The Make Allowance is the input in the product pricing formula that accounts the cost manufacturers incur in transforming raw milk into other dairy products. In order to extrapolate the value that raw milk contributes to the commodity prices of dairy products, and thereby approximate raw milk's true value in the marketplace, these manufacturer costs must be included as part of the formula. The costs of producing milk, in contrast, are in the aggregate reflected in the supply and demand conditions that affect the NASS commodity prices of dairy products."

You are aware that's USDA's historic explanation of how they go about, A, setting Make Allowances, and B, fulfilling their obligation to consider things like feed and fuel costs?

A. I am not aware of that. And I would follow up by saying, a decision written during the Bush Administration I don't think is relevant to the facts that exist today in this proceeding under the Biden Administration.

Q. Actually, Order Reform took place under the Clinton Administration, didn't it?

A. It's not the Biden Administration. And I would say -- you set me up too well for this. I would say that, as a Secretary of Agriculture -- it escapes me, who was the Secretary of Agriculture in 2000?

Q. It will come to me in a minute, but it is not on the top of my mind.

A. So as the Secretary of Agriculture, he failed so badly that Congress had to override his decision, not once, but twice. Secretary Glickman. That's just an aside.

Q. But you are not -- I thought you were trying to make this somehow a Democratic --

A. No.

Q. -- versus Republican --

A. No. This is --

Q. -- issue.

A. -- just different administrations, no.

Q. I see.

A. It is just different administrations, and they view supply chains and the agriculture industry and -- they all view it a little differently.

Q. So far they have all done it the same way, actually, which is to only look to the cost of manufacturing in setting Make Allowances; is that right?

A. I'm not sure what Mr. Glickman thought when he got corrected by Congress. And I do believe, am I right, that he -- that in the end they raised the Class III and IV prices based on the hearing in 2000? Do you recall -- get Mike Brown to look at that, would you?

Q. Let me say, I was there, so you would think I would remember. My recollection is that the changes were modest --

A. Oh, they --

Q. -- since 2000, so --

A. I agree that they were modest, but I think they increased the cost a little bit.

Q. So I would like to call attention to a statement you made. It's one of the ones that you read. It's on page 21 of your testimony. And I'm going to -- because this statement follows things you already said, I'm going to throw in a few extra words, but I'm trying to capture what you are saying. Okay? So -- but if I don't do it correctly, you -- I want to you correct me. Okay?

What you are saying is, in my parlance -- and I'm just -- the changes I'm making are just to the initial clause. What you are saying is, even if credible and reliable information regarding cost of manufacture existed and it suggested a Make Allowance change of more than a few cents per pound, we would be restrained from advocating for the full implementation of the change due to the impact on milk prices and profitability of our farmer-owners.

Is that a fair characterization of what you said there?

A. It's almost exactly what I said there.

Q. I just stuck in the word "even." I stuck in the word "credible and reliable" --

A. Okay. So --

Q. -- which appeared earlier in the paragraph.

A. -- which sentence -- where is it that you are -- because I was focused on your question.

Q. Okay.

A. I wasn't reading the document.
Q. Yeah, okay. So it's -- okay. It's the "if that information existed"?
A. Yep.
Q. That's what I was reading.
A. So can you go through where you are adding words for me?
Q. So I'm saying -- and I'm just trying to pick up what you have been talking about when you got to that. I'm really trying to capture what you are saying without having to read six paragraphs into the record, which would be painful for everyone.

Okay. Even if credible and reliable information regarding costs of manufacture existed, that's the end of my changes.

A. That is the essence of my testimony. Yes.
Q. Okay. Okay. So I mean -- so I'm -- I mean, there has been some suggestion -- well, let me back up.

We do not have a system in place now where there is audited mandatory costs of manufacture data being gathered, correct?

A. Correct.
Q. Okay. And industry is basically in agreement that that would be desirable, and indeed I saw you add in your oral testimony, what had not appeared in your written testimony, namely you added IDFA as -- my client -- as one of entities that is seeking legislation to -- to achieve that result, correct?

A. That's correct. We have a -- we have a broad coalition that, in my mind, when IDFA and the National Milk Producers Federation and the American Farm Bureau Federation all support the same thing, Congress generally gives it to us.

Q. Okay. But what I'm hearing from you in that paragraph is that you -- and I assume by that you mean Dairy Farmers of America -- would be restrained from advocating for the full implementation of a Make Allowance change reflecting that audited data, if it suggested a Make Allowance change of more than a few cents per pound; is that fair?

A. It's fair for today at this proceeding. So -- so I don't know what it would mean for Dairy Farmers of America three years from now at a different proceeding. I'm talking about this proceeding.

Q. Okay. But I'm just -- fundamentally, you -- there has been some suggestion by some witnesses that, look, we just get the audited -- let's just wait, we'll get the audited data, and we'll just use it. But you are not committed to that; is that fair?

A. I'm not going to agree to your characterization of the other witnesses because I think they probably -- we don't know what the data is going to show, and so I think, as an industry, it's important to see the data, evaluate the data, and then discuss within the industry, as we do in the National Milk Producers Federation, what we should do with the data. Again, I'm -- I'm not commenting on

what we are going to do as DFA when we get that data. I'm just saying, because of the magnitude of the decrease in the milk price, even if we had that data right now, and it showed that -- if by chance it showed your information was correct, we still would be opposed to increasing Make Allowances by that degree. Fair enough?

Q. Yes. And so --

A. Thank you.

Q. I mean fair enough as a statement of your position.

So it is fair to say, waiting for that information is not a silver bullet that's going to address some of the underlying issues that you have identified, correct?

A. I don't know. I don't know. We are all on pins and needles waiting for the information, though.

Q. When -- is most of the milk that DFA processes Class I and Class II milk?

A. That we process ourselves?

Q. Yes.

A. Is that the question --

Q. Yes.

A. -- not that we sell?

Q. Yes.

A. I would think it is. I haven't reviewed that information for the purpose of this -- my testimony today. But it would make sense that it would be.

Q. Okay. And with respect to the milk that you sell to others for processing, does most of that go to Class I

and II?

A. Again, I haven't reviewed that information, but there would be a substantial amount of milk going to Class III.

Q. And so you mentioned some plant -- a variety of plants you have, and many of them make condensed milk; is that correct?

A. A number do, yes.

Q. Well, you noted --

A. Yeah.

Q. -- them one by one --

A. Yep.

Q. -- no reason to go back to that. We can confront that independently if we want to -- look at that independently, not a confrontation -- and see -- and see how many there are.

But the condensed milk, you're basically -- I may be making this sound too simple, but you're basically taking out some of the water; is that what you're doing? Or you are doing something more than that? Taking the lactose out? What are you doing?

A. We're taking some of the water out.

Q. Okay.

A. And -- yes.

Q. Okay. And -- but -- and then -- and does that then typically go to -- for Class III use?

A. It may could -- it could go for ice cream.

Q. Okay.

A. Could go to a variety of Class II and III uses.
Q. Okay. But --
A. And I don't know -- I haven't reviewed the information, and I'm not into the -- not involved in the daily movement of any of our milks, raw milk, or other types of milk, condensed cream. And so I don't know where -- where predominantly it would go or how frequently.
Q. And I take it that to the extent that you are making condensed milk and selling it to others for Class III purposes, it's priced at Class III, correct?
A. Again, I don't get into the pricing and the pool reporting. I would assume it would get reported on our pool report as a Class III sale.
Q. Okay. But most of the cost of actually converting that milk to a Class III product is going to be incurred by your buyer, not by you; is that right?
A. I don't know the answer to that.
Q. Do you support the proposition that the minimum prices set need to be market-clearing?
And let me just read from the 1999 decision that put federal -- the new product pricing regime in place. This is the April 2nd, 1999, decision. It's volume 64, page 16095, quote: "The importance of using minimum prices that are market-clearing for milk used to make cheese and butter/nonfat dry milk cannot be overstated. The price for milk used in these products must reflect supply and demand and must not exceed a level that would

require handlers to pay more for milk than needed to clear the market and make a profit," end quote.

Do you support that proposition?

A. No.

MR. ROSENBAUM: That's all I have.

THE COURT: Further examination?

Ms. Vulin.

CROSS-EXAMINATION

BY MS. VULIN:

Q. Good afternoon, Mr. Gallagher.

A. Good afternoon. How are you?

Q. Good. How are you doing?

A. I'm doing well. Thank you.

Q. Good. I'd like to start on page 2, please, of your testimony.

A. Okay.

Q. The second to the last paragraph at the bottom, the last sentence says, "Since a Make Allowance increase directly reduces milk prices, impacting dairy farmer milk checks, we believe a strong burden of proof backed by strong and credible data are absolutely necessary to justify a large Make Allowance increase."

Do you see that?

A. I do.

Q. What exactly do you mean by large -- excuse me -- "strong burden of proof"?

A. We need to have data that has been collected by a government source, that has been audited and has the

confidence of the dairy industry.

Q. And if you have data that meets this strong burden of proof, then that would be necessary to justify a large Make Allowance increase?

A. It -- it would be information that would be included in a decision to adjust Make Allowances, that would have at least some credible value to it.

Q. And what I'm getting at is you -- you seem to draw a line here that there is some standard data could meet that would justify a large Make Allowance increase. But I can't quite fit that with your testimony earlier that there's no amount of data that would support a large Make Allowance increase.

So can you help me out there? How can both --

A. Sure. There's --

Q. How can both be true?

A. I'm sorry. I apologize for cutting you off.

They both can be true. So in the first instance, in order to make -- to even consider a significant Make Allowance increase, you have to have the data, which we don't have.

In the second instance, then USDA has to take that into consideration relative to the cost of feed and the impact on the supply of milk in making their decision on what that change should be.

Q. So the only way you can make a large Make Allowance increase is both if you have data that meets a very high burden of proof and implementation of

that Make Allowance level would not negatively impact farmer profit?

A. That's how I'm viewing it today.

Q. And is the inverse also true? If there were to be a proposal that significantly increased prices that processors had to pay, would you agree that that proposal would also have to meet a very strong or high burden of proof?

A. No.

Q. So you apply a different standard to processors than to farmers?

A. Depends on the proposal that we're talking about. Right now we're talking about a proposal to adjust Make Allowances. If you would like to bring up information about a different proposal, I have opportunities to talk about that later when we actually present our testimony on different proposals.

Q. And you anticipate for those different proposals to hold yourself to a different standard than you are applying to processors here?

A. It's a different -- I'm sorry, I cut you off again. I apologize.

They are different issues, and we need to reflect on what the issues are that are the problems that we're trying -- the disorderly marketing conditions that we're trying to resolve. And it's not a difference in how -- how I would view changes in pricing. And we will more than amply provide evidence on why, when we get there, we

need to have a substantial increase in the producer price surface. Stay tuned.

Q. Oh, we will.

A. I'm sure.

Q. So we -- you have talked a bit about the necessary -- the necessity to have adequate survey data, and that you believe Mr. Stephenson's and Mr. Schiek's studies are insufficient, correct?

A. Yes.

Q. And I believe you testified earlier that NMPF did not participate in Mr. Stephenson's 2022 study; is that right?

A. You -- you said NMPF. Did you mean DFA?

Q. Yes, I'm sorry.

A. Yes. DFA did not participate in the 2022 survey.

Q. And one of your criticisms of that 2022 survey is that there's incomplete data; is that right?

A. Yes.

Q. And so DFA both refused to participate in the study and then is critical of the study because it does not have full participation?

A. So we aren't the only ones that didn't participate. And we participated in the prior study in 2019 because USDA had some measure of oversight in that study, and we felt that the data that we were sharing in that study had some protection because of the USDA interaction.

In the study in 2022, it was a private study by

the International Dairy Foods Association, and we did not have confidence in the International Dairy Foods Association to be able to keep our information confidential mand so we didn't participate.

Q. But you would have provided the data only to Mr. Stephenson, not to IDFA directly, correct?

A. That's incorrect. We would -- we chose not to participate in the study because it was an IDFA-sponsored study that they owned. We weren't sure what they could do with our data. And we didn't want them to have our data.

Q. And did NMPF undertake its own Make Allowance study?

A. We didn't have a formal study.

Q. An informal study?

A. We had an informal study.

Q. Has NMPF presented that here?

A. We have talked a lot about it. Myself and the National Milk witnesses, we have talked a lot about the process that we went through to review different costs of productions across the spectrum of the National Milk member cooperatives, and we have come to our proposal that is a balanced approach, taking into account the impacts on the Class III and IV price and what we believe are Agricultural Marketing Agreements Act's requirements of the Secretary to have a balanced approach.

Q. That's a little bit beyond what I asked.

Did NMPF provide that informal study for this hearing or does NMPF intend to?

A. We -- we don't have a survey to present.
Q. You said you had an informal survey, correct?
A. We had an informal survey. We don't have a survey to present to the record.
Q. But you still are requesting that USDA rely, in part, on the results of your informal survey to raise Make Allowances to the levels that NMPF proposes, correct?
A. Yes.
Q. If you could go to page 3 of your testimony, please. You say that adoption -- let's see, at the very bottom of the page, right above "Farm Input Price Inflation," at the last sentence of that paragraph, you say that a significant change could result in reduced milk production that would otherwise occur, which in turn could likely create disorderly marketing conditions relative to the supply of milk to meet the needs of consumers.
Do you see that?
A. Yes.
Q. Have you done any economic analysis to support this statement that there will be a decline or reduction in milk production if IDFA's proposals are accepted?
A. I have not. I would be more than happy to draw some graphs to show you what in economic theory would happen if you did something like this.
Q. And under NMPF's proposal, prices are still going to go down for farmers, correct?
A. Correct.
Q. Have you done any economic analysis that confirms

whether or not that would create disorderly marketing?

A. I have not performed any economic analysis, no.

Q. And if you could turn to page 6, please.

In the middle of that page, you say, "Federal Order milk pricing formulas and blend price pools do not include a factor to help dairy farmers recover their costs related to feeding more expensive feed to their herds."

Is that right?

A. Correct.

Q. But despite that reality, you're advocating here that USDA should adopt a new policy that does take into account those factors?

A. So I think you are mischaracterizing what I intended to say, so let me clarify.

Q. Please clarify.

A. Yes. So there is no -- as there is in determining the product price formula -- to determine the Class III and IV prices using the product price formula, there is a formulation, there is a factor in the law, in the equation, that determines the Class III and IV price formulas, to take into account Make Allowances.

When we compute those class prices in -- and bring them into the pool and run the calculation of the value of the pool, there is no Federal Order price factor that includes something for the price or cost of feed paid by dairy farmers or their cost of production. That's what I meant.

Q. And you believe that the impacts of inflation on

farmer costs need to be taken into account when setting Make Allowance levels; is that right?

A. So the Secretary of Agriculture is required to consider what the cost of feed is and whether there's going to be an adequate supply of milk. And so in determining the adequate supply of milk, and including the feed, that there are inflationary factors on feed prices, and there's inflationary factors on other costs of production that erode the profitability of dairy farmers and their ability to adequately supply milk. And so those factors do need to be considered.

Q. Beyond the feed, though, nothing else is mentioned explicitly in any regulation or act, correct?

A. I would say it's encompassed in the requirement that there is an adequate supply of milk.

Q. And so would you agree then that inflationary impacts on processors are also relevant and should be taken into account?

A. And we have in the National Milk Federation proposal.

Q. And if you could go to page 9, at the bottom of the page, please.

You mention that you're presenting data collected by Frazer and --

A. Nietzke Faupel.

Q. Thank you.

A. You're welcome.

Q. Is that data included in the tables here or will

it be coming from a later witness?
A. The witnesses have already appeared.
Q. And who --
A. And they have submitted their data. So I don't know the exhibit numbers. Somebody's going to have to help me.
Q. That's all right. Just the names are fine.
A. Pardon me?
Q. Do you know the names of the witnesses that presented?
A. Yeah. Leland Kootstra presented the data for Frazer, and Jeffrey Bushey presented the data for knit Nietzke Faupel.
Q. And you think that data is reliable data that USDA should rely upon in making its determination?
A. I do.
Q. But that data isn't collected by USDA, is it?
A. It is not. But it is collected under the generally accepted accounting provisions.
Q. And it's not data for all farms, right? It's just those that partic- -- work with those accounting firms; is that right?
A. Correct.
Q. And then your chart on page 11, if you could pull that up, please.
Oh, you can just turn to it, but if you'd like to --
A. I'll pop it up here for you.

Q. Thank you.
A. Page 11?
Q. It is a bar chart with a red line tracking.
A. Okay. This one? Maybe I won't pop it up, but I know what you are referring to -- there it is.
Q. So this red line, you subscribe it as "milk sold," which represents the average milk price; is that right?
A. Yes.
Q. What's the source of that data?
A. Right here?
Q. It is USDA?
A. Yes.
Q. And do you know, is it minimum prices or -- is it Federal Order prices or mailbox prices? What does it reflect?
A. It's the data that USDA collected in their surveys of cost of production and returns of dairy farms. They conduct these surveys every few years. And so they conducted a survey in -- for 2005, 2010, 2016, and 2021. And how the -- how they conduct those surveys and how they get the information is all described on this website. If you go to documentation, you can -- it provides quite a bit of information of --
Q. And rather than go through the website I would like to know from you, as you put this together -- and I can go back and check if you are unsure -- but do you know, does this include government support program payouts?

A. I believe it does.
Q. And does it include risk management returns?
A. I don't know the answer to that.
Q. And so you will -- you agree that --
A. Well, wait. Hold on for one second. Let me go back real quick.
Q. Sure.
A. Milk sold -- I'm not sure. There's a line, "other income." On the footnote for other income -- I should have copied it on this, and I apologize, I didn't, but it's in here. The other income is income from renting or leasing dairy livestock to other operations, renting space to other dairy operations, co-op patronage, dividends, assessment rebates, refunds, other dairy-related sources, and fertilizer value of manure production. That's a good one.

So I -- and I was -- I was hoping to have somebody here from USDA to describe this data, and something got messed up in the communication between us and USDA, and there hasn't been a person yet here to describe the data.
Q. And the data wouldn't include returns from cooperative-owned plants, correct?
A. Not in the "milk sold" line.
Q. Uh-huh.
A. In the other income, the other income states -- in the footnote, it says cooperative patronage dividends. And so I would suspect -- again, I'm not the one that is the expert on how the data was put together. I would

suspect if there was earnings paid out by a cooperative from the profits at their dairy plants, that it would show up as other income.

Q. And does it include unpaid family labor or returns to management?

A. The milk sold? Which line? Are you still talking about the milk sold line?

Q. Uh-huh.

A. It does not.

Q. And so under NMPF's proposal, that will also lower farmer milk prices, correct?

A. I'm confused with your question. Could you restate it?

Q. If USDA adopts NMPF's Make Allowance levels as proposed, farmer milk prices will still go down, correct?

A. Yes.

Q. And when prices go down, as you said, farmer -- farms will consolidate and milk supply could shrink; is that right?

A. Mischaracterization a bit. So there are -- and I -- I mentioned it earlier -- milk prices go up and down all the time because supply and demand is changing. So this change is a structural milk price change that reduces milk prices on top of all that other stuff. And it reduces milk prices to a point that is going to be very unprofitable -- if you go all the way to the IDFA proposal, reduces milk prices to the point that it's going to be unprofitable, that over time, there's going to be a

restructuring in the dairy industry of those who produce the milk, and there's going to be a long, painful process involving human beings that operate dairy farmers (sic) that aren't going to be able to cash flow, maybe not going to be able to make feed bill payments, aren't going to be able to pay back their loans. And those family farms are going to be forced out of business. And it will be a slow, painful process, that over time will decrease milk production, before something else changes and you reach a new equilibrium and something else changes. It's going to be an ugly situation. And we're trying to prevent that from happening.

Q. If supply and demand forces drive that, though, eventually, prices will have to go back up if supply shrinks; isn't that right?

A. Some day they will. But the aftermath of -- of that is going to be an awful, awful situation for dairy farmers, leading up to that.

Q. And I think it's true that everyone in this room wants to sell more milk, wants to sell more dairy products, and expand that as much as possible. Isn't that right?

A. I think everybody in this room has a goal of having the U.S. dairy industry being strong and prosperous for everybody.

Q. I absolutely agree. But we're also subject to market forces, correct?

A. We are all subject to market forces.

Q. And so when considering if supply goes down, and demand will eventually rise above that and bring prices back up, does your forward-looking analysis on the impact on prices take into account that market reaction?

A. I don't have a forward-looking outlook that I have presented. I am bothered by your suggestion that there is no harm that's caused in the transition to get to the new equilibrium.

Q. And I never meant to suggest there was no harm caused. So apologies if that was misstated.

A. Thank you. Thank you.

Q. That was kind of the long-term view.

In the short-term, isn't it true that over-order premiums could adjust if there are tighter milk supplies or needs for milk that aren't being met through the minimum milk price?

A. So over-order premiums exist now. There's manufacturing plants that are paying over-order premiums. I believe Mr. Lyons (sic) testified that those over-order premiums have declined. We have seen that in our own returns, although I don't have data to show you.

And I think you have heard from some of the DFA farmer-owners who are worried about a double-dipping, that you are going to increase the Make Allowances even though some of those higher costs that are being complained about in this hearing have been covered by reducing the milk prices by reducing over-order premiums. That's the double-dipping that some dairy farmers reference.

And so those over-order premiums some day may come back, but it is -- I don't do this negotiation, but I hear about it -- it is a battle to get a penny a hundredweight from somebody on over-order negotiation. It is -- it is a battle. And so some day maybe some of that value might come back. But I don't know how much, and it's not going to automatically come back, in my mind.

Q. And Dr. Wolf testified that the risk of Make Allowances being too high is that manufacturers could make too much product or disrupt the market. But isn't true today that we don't have an issue of too much production being available to farmers?

A. I would say we're in a pretty good supply/demand balance right now across the U.S. dairy industry. Our current issue is more of a demand issue than anything else. And that demand issue is stemming from, you know, the reactions to the pandemic and structural supply chains and inflation, and we're still waiting to sort of get back to even on that. And there's all kind of issues with -- leading back to a significant buyer of -- importer of dairy products, businesses in China, who are aren't buying as strongly as they have been.

And so we're in this weird supply/demand spot right now that we're trying to work back to an equilibrium. But I would say overall there's a pretty good supply/demand balance across the United States dairy industry.

Q. And on page 18 of your testimony, you talk about a

number of new plants that were being built and that were built based on the current Make Allowances and FMMOs prices.

Do you recall that?

A. I do.

Q. And -- but these cheese plants can choose not to pool their milk, correct?

A. I don't think any of the -- well, I -- let me back up. A lot of the plants that are being built buy milk from dairy cooperatives and don't pool milk because the cooperatives pool the milk.

Q. But the cheese plants can choose not to, correct, and then they would not be subject to minimum FMMO prices?

A. I think we're missing on something. The -- most of the cheese plants that are being built do not have a producer milk supply of their own, and so -- pooling or depooling is a Federal Order handler decision. And so these cheese plants being built aren't Federal Order handlers, so they don't have a choice to depool because they are not part of a pool report that pools milk.

Q. Other than the fact that they were built, do you have any other evidence that these plants were built based on -- or planned or relied upon the current Make Allowances?

A. I don't. They didn't consult with me on the economics of the situation, and so I didn't -- I didn't consult with them. And so I don't have that information.

Q. So you don't know what milk formulas they used in

their business plans to determine the payback for the investment of building those plants?

A. I don't.

Q. And then you mention that NMPF's members operate significant manufacturing businesses across cheese, butter, and powder, correct?

A. Yes.

Q. And -- but you would agree with me that when Make Allowances are increased, farmers with cooperative-owned plants would experience financial benefits from those increases through the plant side of their cooperative income, correct?

A. No.

Q. "No"? Why not?

A. So if you could think about two ledgers at a cooperative for determining pay prices at their own plants. One ledger -- I'm not going to be able to get this on the record, I'm sorry, if I use my hands. I like to use my hands to make -- but one ledger is the ledger at the plant, and the other ledger is the ledger of what you pay dairy farmers.

So if a dairy cooperative is losing money, they can only afford to pay what -- what they have to pay out, and so dairy producers receive less money. If there was a Make Allowance change of $0.04 a pound that allowed a Class III manufacturer to make $0.50 a hundredweight more on the milk going into their plant, it would on the other ledger result in a milk price decrease to their

farmer-owners of $0.50 a hundredweight. So there is no change in the valuation or the value of the farmer milk in that example.

Q. And I'm talking about just the plant side of that ledger. So I understand the impact of both, but just on the plant side, farmers who are members of cooperatives with plants would benefit on that side of the ledger from an increase in Make Allowances, correct?

A. You have to -- at a dairy cooperative, you have to look at both sides, unlike a proprietary cheese plant that doesn't have its own producers and that $0.50 falls right to the bottom line and there's no additional income for the dairy cooperative whose dairy farmers are supplying the plant.

Q. I understand that. And we'll get to the second side of the ledger. I would just like to approach them one at a time.

Would you be willing to do that for me?

A. Yep.

Q. Okay. So just on the plant side of the ledger, farmers who are members of cooperatives that own manufacturing plants would experience financial benefits on that side of the ledger, correct, if Make Allowances are increased?

A. They would, but it is not that simple because you got to take into account both sides of the ledger.

Q. And on the other side, as you mentioned, right, they would see a decrease that would essentially

neutralize or balance out the increase they experience on the plant side; is that right?

A. That's what I -- yes, that's what I've been trying to describe. Thank you for clarifying that.

Q. Okay. So for members -- farmer members of cooperatives that own significant manufacturing facilities, changes in Make Allowances kind of come out as neutral; isn't that right?

A. No.

Q. "No"? Isn't that what you just said?

A. Well, we -- I was only talking about the milk going into their own plants, not the rest of the milk.

Q. Okay. And that's fair. So then for farmers, though, who are members of cooperatives without significant manufacturing plants, they would not experience the same balancing of an increase in Make Allowances; isn't that right?

A. Correct.

Q. And you had said I believe that DFA has the majority its milk -- or excuse me -- the majority of its processing is for Class I; is that right?

A. I believe that's the case.

Q. Okay. And do you know what share of DFA's manufacturing milk is sold rather than processed? Can you share that with us?

A. I can't. It goes beyond trying -- I don't know.

Q. Okay.

A. How's that?

Q. That's a great way to answer a question.

So when thinking, though, about members of NMPF that have more significant investments in Class III or IV plants or a more significant portion of their member milk going into their own III or IV plants, they would benefit much more significantly from higher Make Allowances than perhaps DFA, correct?

A. They don't benefit from higher Make Allowances.

Q. Well, they would on the plant side of their ledger?

A. You got to take in both -- into account both -- I feel like this is a little bit like Abbott and Costello.

Q. But let me rephrase. It would not -- that for farmers who are members of cooperatives with a larger share of ownership in Class III or IV plants, they would not experience any negative effects of increased Make Allowances to the same degree as farmers whose cooperatives do not have such a significant share of Class III or IV plants?

A. Maybe. So -- so let's go back to the purpose of Federal Orders. So the purpose of Federal Orders, the Agricultural Marketing Agreement Act and Federal Orders were established to fairly distribute -- to prevent uneconomic competition for -- for sales to Class I fluid plants and to fairly distribute that revenue to dairy farmers supplying that milk shed. That's what the purpose of Federal Orders are. And so everything else is sort of, how do you value the rest of the milk in the pool?

And so the number one purpose of Federal Orders is all about the Class I market. And if we have a significant Make Allowance change that decreases milk prices by $1.45 a hundredweight, you are significantly decreasing the pay prices for dairy farmers doing what the policy of the federal government is, supplying milk to Class I milk plants. I think USDA needs to consider that impact. Thank you.

Q. And that wasn't quite my question, so I would like to revisit that and request that you --

A. I needed to get that in.

Q. And you can do that with your counsel, but please don't interrupt.

So I'd like to revisit my question if I could. Members -- farmer members of cooperatives that have significant investments in Class III or IV plants, ownership investments, will not experience negative impacts to the same degree as cooperative members whose cooperatives do not have such manufacturing in III and IV if Make Allowances increase; isn't that right?

A. It could be, but I don't know. I haven't done the analysis on that.

Q. Okay. And you mentioned 14 plants that you said DFA owns that make a Class III or IV product; is that right?

A. Yes.

Q. And how many of those sell a Class III or IV product?

A. Well, they all would.
Q. Did -- which of -- how many of those plants sell cheese?
A. Turlock California; Beaver, Utah; Pollock, South Dakota; Zumbrota, Minnesota; and New Wilmington, Pennsylvania.
Q. And you mentioned that a number of those plants sell a condensed product; is that right?
A. I did.
Q. And that condensed product is typically sold to another Class III or IV plant, correct?
A. Or a Class II plant.
Q. And so of the plants that you mentioned, how many will experience a benefit from higher Make Allowances, and which ones?
A. So it's the same thing, it is the ledger thing. So there's -- there's no added benefit.
Q. I'm asking just on the plant ledger, if you can do that for me, which of DFA's plant would --
A. So I don't want -- I don't want to -- I'm sorry for interrupting, but I don't want to answer that way because you got to take both sides of the ledger into consideration. That is -- that is the reality of the situation. You can't sort of make up a world that there's only one impact when you've got a dairy cooperative. There's two impacts. That's the reality of the world. So I'm not going to agree to answer some hypothetical question that has no reality in the industry. I'm sorry.

Q. So --
A. We have to agree to disagree on that one.
Q. Well, you refuse to answer the question; is that right?
A. No. I'm answering the question.
Q. Okay.
MS. VULIN: No further questions.
THE COURT: Very well. We have been going for about an hour and a half. I don't know whether there's further cross, but would now be a good time?
MR. HILL: I think it is an appropriate time to break.
THE COURT: Dr. Bozic?
I was going to ask if it's an appropriate time for lunch. Can you wait --
DR. BOZIC: I can wait.
THE COURT: And I think there may be more, too. Duly noted.
We'll come back at 1:30.
(Whereupon, a luncheon break was taken.)
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TUESDAY, SEPTEMBER 12, 2023 - - AFTERNOON SESSION

THE COURT: On the record.

CROSS-EXAMINATION

BY DR. BOZIC:

Q. Marin Bozic for Edge Dairy Farm Cooperative.

Good afternoon, Mr. Gallagher.

A. Good afternoon. How are you?

Q. Very good. How about yourself?

A. I'm doing well.

I got to ask you a question. It's been a long time since I've had to see somebody duck walking in through a doorway. Do you always have to duck walking through a doorway?

Q. Maybe just at regulatory hearings. I'm not sure.

A. Okay.

Q. I only have three questions.

With -- my first question, with respect to Proposals 8 and 9, submitted respectively by Wisconsin Cheese Makers Association and International Dairy Foods Association, do you find that Make Allowances as proposed in those requests, in those proposals, are necessary to secure sufficient supply of raw milk for DFA's Class I plants?

A. This is their Make Allowance proposal?

Q. Yes.

A. Are they -- no.

Q. At present time are Make Allowances higher than National Milk's numbers or National Milk's proposal needed

to secure milk for Class I plants?

A. Say that question again?

Q. At present time, today, are Make Allowances any higher than National Milk's request, Proposal Number 7, needed to secure milk for Class I plants?

A. No.

Q. That was my first question. Thank you very much.

My second question: With respect to Proposals 8 and 9, would you agree that Make Allowances should not be set at such level to single handedly encourage dairy product manufacturing for which there is no defined target buyer? In other words, somebody expands and then just doesn't even have a buyer for their cheese and just pushes it over to CME.

A. I would agree with that.

Q. And in the Exhibit IDFA-1, did you see that the cost of processing for low cost cheese plants is $0.22?

A. That's in the Mark Stephenson study that came out in 2022 -- or using 2022 data?

Q. I believe so, yes.

A. Yes, I did see that.

Q. And as such, can we really rule out the possibility that Make Allowances higher than $0.24, which is requested by National Milk, would not be excessively stimulative?

A. No.

DR. BOZIC: Thank you very much.

THE WITNESS: You're welcome.

THE COURT: Anything further?

CROSS-EXAMINATION

BY MR. MILTNER:

Q. I don't have to duck going through a door.

A. Mr. Miltner. How are you today?

Q. I'm fine, Mr. Gallagher. How are you?

A. I'm well. Thank you.

Q. I appreciate you providing information on DFA's plants. I have a couple of additional questions --

A. Okay.

Q. -- on those, which maybe you can help me with, and maybe you can't.

The plants that primarily produce milk powder, so Fallon, Garden City, Portales, Fort Morgan, Goshen, and the plants in the Northeast, do they just take in raw milk to produce their products?

A. So when I talk about raw milk, it's milk picked up at the farm that hasn't been processed in any form yet versus a load of condensed fluid milk. They may -- they may purchase loads of condensed fluid milk from time to time, even though they also make condensed fluid milk.

(Court Reporter clarification.)

THE WITNESS: But I don't have the specific information on that. I'm not involved in the day-to-day operations of any of those plants.

BY MR. MILTNER:

Q. Okay. I believe you said the Fallon plant produced skim milk powder and whole milk powder.

Did I get that correct?

A. You got that correct.

Q. Do you know what -- do you know what the Fallon plant does with its cream?

A. Yeah, good point. I was wondering that too when I got my cheat sheet.

I'm sure they also sell cream, but I don't know to what amount.

Q. DFA does not produce any butter, does it?

A. Yes, we do.

Q. You do. At which plant?

A. Oh, you know what? Different group. We do at -- no. We do. I'll think of it in a moment.

Q. Okay.

A. I'll think of it in a moment. We do produce butter at one plant. That's 15 plants then.

Q. So for those powder plants --

A. Winnsboro, Texas. That's where our butter plant is.

Q. I should have thought of that one myself.

A. Yeah.

Q. Other than the Winnsboro plant, those plants that are producing -- well, let me back up. Does Winnsboro produce any milk powder?

A. Not to my knowledge.

Q. Okay. So those plants that do produce milk powders, are they able to utilize all of the nonfat solids in the milk that comes in the door?

A. So help me out here a little bit. So you are talking about we pick milk up, raw milk on a farm, and we deliver it to the plant. And then we pump it into a silo, and then we make nonfat dry milk. And so we take that output and then convert it back to see what the milk equivalent would be, and that there might be some slippage called shrinkage. I'm sure there's shrinkage at all our plants, whether they are nonfat dry -- is that -- I'm sure there's shrinkage at all our plants and not just the nonfat dry milk plants.

Q. That's a good answer to the question I posed.

A. Well, thank you.

Q. Most of your answers have been quite good.

For a plant that was a true butter/powder plant, when you make butter, you get buttermilk, correct?

A. You would get buttermilk as a byproduct, yes.

Q. DFA's plants producing powder, because you're skimming the cream and presumably selling it, there's no buttermilk there, correct?

A. That is my knowledge.

Q. There is some certain amount of nonfat solids in liquid bulk cream, correct?

A. Yes.

Q. But that's sold with the cream off to whatever it's going to get processed, correct?

A. That's correct.

Q. There were some questions about the data from the two CPA firms, Frazer and Nietzke & Faupel, and you

indicated that you found those -- that data to be reliable for purposes of USDA's analysis, correct?

A. Yes.

Q. And am I correct in stating that that data was collected in the normal course of business of those dairy operations and those CPA firms, correct?

A. I believe it to be. I didn't collect the data, so I can't state it -- state anything other than that. But it would be my understanding that it was.

Q. To your understanding, did National Milk or DFA commission, not the testimony, but didn't commission those compilations of data for purposes of this hearing, did they?

A. We did not.

Q. And so the fact that that information was not compiled for the express purpose of supporting a proposal, does that improve your confidence in the reliability of that data?

A. Yes, it does. The data -- the data had been compiled years before this proceeding was ever thought of. At least the beginning of the data series.

Q. Mr. Rosenbaum also asked -- or he stated, I think, in preface to a question, more precisely, that we -- a royal we in this case -- have waited 15 years or quite a long time to update Make Allowances.

Do you recall that statement?

A. I do recall that.

Q. Are you aware of any request made to USDA between

2008 and 2023 to update Make Allowances?

A. No.

Q. And are you aware of USDA ever on its own initiating a proceeding to amend a marketing order, absent a proposal?

A. Maybe. I'm trying to -- maybe. From time to time Congress requires USDA to change Federal Milk Marketing Orders, and I believe they may -- and I don't know who proposes those hearings, but from time to time there is a hearing that goes along with it. I'm not sure if that's USDA calling the hearing or somebody in the industry or it was Congress but -- so I'm -- I don't know. How's that? That's a big I don't know.

Q. How about absent Congress or somebody from the industry, do you recall USDA ever on its own saying, let's have a hearing to update a marketing order?

A. No.

Q. I flipped past several questions that have already been addressed by others. But I am on now page 12 of your testimony, and I had a question about the data box there.

The income figures that get baked into this, this table or this chart, do those include government payments to producers through Dairy Margin Coverage?

A. I don't know that specifically, but I believe they do.

Q. Okay. And because -- well, assuming that it does include the DMC payments and knowing that they are effectively capped at 5 million pounds a year, would that

mean that the profitability of the first column is artificially higher than that in the second column?

A. So hoping we could see the chart. So what page are you on?

Q. 12.

A. Page 12. So you are talking about the chart that shows 1,000 to 2,000 cows, 2,000 and more?

Q. Right.

A. Okay. So say -- ask the question again.

Q. Sure. Assuming that the DMC payments are included in these calculations --

A. Uh-huh.

Q. -- and recognizing that Tier 1 of DMC caps at 5 million pounds of production --

A. Uh-huh.

Q. -- the profitability of the farms in the 1,000 to 2,000 column are what I would characterize as artificially inflated by the DMC payment.

A. Correct.

Q. So if you wanted to really compare the profitability of just the farming operation of these, you would have to somehow back out the DMC payments?

A. That's fair. Although I would have to say, I don't think you're backing out very much an a dollar per hundredweight basis because they don't receive that much on a dollar per hundredweight basis on the DMC in that first column. Fair enough? But there is something to back out.

Q. Yeah. I think we can look at it, and in certain years it would be more significant than others, right?
A. Yes.
Q. I'd like to ask you a couple of questions about the data box at the top of page 17.
A. Okay.
Q. And as a preface to that, at -- on page 18 there is this sentence: "Really large Make Allowance increases will shift income from dairy farmers to large and efficient milk plants that do not need that kind of financial support provided them by dairy farmers."

And I'm looking at now the data box on page 17 and the line item for New Mexico.

As part of your duties with DFA, do you have familiarity at all with the cheese plants that operate in New Mexico and West Texas?
A. I have some familiarity with them, yes.
Q. Would those plants be included within your category of large and efficient milk plants that do not need that kind of financial support?
A. I'd prefer not to comment since they are good customers of ours. Fair enough?
Q. Sure.
A. As they are of you and your cooperative.
Q. They are.

As part of your risk management duties do you work with DFA members in New Mexico?
A. My team and I do, yes.

Q. Do you find the average net income numbers presented in your data box to be reasonable given what your team understands about your membership in New Mexico?

A. I do. We -- I do. We don't have -- receive income statements or balance sheets in our process, but we do have conversations with our farmer-owners about how a current -- or the futures milk prices when converted back to a pay price for the dairy farmers in that area, how that relates to their costs of production, and their profit margin is really tight in that area.

Q. I would -- I would -- I would presume that in order to effectively advise your members on the risk management tools available to them, you or your team would need to have some discussions with the members about their input costs, their margins, their profitability overall; would that be correct?

A. That is correct.

Q. If you --

A. So -- so just as a follow-up to that. One of the DFA farmer-owners that testified last week, Eric Palla, resides in New Mexico. I do not know if his data is in the Frazer dataset, but he did respond that he was concerned about even a $0.50 increase in the Make Allowance would threaten the profitability of his dairy farm. So that would suggest there's some pretty tight margins in New Mexico.

Q. Would it -- well, would it surprise you if the most recent information from the Order 126 Market

Administrator showed fewer than a hundred farms active in New Mexico?

A. I don't know. I don't look at that particular price announcement very often, so I'm not sure what the number would show.

Q. As you noted, Mr. Palla had testified about the impact of a $0.50 increase, which is according to the data box on page 13, real close to what National Milk's Proposal 7 would cause in terms of an all-milk price impact.

I guess my question for you is, if you look at New Mexico and their negative net income over the last seven years of $0.64 a hundredweight, what do you think an additional $1.45 in all-milk price reduction would mean for the dairy producer industry in the state of New Mexico?

A. It would be crushing. I think it would hasten the exit of a lot of dairies in the state of New Mexico.

Q. And there are two very significant cheese plants customers of DFA located in the state of New Mexico, aren't there?

A. Yes.

Q. Which, with a continuing loss of farms in the state, would burden DFA in terms of supplying those cheese plants, wouldn't it?

A. At -- yes.

Q. You would have to source milk from further distances presumably to service those plants, wouldn't

you?

A. Potentially, yes.

Q. And if that were to occur, that additional hauling cost would be shared among DFA's members in the Southwest council, wouldn't it?

A. Yes. Yep.

Q. And so not only would you have the loss of the economic impact to the state, a loss of milk supply to the plants, but even those farmers that would be more financially sound would likely have increased costs, correct?

A. That's correct.

Q. You mentioned DMC, and DMC uses -- to calculate the margin, uses a national all-milk price, correct?

A. That is correct.

Q. And it uses a national feed price calculation, correct?

A. It -- it uses a national corn price the best they can to get a national alfalfa price, but it uses a soybean meal price from the Upper Midwest.

Q. But a single soybean meal price, there's one price applicable to the whole country, correct?

A. That is correct.

Q. Do you know if the pay price received by farms in New Mexico is lower than the national all-milk price?

A. Yes, it is.

Q. By about $1.50 a hundredweight?

A. Maybe. I didn't review that for --

Q. Do you know if the feed costs for farms in the Southwest are higher or lower than the national average?

A. Let me look.

(Court Reporter clarification.)

THE WITNESS: So my first reaction would be to say they are importing feed from an awful long distance, and so the cost of bringing that feed in has gone up tremendously. But they do grow some of their feed in that area, but I don't -- I don't -- I can't -- I don't have a comparison of New Mexico versus the average that I can easily look at.

BY MR. MILTNER:

Q. So I don't want to pin us to numbers, but if the DMC margin is below $4, which is catastrophic, correct? I think that's the definition of a catastrophic payment.

A. We never would have thought that we would ever see a DMC margin less than $4. So it is pretty bad.

Q. And for -- I mean, perhaps this is already in the record, but that margin is supposed to represent the money to a farm that is left over after they take their milk check and they feed their cows, correct?

A. That is correct.

Q. To cover all expenses other than feed, correct?

A. That is correct.

Q. So if the national number is below $4, and in New Mexico they are receiving a dollar or $1.50 less on the milk and paying more than the national average on grain, that would put them with a margin of 2 to $3 or somewhere

in that neighborhood; would you agree?

A. If your numbers are correct, I would agree that they are getting less than the national price on milk. I don't -- I'm sure their cost for feed is -- isn't less than the national average. I am just not sure where in relation to the national average it is. But using the example that you -- you suggested, that I would think their -- the New Mexico milk feed margin would be less than the national average.

Q. And if you were to reduce that an additional $1.58, they might not even be able to pay their feed bill, right?

A. Correct.

Q. Or any other bill in addition to that, right?

A. Correct.

Q. How long does a dairy farm last if that's the situation?

A. Until their line of credit runs out and then they are done.

Q. The bank will be calling very soon, wouldn't they?

A. Yes.

MR. MILTNER: Thank you. I don't have anything else.

THE COURT: Anything else?

Redirect I guess -- or AMS, sorry.

MS. TAYLOR: I also take a big long pause to see.

THE COURT: I didn't mean to wake you. You weren't asleep.

Thank you. You are up, Ms. Taylor.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good afternoon.

A. Good afternoon. How are you?

Q. I'm great. Thank you for coming to testify today.

A. You're welcome.

Q. You talk on the second page, and all throughout your testimony really, about not -- not -- the importance of not adopting a Make Allowance that is too large and its impact to producers. And I just want to ask kind of what would you consider too large? That's a pretty subjective statement.

And I'll add, you are not the only one who said that, but I'm trying to get your opinion of what is too large.

A. I have an opinion. I have a strong opinion. Too large would be something that reduced average dairy farm milk prices by more than $0.56 a hundredweight.

Q. That's very objective.

A. I try to be objective often.

Q. Okay. You have kind of hit on it a little bit here and there about your -- what you consider data issues on some of the surveys that are going to be introduced through this hearing. I just -- we have heard some of those, but I was wondering just to make sure that the hearing record is clear if you could elaborate more kind of what the data issues are that you see with those.

A. On the surveys?

Q. Uh-huh. I assume that's what you are talking about.

A. Yep. So I think more of this will come out during the cross-examination of Mr. Stephenson, but here is one.

So -- and I focus on the data collected for cheese manufacturing plants. You know, Mr. Stephenson can only -- can only analyze what the businesses send them, and the cheese businesses didn't send them enough. And so in the first survey in 2019 -- I can't remember if it was eight or ten milk plants that were cheese plants that were included -- and when you looked at the more -- he -- he -- he divides his sample size -- I believe this, and I apologize if I'm misrepresenting it. Mr. Stephenson can correct me when he gets up here -- or he can cross-examine me and fix it right now.

I think he takes his data sample and divides by two. And he takes -- he sorts from most -- you know, by lowest costs, so if you had ten, he has an array of ten plants, and he goes in the -- divides -- takes the first five least cost plants, and that's one group, and then -- and he did.

So -- so when you look at that in his first study, his first survey, and you looked at then what was the total amount of cheese, it was obvious there was not a lot of large cheese plant contribution. Study two, sort of doing the same thing he had better, better information from the cheese plants, because I believe he had 18 cheese

plants.

When you take his average for all 18 and multiply it out by the 18 plants, you get about roughly 2.2 to 3.9 billion pounds of cheddar cheese made in 2022. And when you look at the nine plants that are most efficient, and you look at -- you convert that back to the average milk intake per month, it's about 130 million pounds of milk a month, on average, for the most efficient.

And so there -- there are a lot of very large cheese plants that still did not contribute their data. And I don't know this, but I would be concerned that those large -- those -- the rest of the data is from large -- most of the rest of the data is from really large cheese plants, seven or eight of the largest cheese plants in the United States and that their costs of manufacturing cheese are at the low end.

And when you look at his -- his low end, which I believe is $0.22 a pound, if you just took the low end by the delta of the cheese that's missing from the survey, determine the total cost from all that, add it into the total cost that's already in the survey, and then divide it by all the cheddar cheese, you come out with $0.245 a pound. And this is a rough estimate, a back-of-the-envelope calculation that I have done.

So that would suggest that the average price that he's -- because he doesn't have the full data -- is suspect in its accuracy.

I'd take one more step, though. That in the

average of the nine plants that is $0.22 a pound, and we all recognize an average means probably four or five are higher than the average and four or five were lower. We don't know what the lower -- it could be a tenth of a cent, it could be a couple cents. I don't know. I would be concerned that of those seven or eight large cheese plants that I believe aren't included in the survey because they didn't provide Mr. Stephenson with the data, I believe they could be averaging below the average.

So there's serious questions about whether we have enough data in the survey that accurately represents a meaningful cost of production to lower dairy farmers' milk prices. I think with what we have done across National Milk Producers Federation have come to a pretty reasonable point that I think, in my back-of-the-envelope calculation, I hope we're not too high.

Fair enough?

Q. Yes. Thank you for that detail.

A. You're welcome.

Q. I'm getting questions from all over.

A. Oh, can I send you some.

Q. I'm not just texting a random person, so -- all over this room.

A. I didn't see Mark send you one, so --

Q. No. Only from appropriate USDA people, I'll add that caveat.

On your chart on page 5, and I think this is the -- it is the NASS feed price index --

A. Yes. Yep.
Q. -- on the top line, and in the bottom line is the PPI for final demand.
A. Which is used by Federal Reserve. It's widely talked about in the press whenever they are about to meet or right after they meet.
Q. You have to say that a little louder.
A. Widely talked about in the press before the Federal Reserve meets or right after they meet because that's an important inflation factor that they look at.
Q. Okay. My question was kind of around why is -- why do you feel that PPI is the appropriate one to compare against the NASS feed index?
A. It's a well known PPI. That's it. It's a well known PPI that we can compare something to. The -- I didn't have I guess enough confidence in any of the other PPIs that might be more dairy specific.
Q. Okay.
A. One of the other issues with the other PPIs, the dairy specific PPIs, since it's what -- somewhat a manufacturing business would -- a dairy manufacturing business would sell their product for, most of the cost of what they sell the product for is the cost of milk. And so one of the problems with a dairy PPI is in its inflation review, it also takes into account, did milk prices go up or down. So I -- it doesn't seem like that's an accurate way of looking at inflation overall for a manufacturing business.

Q. Okay. On your chart on page 10, I think I figured out the math that you did, but if you couldn't just walk through for the record to make sure it is clear, you can just pick a year, so you can pick 2012 if you want, if that's easiest, how you got to your adjusted net profit. I just want to make sure it's clear for the record where you pulled that from.

A. Okay. Very good. Fair enough.

So the five rows up from the bottom is total cost listed, and that is a summation of operating costs and allocated overhead. Within the allocated overhead are opportunity costs of unpaid labor and opportunity costs of land. Those two factors are not included in the accounting data that I -- that was provided.

So for 2012, I would have taken the $2.16 of unpaid labor, and the $0.02 of opportunity cost of land, so $2.18, and I would have recalculated the cost less. So the second line up is $28.35 minus the $2.18 to get the $16.17 -- excuse me -- the $26.17. And then I took the total gross value of production, and from that I subtracted the information on that second line, that $26.17, to get the minus $4.98.

Q. Okay.

A. And I did that for the rest of this table. And then, although I don't have the layout like is shown on that table for the two larger production sizes, I would have done the calculation the same way.

Q. Is that what's on page 12?

A. That's correct. So page 12, if I -- I don't have all this data, but it would be the adjusted net profit line that you would see on page 10, just for those two size dairies.

Q. And you used the same ERS data that's broken out for those sizes then?

A. I did, yes.

Q. Thank you. That's helpful.

On page 11 at the top, this cost less opportunity -- let me start again.

The milk sold minus cost less opportunity cost unpaid labor and land has averaged 2.06 since 2015. That's just an average of that adjustment over those years for all sizes. Is that where that 2.06 came from?

A. Yes.

Q. Okay. On page 13 in your chart where you estimate the various impacts to all-milk prices for the different proposals under consideration, I know there was some discussion earlier about I think -- what I will put in my head as the short-term impact of $1.45 coming off producers' checks. I think that's what you talked about, that in your opinion a lot of farms would go out of business if they had to take that hit. Is that correct?

A. Yes.

Q. That's an appropriate interpretation?

A. Yes.

Q. Okay. I'm just wondering if you could speak if there would be any type of market reaction that would

dampen some of that impact?

A. I don't know. We have never gone through -- I don't think we have ever gone through a structural milk price change where there would be that dramatic of a price change. So I'm not sure exactly what would happen that might dampen some of the effect, but there could be some things.

But I don't know -- so the one thing that everybody talks about is that you go and you try to renegotiate over-order premiums. On day one, supply/demand hasn't changed. The end of month one, supply/demand hasn't changed. And so you keep taking that another month and another month and another month, and I'm not sure when it changes enough that you can maybe get -- start to maybe get maybe an adjustment in over-order premiums, if at all. So I don't know when that might occur. It could occur, but it is not day one.

Q. I think you said something earlier, and I wrote it down, that over-order premiums may come back some day, but it's a battle and takes time.

A. That was in some cross-examination. I do remember saying that, yes.

Q. That's along the same line. I'm just trying to put --

A. Yes.

Q. -- all the pieces together in my head.

A. That's correct. That's along the same lines.

Q. Okay. On 19, you are talking about the historical

precedent. And the last sentence says, "The resulting changes from these hearings had modest changes to farm level milk prices, with the largest impact of $0.35 per hundredweight resulting from the 2006 hearing."

Where did the $0.35 come from in that statement?

A. Yes. So it was in -- I think it was in your economic policy statement analysis for those hearings. And there is -- there's a narrative about what the impact on Class III or IV prices would be. And I found that for that hearing and the prior hearing.

Q. Okay.

A. So that's where I got those numbers.

Q. Okay. So that's the forecast of what USDA says could possibly happen?

A. I'm not sure. I'm not sure if that was the forecast or that was what the immediate change in the prices would be because of the changes.

Q. Okay.

A. I interpreted it to mean that was the immediate change in the Class III or IV prices as a result of the changes to the formulas.

Q. Okay.

A. Are you familiar with what I'm trying to describe as the analyses?

Q. Yeah. I'm very familiar with that, but I have --

A. Yeah. Well --

Q. -- lot of reading to remind myself of what we said all those years ago.

A. Fair enough.

Q. Let's see. I think my final question for me, others might have other questions, and I have asked this of other co-op witnesses, trying to square on the one side argument to not ask producers to take a dramatic decline in the prices they receive for a Make Allowance that's too large, as you would term it; on the other side, the testimony that farmers are already paying for this through decreased premiums or reblends, etcetera.

And so I'm just trying to kind of get your reaction to that statement on how USDA should think about those two pieces of information that have been put on the record.

A. Yes, that's -- that's complicated, and it's not easy to sort of work through. I don't envy your challenge.

So first of all, if you make a Make Allowance increase that reduces milk prices by $1.45 per hundredweight, dairy farmers that are supplying the Class I marketplace will receive $1.45 less. And it doesn't matter whether they belong to a dairy cooperative that has manufacturing facilities or not, because any one of those dairy cooperatives with manufacturing facilities, if they are a Federal Order handler, probably has some Class I sales, and so their producers, their farmer-owners will see a net decrease. So that's pretty significant.

For dairy cooperative members where their milk goes to their own plants and they're Class III or IV

plants, it's a -- it is probably a net sum zero game because there's these two ledgers. Right?

We have already seen -- and again, I come back to the cheese side. You have got a block-barrel spread that a lot of the cheddar cheese manufacturers benefit from, that is like a back door Make Allowance increase, that's probably worth 3 to $0.04 a pound to them. I don't think I'm understating that over-order premiums have gone down at least $0.50 a hundredweight, so that's about another $0.05. For some, there's depooling income. For some, they passed higher costs along during the inflationary period because everybody else did. And most of the -- most of the cheese produced in the United States isn't included in a survey, so there is no circularity.

And so when you square all that up, some of these cheese plants have over the course of time since 2006 received anywhere from 5 to $0.10 a pound or so in reduced cost or increased revenue. And so when you hear of double-dipping, dairy farmers want to make sure that you're not allowing them that and then also taking the value of the milk price away from them.

So there's a lot to weigh here, and unfortunately we don't have good data, so you're in a -- you're on a slippery slope about how you look at all these things. And I would say, I think, of the -- of the handlers that are participating in this hearing, I think most of the handlers accept the fact that a Make Allowance increase of the equivalent of the National Milk proposal is okay.

That's all I can do to help you out on that. Good luck. We wish you the best. We hope you side with us.

CROSS-EXAMINATION

BY MR. WILSON:

Q. Good afternoon, Mr. Gallagher.

A. Mr. Wilson, how are you today?

Q. I'm doing well.

On page 17 -- well, let's transition from the bottom of page 16, to the top of page 17. The very last line on page 16 references 2002 to 2022. The chart --

A. Good catch. Thank you. It should be 2012. That was a typo.

Q. Okay. So it is correct to be 2012 to 2022 as the chart or the table represents?

A. Yes. Thank you for pointing that out.

MR. WILSON: That is all I have.

THE COURT: Is that it for AMS?

MS. TAYLOR: Yes, that's it. That's it from AMS.

THE WITNESS: So -- so can I follow up on one other thing that I think is important.

THE COURT: Well, we're at redirect anyway. Your counsel just asked if there's anything you would like to follow up on.

THE WITNESS: Yeah, there you go.

MS. HANCOCK: I'd like to adopt the judge's question.

THE COURT: I didn't mean to step on you there if you are afraid of following --

MS. HANCOCK: It was the only zinger I had too.

REDIRECT EXAMINATION

BY MS. HANCOCK:

Q. Go ahead.

A. So --

Q. You have something you wanted to say?

A. So when Jeff Bushey was here from Nietzke Faupel, there was -- there was a question of from Mr. English -- that's okay, you can come up -- there was a question from Mr. English, and he was -- he was pointing to some estimate of a net return for -- for the data of being over a million dollars. And I think he -- I think there was -- I know in redirect, Ms. Hancock and Mr. Bushey covered some things to help people understand it isn't profit, it is profit, but it is not money in the bank because -- like, dairy farm is a business, and like any business, you have to continue investing in your business, recapitalizing your business. You have to buy new things to replace things that get worn out.

And so what dairy farmers do, is from their profits, they use that to help buy things they need or make down payments on things they need and then borrow the rest. There are very, very few dairy farmers that -- in fact, I don't know any -- that can borrow 100% of the cost of anything.

And for dairy farms to be able to remain viable, they need to continually recapitalize, and that includes recapitalizing their milking facilities, which can cost

millions of dollars. They buy tractors. They have lots -- a big farm, a large farm, 2,000-cow farm, they have lots of tractors. And so they need to continue to recapitalize. And a lot of what they earn in profit is used to support that recapitalization. So they are investing it back in their business to maintain the viability of their business.

Fair enough, Mr. English?

That's all I had on that. I wanted to make sure that was clear.

Q. Thank you, Mr. Gallagher.

You were asked a question during your cross-examination about the 1999 order language that talked about market-clearing, and I think they -- Mr. Rosenbaum read a sentence from that to you about market-clearing, and you -- and asked you whether you agreed with the proposition that he read you.

Do you recall that?

A. I do.

Q. And you answered no?

A. Correct.

Q. Would you like to elaborate on that?

A. Yes. So one of the things -- thank you for the question -- one of the things we haven't established and -- is, what does market-clearing mean? And it didn't even get established in that 1999 decision.

For historical perspective, there's a few of us here in the room that can remember the Dairy Price Support

Program. The Dairy Price Support Program doesn't exist anymore. It existed in 1999. It was active in 1999, and 2000, and 2001, and in 2002. And it was buying surplus nonfat dry milk products off the market. In fact, we -- when -- if you recall, when the EU removed their dairy quotas, and milk production increased at a time that demand didn't, and they turned that milk powder -- or that milk into milk powder, and we would go to outlook sessions and talk about mountains of powder in storage at the EU. Well, in 1999 and 2000, and 2001, and 2002, we had mountains of powder -- Todd, maybe in caves in Kansas City.

And so market-clearing meant something different than it does in my mind now. We do not have mountains of surplus product that have been removed from the U.S. dairy industry. In fact, we don't have any that have been removed because -- by the federal government because there is surplus dairy products.

I would say the pricing that we have now is a market-clearing pricing system because pretty -- pretty close supply and demand are pretty closely connected. And there will be from time to time an imbalance. We're seeing a little bit of an imbalance now. There will be seasonal imbalances. There will be imbalances because a plant closes or it shuts down or the workers don't show up and you can't operate the plant for whatever reason. So there's always going to be these imbalances. But we never really defined what market-clearing is.

I can tell you that from time to time, there are loads of milk that get sold at Class III minus a dollar, or minus $2, or minus $3, because even with that discount, and the cost of transporting the milk to wherever it's going to go, there's still money left over to pay dairy farmers. But that happens on a small volume of milk.

Now, I hope in your deliberation of what market-clearing is that you don't consider that a market-clearing price. Because if that's the market-clearing price that you think you have to set Federal Order milk prices at, there won't -- you don't need to have a Federal Order anymore because you will lower milk prices so much nobody will care if there's one or not.

So that's sort of some commentary on market-clearing. Thank you for asking.

I guess following up on that gave Nicole a few more minutes.

Q. I'm trying to read my note.

A. So -- so it is different now than it was when that decision was written. We don't have a federal price support program. We don't have mountains of surplus product that needs to be removed. So -- so the factors that influenced whoever wrote that in that decision is far different today than it was then. And I don't think whatever was written then should just be broadly interpreted and used today. You have to rethink that.

Q. And just to follow up on the sentence that was

read, the next sentence says that "the prices for milk used in these products must reflect the supply and demand."

And that's what you have been talking about in your testimony; is that -- is that right?

A. Yes. It is.

Q. And -- and one of the factors that you have talked about in your testimony, throughout the course of today, has been the effect on a dairy farmer's willingness to continue to provide that supply if the conditions get too extreme for them?

A. That's correct.

Q. One other question. You were asked about whether you performed an economic analysis of disorderly marketing.

Do you recall that?

A. I remember -- remember being asked if I did an analysis of what the impact would be relative to a large Make Allowance increase.

Q. And whether that -- you had done an analysis that would have drawn you to the conclusion that it would create disorderly marketing?

A. Yes, I remember that.

Q. And you said you didn't perform that, but you did perform an analysis about whether or not dairy farmers could absorb the increase as proposed by IDFA; is that fair?

A. Yes, that's fair.

Q. And that is a condition, if -- if -- that you think, if that was implemented, could cause disorderly market conditions?

A. Yes.

Q. Okay.

MS. HANCOCK: That's all I have, your Honor. We would move to admit Exhibit 175.

THE COURT: Any objections?

Mr. Rosenbaum.

MR. ROSENBAUM: I'm not objecting to the exhibit being admitted, your Honor, but I do have a follow-up question generated by the last round of questions.

THE COURT: So we can go ahead and admit this then. Exhibit 175 is admitted into the record.

(Thereafter, Exhibit Number 175 was received into evidence.)

RECROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. So the statement that I read from 1999, I read to actually contain its definition, which is as follows: The importance of using minimum prices that are market-clearing for milk used to make cheese and butter, nonfat dry milk cannot be overstated. The prices for milk used in these product must reflect supply and demand and must not exceed a level that would require handlers to pay more for milk than needed to clear the market and make a profit.

Isn't the definition of market-clearing here

clearly one that says you have to set the price, the minimum price, at a level that would allow handlers to buy milk that's available and make a profit in doing so?

You may not agree with that approach, but I think the definition is clear, isn't it?

A. That -- that definition was developed in 1999, and this is 2023.

Q. And --

A. I'm encouraging USDA to -- to think about whether that's an appropriate -- that the definition as is actually defined and means what Mr. Rosenbaum is suggesting it means, does it mean the same thing today. That's all. Fair enough?

Q. You're the testifier, not me.

A. All right. You guys will get a whack at it here in a couple of days.

THE COURT: Anything further?

MS. HANCOCK: Nothing further.

THE COURT: Seeing nothing, you are dismissed.

Thank you, Mr. Gallagher.

THE WITNESS: Thank you.

THE COURT: Let's come back at -- let's come back at five of, 2:55.

(Whereupon, a break was taken.)

MARK STEPHENSON,

Being first duly sworn, was examined and testified as follows:

THE COURT: Your witness, Mr. Rosenbaum.

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Can you please state your full name for the record?

A. Yes. My name is Mark W. Stephenson.

Q. And what is your current mailing address or business address?

A. My current mailing address is 7791 Priest Road Northeast, that's Mancelona, Michigan, and the zip code is 49659.

Q. Dr. Stephenson, we have several -- a few exhibits to mark, and a couple others that I will make reference to at the same time.

Let's start with updated Exhibit Stephenson-1.

Do you have a copy of that?

A. I believe I do.

Q. Seven pages?

A. Yes.

Q. Okay. And is that your written testimony for today?

A. It is.

MR. ROSENBAUM: Your Honor, I'd ask that that be marked with the next Hearing Exhibit number.

THE COURT: Yes. That identified exhibit will be identified for the record as 176.

(Thereafter, Exhibit Number 176 was marked for identification.)

BY MR. ROSENBAUM:

Q. All right. And, Dr. Stephenson, you have over the years performed a series of cost of manufacturing reports; is that correct?

A. I have done that for many years. More than 30 years.

Q. I want to just start by making the documents so that we have them all together. The first one that's in our collection is the one that's IDFA Exhibit 29, dated September 1, 2006.

Is that, in fact, a copy of the cost to manufacturing study that you did back in 2006?

A. That is.

MR. ROSENBAUM: Your Honor, I'd ask that this document be marked with the next hearing exhibit number.

THE COURT: IDFA Exhibit 29 is marked for identification as 177.

(Thereafter, Exhibit Number 177 was marked for identification.)

BY MR. ROSENBAUM:

Q. And then the next, taking it chronologically, I believe the next report that you did is the document that -- dated July 9, 2007, which was -- has already been marked as Hearing Exhibit 145. It also says IDFA Exhibit 28.

Is that correct -- is that a correct copy of your 2007 report?

A. That is what I have here, yes.

Q. Okay. And then continuing chronologically, the

next document is a document that's been marked already as Hearing Exhibit 158. It also had the name NMPF 18-C.

Is that a true and correct copy of the cost of manufacturing report that you created in December 2021?

A. Yes, it is.

Q. Okay. And then, lastly, there's a document that's marked as IDFA Exhibit 1, which is entitled Cost of Processing in Cheese, Whey, Butter and Nonfat Dry Milk, June 2023.

Is that a copy of the report that you prepared in June of 2023?

A. Yes, it is.

MR. ROSENBAUM: Your Honor, I'd ask that this document be marked with the next hearing exhibit number.

THE COURT: Yes. IDFA Exhibit 1 is marked for identification as Exhibit 178.

(Thereafter, Exhibit Number 178 was marked for identification.)

BY MR. ROSENBAUM:

Q. Okay. Now, I have a few questions before you start and read your written testimony.

First, is it correct that you are not here today appearing in support of or opposition to any particular Make Allowance proposal?

A. That's correct.

Q. And am I correct that you, in this decade, have done initially a study, which has now been marked as Hearing Exhibit 158, that you did at the behest of USDA,

correct?

A. That's correct.

Q. And you have also done the study which is Hearing Exhibit 178. Am I correct that you did this at the behest of my client, the International Dairy Foods Association, as well as the Wisconsin Cheese Makers Association?

A. That's correct.

Q. And is this Exhibit 178 in certain respects an update of the work you had done for USDA in Exhibit 158?

A. It is exactly. The methodology was identical with the exception of the way the final costs were calculated. I'd be happy to elaborate about that.

Q. Okay. And your written testimony, which is Hearing Exhibit 176, did you prepare this yourself?

A. I did every word, jot, and tittle.

Q. And IDFA did not prepare this document, correct?

A. That is correct. And there's been no recommendations for changes. These are all my words.

Q. Okay. In fact, I believe you e-mailed this in late the evening before it had to be turned in; am I right?

A. What is your point?

Q. No point.

All right. Now, I think you referenced one difference between the 2021 and 2022, '23 report, that is to say between the Hearing Exhibit 158 and Hearing Exhibit 178, which I would just like to bring out before you start talking about it.

In Hearing Exhibit 158, did you use a different method to allocate costs between nonfat dry milk and butter than you had used previously?

A. I used a somewhat different method for weighting the allocation of costs. The total costs were the same, but there was a secondary weighting scheme that was applied in the 2021 report, Exhibit 158, than there was in 178. In 178, I went back to the same methodology that I had used years before, having heard some groaning from the industry.

Q. About what was in Hearing Exhibit 158, correct?

A. Yes, that's correct. About the additional methodology that placed some weighting on highly transformed products versus lightly transformed products.

Q. And do you still think that what you did in Hearing Exhibit 158 makes sense?

A. I do, although it makes some of the data in those tables less directly comparable to previous and subsequent report.

Q. With that exception, are the two reports, 158 and 178, substantively the same, methodologically?

A. Precisely the same, yes. The collection of the data was slightly different, just a different mechanism that was used, but same question, same methodology.

Q. Now, there has been some testimony about surveying that was done by the California Department of Food and Agriculture, CDFA.

So going back to an earlier time period, I'm

not -- sort of two decades ago now I guess, when you were doing your very first work on the 2006 survey that's been marked as Hearing Exhibit 177, what, if anything, did you do to examine how the California Department of Food and Agriculture was conducting its surveys and how did that affect what you were doing?

A. And, in fact, my interaction with California and the way that they had done their cost studies predated even those two studies that you are talking about. I had done costs of processing collection prior to that without input from or examination of what California had been doing. But I felt that, as I was starting to do more national work collecting data, that it would be important to have a couple of different things that were established.

So, for example, California could compel plants -- and did, in fact, do that -- for their data. And they had established a methodology for both collection and allocation, and I wanted to be able to look at California data because I also had California plants included in there, that would allow me to correlate what I had been doing with the California data and then be able to use that same methodology throughout the United States.

Q. Okay. And did you actually receive documentation relating to how California performed its surveys?

A. I did. California had a -- an instructional method book, fairly substantial as I recall. I haven't looked at it in some time. But it was probably a good

half inch thick, at least. And they had a team of, I can't remember, I think probably four people that worked in that branch of CDFA that collected data from the plants. So I did work rather closely with David Ikari, who was the program director there in California Dairy Programs.

Q. And to what extent did your own surveying mirror what California was doing?

A. Very similar. I did change a couple of things.

So as an example, rather than just take the annual expenditures for some of the inputs to manufacturing, like packaging, for example, I used for that portion of it something that we would call an economic engineering concept, where we try to build up the cost of a package. And the reason is that those are smaller dollar values, and if you pre-bought a substantial amount of cardboard or labels or glue or other things, then you could have spent a fair amount perhaps just during that calendar year, the fiscal year that you were looking at, that would have distorted what the packaging costs were. So rather than that, we worked by looking at the cost of a cardboard box and the cost of a yard of tape or the amount of glue that's used on there, and so we build up or construct the packaging cost. That was a little bit different but not much.

Q. And is it your understanding that USDA did rely upon your reports, which are Hearing Exhibits 177 and 145, in setting the Make Allowances that we are now under?

A. Well, I wasn't in the room where it happened, but I did submit the data and was available for examination and testimony at a Federal Order hearing. And I believe that they -- they did use that as some of the evidence in coming up with the Make Allowances that were changed.

Q. Now, were you also involved in interaction with USDA when they were engaged in what's commonly referred to as Federal Order Reform, that is to say when they were putting in place for the first time the methodology for setting milk prices based upon product pricing, finished product pricing?

A. Very much a part of that. We -- I was at Cornell University at the time, and our Cornell program on dairy markets and policy coordinated with a number of faculty members in universities around the country to do programatic work within the dairy industry. And this was an opportunity for us to, you know, really work together. We had a team that focused on replacement of the Minnesota-Wisconsin price discovery mechanism, and we also had a team that worked on Class I price relative values. So we had developed the U.S. dairy sector simulator model that was used I believe as input for regional price values.

Q. And what -- was some of your cost of manufacture data also used as part of that original reform effort?

A. Not at the time. At that time, we had not made a decision yet, within the Federal Orders, as to what the replacement of the MW series would be. That was a big

part of the testimony at the Federal Order hearings, just to see what the options were. And then it was a matter of refining the one that was selected as to how that would be done.

Q. Okay. So let me ask some questions about your current, most -- by "current," I mean most recent report, it is June 2023, that's pretty current -- which has been marked as Hearing Exhibit 178.

First, could you tell us what level of participation did you secure from industry in participating in that survey with respect to the four commodities whose costs of manufacturing are at issue?

A. Well, we have -- I have used different methodologies for the types of plants that I was trying to secure. So, for example, in some of the earlier methodologies, we might have been trying to look at what we might refer to as the frontier of plants. In other words, across all sizes of plants, which ones were considered to be best practice plants, and we tried to target plants that we thought were best practice.

At another one of the studies that was done, we looked at plants that had randomized stratum -- randomized strata draw from different regions and across different sizes of plants. So we made sure that we had regional representation and size representation.

For the 20- -- well, Exhibit 145 -- no, excuse me, not Exhibit 145. I'm getting my numbers mixed up here. For the Exhibit 158, the USDA study, we wanted to look at

plants that were constrained to processing products that were surveyed in the National Dairy Products Survey Report. And was doing the same thing with the update for the 2023 study, with the exception that with IDFA's backing and support, they urged members to participate. We had fewer members participate -- fewer members -- we had fewer participants in some of the product categories in the 2021 study.

Q. And what percentage of total production of the four commodity products ended up being captured by your survey?

A. I don't have that in front of me right now, but cheese and whey were close to 50% of the NASS reported volume, and butter and powder were close to 75 or 80% of the NASS reported volume. So it was a large percentage of product in the country that was represented in the study.

Q. And by the "NASS" figures relate to -- to pool production, correct?

A. That's correct.

Q. Of those products. All right.

And when you -- and I understand that information for the most recent report, Exhibit 178, that was -- you had basically devised a computer program where people could enter their information?

A. That's correct. I had done that before, but it was a different -- a standalone version of a program, and, in fact, was the one I had used back in the 2007 and '8 time period. In technology years, that's an old man at

this point in time. And, in fact, there were a few folks who had problems running that just because of the differences in operating systems, the upgrades that had taken place. So for the current version, it was rewritten to be an online web application that asks the same sets of questions, but it was collected as an online web app.

Q. And as people submitted data, what, if anything, did you do to assess that data before you accepted it?

A. Well, I always look, the -- starting from a long time ago, we ask a number of questions that both help us with the allocation of expenses, but beyond that, provide substantial cross-checks on data. So, in other words, if one calculation does not come pretty close to equalling another calculation that could be done later on in there, it is a flag for me that there's something wrong in the data, that we haven't received it all or it's been improperly recorded or something. So we look for those kind of red flags in here, and we -- we get that sorted out with plants by e-mail exchange or phone calls.

The other thing that does also happen that we do, is to take a look at the data that are supplied, and when they are summed in major categories in there, you may look at -- at those to determine whether this is a statistical outlier from the rest of the body of observations that we have. So by the time we have collected all the plants, you can take a look and see, it may not be wrong if it is that, but it's worth following up with a plant to just ask them, is this right or did we miss something here?

Q. Okay. And then could you tell me what a mass balance is?

A. Sure. This is a concept that is often talked about and used in dairy plants, but this is one where we look at all of the components, both the components in the milk and dairy ingredients that were used in the plant to manufacture all of the products in the plant. Then we look at all of the components in the products that were manufactured as final products from the plant, and those comprise a mass balance. And this is one of those cases that is one of the red flag indicators for me, that do those look approximately equal. There could be minor differences, and you would expect that there would be some plant loss, something we would call shrink in the industry. And if it's minor, then no concerns. If it looks like something is unaccounted for, then that mass balance is telling you something.

Q. Okay. And what do you do when -- what did you do when you found a mass balance that looked shaky?

A. Well, generally speaking, you follow up with the plant. The most common cause is that plants might have not reported products that they made in the plant that didn't relate to what they understood was supposed to be studied. But, unfortunately, I still need the component balance for those products to be able to allocate costs across the different products made in the plant, so we do collect those then.

Q. Okay. And -- and if you had a mass balance that

seemed out of whack, did you work with the company that was supplying the information to a point where you came to some conclusion that the information had been made accurate?

A. If possible. If it wasn't possible, then I believe in the most recent, the 2023 study, that there was maybe one plant that just had data that I deemed to be incomplete or inaccurate, and it was not included in the study.

Q. Okay. Now, I think you referred to this a second ago, but did you -- let me start that question again.

Many of these plants make products beyond the four that you were actually trying to determine a cost of manufacture for, correct?

A. Yes.

Q. And so one of the challenges is to allocate the plant costs among the products so that you have isolated as best as can possibly be done the costs that are associated with the product that you are actually trying to establish the cost for; is that right?

A. Yes.

Q. Okay. And so does that necessarily mean that you collected data with respect to products beyond the products that you were actually establishing a particular price for?

A. Some data. You know, as a good example, if a plant made cheese, cheddar cheese, 40-pound block, and yogurt. I didn't care much about the yogurt except that I

needed to know what the pounds of components were that went into the product. I didn't need to know anything about the packaging of that product. So questions like that weren't asked.

Q. Okay. Now, did -- when you -- some questions were asked earlier relating to your work, and so now that we have you, we can ask for a definitive answer.

When you were calculating costs with respect to cheese, do those cost calculations only relate to the 40-pound blocks?

A. No, we collected information for a variety of packages. So as a good example, if you manufactured a fair amount of American- or cheddar-style cheeses, I may have asked for information about barrels, as well as 640-pound blocks, not a part of the NDPSR survey, as well as the 40-pound blocks. In the report, in the table summaries, those values not reported there were not included in the 40-pound block values that are in the tables.

So as an example, I do have barrel values, I do have 640 values, but they are not reported there. Up to the point of packaging, the costs for receiving milk and manufacturing the cheese product itself, and right up to the point of packaging, including utility costs to that point, would have been included, but packaging costs not included. SG&A would have also been included.

Q. Okay. Are you comfortable that the number as reported for cheese, for example, the actual dollar number

is reflective of the cost of 40-pound blocks?

A. To the best of my ability it is. And, obviously, I'm reporting one, or I guess in this case actually three: The high, the low, and the average numbers. But of course, we have individual data from each plant, so there are more data that underlie what's reported here.

Q. Okay. Now, another question that came up during some questioning earlier in the hearing related to what's known as high heat nonfat dry milk.

Are you familiar with that?

A. Yes.

Q. And if -- if a company reported information and identified that as relating to high heat nonfat dry milk, did you include that in calculating the nonfat dry milk cost?

A. Not if it was reported as such. So it's possible that, you know, it might have been just labeled as nonfat dry milk, but if it was reported as high heat, it wouldn't have been included, just like if somebody had pepper jack cheese, it would not have been included in this either.

Q. Okay. Now, are you aware that AMPI during their testimony indicated that they had reported some high heat nonfat dry milk information to you?

A. I had heard that, yes.

Q. Okay. And I take it that was not labeled as high heat nonfat dry milk in the information you received from AMPI; is that right?

A. I did go back and take a look at this because I

was curious about it as well. And, no, it wasn't labeled. It was labeled as nonfat dry milk.

Q. Okay. Now, have you reached out -- not -- now, you have made promises of confidentiality to the various participants in your study, correct?

A. Absolutely true. I -- I always pledge confidentiality at the highest level, and I have never had a breach of that, nor would I. If that was the case, I'm out of business with this.

Q. Okay. Now, have you received special permission from AMPI to reveal certain information relating to their cost information for that?

A. I did, because when I went back in to look at the data, I wanted to see whether or not this was really influential in the reporting of the numbers in here. And I couldn't skew what people were looking at and be construed as, you know, well, throw the whole thing out.

And, no, the answer is, it is not. The AMPI plant granted that -- I'm given permission to say this by AMPI -- was that their data is almost exactly at the mean of the data reported. So even pulling their data out would not change the weighted mean by any significant amount, in the fourth decimal point.

Q. Okay. And, Dr. Stephenson, you have obviously already testified in general terms, at least, with respect to your doing -- having done work for USDA to prepare the 2021 study, correct?

A. I have, yes.

Q. And then you did work for the International Dairy Foods Association, my client, and the Wisconsin Cheese Makers Association, correct, the 2023 report, correct?
A. Yes.
Q. Am I correct that you also have done work for National Milk Producers Federation that relates to the -- what I'll call the Class I price surface issue that we will get to later?
A. I have, yes.
Q. Am I correct that you also have done work for the Milk Innovation Group relating to some of the work they've done relating to Class I issues?
A. I have many friends in this room.
Q. Okay.
MR. ROSENBAUM: Your Honor, Dr. Stephenson is available for examination.
THE COURT: Cross for this witness other than AMS?
Dr. Bozic.

CROSS-EXAMINATION

BY DR. BOZIC:
Q. Marin Bozic for Edge Dairy Farmer Cooperative.
Good afternoon, Mark.
A. Good afternoon, Marin.
Q. When you look at your data, surveys are voluntary, and so people don't have to participate. And processors do have the incentive to report the data if they believe --
MR. ROSENBAUM: I'm sorry -- I'm so sorry to

interrupt, your Honor. I made Dr. Stephenson available for cross-examination a minute too early. I was going to ask him to read his written testimony.

THE COURT: That's a good point.

MR. ROSENBAUM: I'm sorry.

THE COURT: I forgot too. No worries. I'm not minding the farm here either.

MR. ROSENBAUM: Could you please read your written testimony, and then we'll get back to our cross-examination.

THE COURT: Yeah. Are we going to read each of these?

MR. ROSENBAUM: Sorry?

THE COURT: Each of the --

MR. ROSENBAUM: We're going to read 176.

THE COURT: 176.

MR. ROSENBAUM: Only 176, your Honor.

THE COURT: Thank you, sir.

You may proceed.

THE WITNESS: I'd need another bottle of water if we're going to read all of them.

THE COURT: Incoming.

THE WITNESS: All right.

Judge Strother and personnel of AMS Dairy Programs, I am appearing before you to offer a summary of recent research projects in which I collected data on and summarized the costs of processing in cheese, whey, butter, and nonfat dry milk plants.

I am not here to advocate for or against any particular policy action, but rather to offer my insights into the current cost environment for dairy processors. This is a summary of my work and does not represent an official statement of my previous employer, the University of Wisconsin.

I have a Bachelor's and a Master's degree in Dairy Science from Michigan State University and a second Master's and doctorate degrees in Agricultural Economics from Cornell University. Over the course of my career I have conducted and published research on the cost of processing dairy products for 35 years.

Most recently, I have conducted research on the processing costs of cheddar cheese, dry whey, butter, and nonfat dry milk. These are the four products currently surveyed in the weekly National Dairy Product Sales Report2 (NDPSR) and whose prices are used to determine the component values of butterfat, protein, other solids, and nonfat solids used in the calculation of minimum class milk prices in all Federal Milk Marketing Orders.

In 2018, I entered into a Memorandum of Understanding with USDA AMS to update the cost of processing of these four products. The final report was made available to USDA and distributed more widely in 2021. That report has also been submitted as Exhibit 158 for the hearing record. The bulk of the data from plants participating in that project was largely from the 2019 calendar year. Prior to the 2021 report, the last time I

had conducted a cost of processing study on these four products was in 2006.

Shortly after that study, I offered testimony as to those results in a Federal Order hearing in Pittsburgh, Pennsylvania. More recently, the International Dairy Foods Association (IDFA) and the Wisconsin Cheese Makers Association asked that I update the 2021 study to capture the impact of inflation and supply chain disruptions since the pandemic.

This has been done and the results shared in a final report of primarily 2022 calendar year data from participating plants. A copy of that report has been submitted for the hearing record as "IDFA Exhibit 1."

I am here to provide results from the 2019 and the 2022 data and to answer questions as an expert witness regarding those two research projects.

Only plants who manufacture products collected in the NDPSR were solicited to participate in these studies. It is important to note that these plants may not be actual participants in the NDPSR, but they need to be operations manufacturing products whose characteristics are consistent with the NDPSR products.

As an example, exported nonfat dry milk might not be included in the NDPSR because the days between contract and delivery dates disqualify the transaction. But, for my purposes, the cost of transforming milk into nonfat dry milk powder is still valid.

Participation in the survey is voluntary. I would

offer this as both an observation and a potential criticism. I have pledged my adherence to participant anonymity and integrity of their individual data. However, I will offer the observation that in any of the cost projects there has been a great deal of variance across individual plants, and that variability has become greater over the years that I have conducted cost studies.

As it is with dairy farms, and most other businesses, there is no single cost that represents all processors. There are, however, statistical measures that are useful to summarize the observations. In my reporting, I use product-weighted averages.

But because of the variability observed, it is fair to draw the conclusion that the sample matters. Self-selection to participate can alter weighted average values if the same plants are not participating across different research projects.

I do not have audit authority to verify the data submitted by participants. However, there are several key cross-checks in the data collection. Submitting intentionally deceptive costs would raise red flags and prompt questions from me. Follow-up emails or phone calls will usually clarify any data questions that might arise. I also look for statistical outliers across plants to ensure that data entries are as accurate as possible.

Beginning with the 2006 cost project, I have used a custom computer program to generate and collect plant data. Prior to that time, paper surveys were used which

yield a weighty document that may be sparsely filled out. That results because you need to ask all possible questions to cover the unique aspects of each plant. A computer program can begin by asking basic questions, like what products are produced in the plant, and then follow that up with only questions relevant to those products.

The 2006 and 2019 projects utilized a standalone custom application which participants used to complete data entry. I developed an online web application for the 2022 project that produced a similar set of customized questions for participants.

The papers noted in footnotes 3 and 6 of my testimony include screenshots with example questions from those survey instruments.

It is important to understand what plant costs are included in the cost of processing. My objective is to determine the costs of product transformation from, but not including, raw ingredients to finished wholesale products. The costs of raw milk, purchased cream, nonfat dry milk, etcetera, are excluded. But non-dairy ingredients, such as salt or enzymes, are included.

Costs are inclusive through product packaging but do not incorporate post-packaging costs such as long-term storage, product aging, sales costs or product distribution. The costs are meant to represent the cost of transformation of milk, or milk ingredients, into the finished wholesale dairy product. An economic depreciation is included to cover consumed capital, and a

return on the market value of assets is added to reflect opportunity costs.

Some processing costs are easily allocated to the product of interest. For example, the cost of cardboard for a 40-pound block is directly assigned to cheddar cheese. Other costs must be allocated across multiple products. I collect component values on all products produced at the plant. The weight of total component solids in a product becomes the basis for allocation.

For instance, if there was 75,000 pounds of components in cheddar cheese produced at the plant and 25,000 pounds of components in mozzarella cheese, then 75% of the costs of salt used in the plant would be attributed to the cheddar cheese.

Other costs are more complicated to allocate. If a plant brings in only raw milk and produces butter and nonfat dry milk, then the labor cost in the churn room is directly allocated to the butter produced. But if the plant has only one electric meter, the total electric costs are allocated by the pounds of components in the butter and nonfat dry milk produced.

This has been a standard practice utilized by the industry and previously used by the California Department of Food and Agriculture in their cost accounting for dairy plants.

I had also used this methodology in previous projects, but I found that in some cases it can produce misleading results. For example, a butter-powder plant

that brings in milk, but may sell a considerable amount of skim or condensed milk, has not incurred much of the costs of final drying. The pounds of components are the same, but you are now allocating a lower proportion of the final costs to the butter and powder that was produced and too much to skim and condensed.

In the 2019 project, I employed a second weighting factor based on the degree of transformation of the product. Products like skim milk are lightly transformed while fully dried and bagged powder has incurred additional utility, labor, packaging, etcetera, costs.

This additional methodology fully accounts for the total costs in the plant, but, ceteris paribus, more costs are placed on powder than butter, and much less on the skim milk sold.

After the 2019 study was published, I heard from many folks in the industry that they were concerned about the new methodology and were not yet comfortable with its use.

For the 2022 study, I have since gone back to the previous methodology using the pounds of components as the allocation factor and not the degree of transformation. Although I stand by the concept of further accounting for the degree of activity needed to produce a product, I believe that the industry needs to be comfortable with the methodology used.

Table 1 shows the weighted average product costs from the 2006 study, the 2019 data, and the 2022 plant

data. I won't go through all of those data in the cells, but it can be seen in the -- in the exhibit.

And I will just acknowledge that I have also included two columns that show a percentage change from the 2022 data in comparison to the 2006 data as well as 2019 data in comparison to the 2006 data.

Table 1, that I just referenced, summarizes these costs from the years 2006, '19, and '22. The table also provides the current Make Allowances which were last updated in 2008.

Observations: The sample matters. In the 2019 data, there were 27 nonfat dry milk plants who had participated, while in the 2022 data there were only 15. However, the average pounds of product per plant was much larger and the total pounds of product reported for 2022 was slightly more than the previous study.

The 2022 data sample included 18 cheddar cheese plants versus 10 in the 2019 data. Like the nonfat dry milk plants, they were also much larger average size and represented a significant proportion of the NDPSR volume.

The butter data are the most puzzling for me. Although the number of participating plants are similar (13 versus 12 in the 2019 data) and the total volume of butter represented is similar between the two years, the plants participating are significantly different.

The 2022 data represent both larger plants and smaller ones compared with the 2019 data where the size was more homogeneous. I believe that the different sample

is most responsible for the very different results.

Like the butter plants, dry whey processing had a similar number of operations in the sample. Eight plants were included in the 2019 data and nine with 2022 data, but the volume was almost 50% greater with the most recent sample.

There may be a variety of reasons why the sample matters and we see such variations across the plants in the studies. New automation technology has become available, which can reduce labor costs, and there is considerable variation in per unit utility costs across plants. Further, larger multi-plant firms may have input purchasing cost advantages that smaller single-plant firms do not.

Plant ownership might possibly suggest different objectives for firms. In a commodity-based industry, proprietary firms can only improve their profit margin by reducing supply chain and processing costs. Cooperatively-owned plants certainly strive for profit for their members, but assuring a home for member milk may be an even stronger objective which could limit plant investment.

Because the sample can make a difference, it would be best if plants were compelled to participate. Ideally, the sample would be comprised of all plants with reportable product in the NDPSR. That way the price discovered in the survey for products would most closely correspond to the costs of transformation used in the

Make Allowance.

I would also suggest that any parameters in the product price formulas, such as Make Allowances and yield factors, have periodic assessment to assure validity of price announcements.

It has been 15 years since the Make Allowances in product price formulas were updated. It would be my opinion that this interval is too long between the assessment of processing costs. Per unit processing costs, such as the costs of a therm of gas or a kilowatt hour of electricity, have fluctuated over the intervening years, but some costs, such as wages, have only increased.

To some extent, labor used has been reduced by substituting with automation, and there have been energy recapture technologies employed in plants that we didn't see 15 years ago. Over that time, total manufacturing costs per pound have increased.

There are safety relief mechanisms in Federal Orders that are only expected to be employed when the system isn't working properly. One of those is depooling of milk. Depooling can happen for various reasons, but one of them is when processors routinely find that obligations to pay the minimum price for milk is more than they can recover from their product prices. This happens when the Make Allowance is inadequate. The relief is to opt out of regulation and pay what you can afford. We have seen much more unregulated milk in the last several years.

Table 1 shows that there are surprisingly uniform increases in the cost of processing from the 2006 data to the 2022 data of somewhere around 65 to 70% across all four products. An increase in the Make Allowance reflecting contemporary costs would do much to return product price formulas to the functionality they had in 2008 when they were last updated.

MR. ROSENBAUM: Thank you.

Dr. Stephenson is now available for cross-examination.

CROSS-EXAMINATION

BY DR. BOZIC:

Q. Marin Bozic for Edge Dairy Farmer Cooperative.

Dr. Stephenson, anything else you need to read?

A. No, thank you.

Q. Good.

All right. So looking at your data, if surveys are voluntary, and recognizing that processors have economic incentive to effectuate a higher Make Allowance, in which direction would you expect the results to move under a mandatory audited survey, assuming no change in actual costs for packaging, natural gas, etcetera, so the only change is the sampling of participation and auditing?

A. I don't know how I could say, Marin. It could very well be the case that we got the complete census of plants involved in NDPSR, evaluated their costs, and it would be exactly the same as what we had here.

So I think that what you are hinting at or

implying is that maybe there is a self-selection bias that would say, well, if I think I have low costs, I don't want to participate. I'm not prepared to examine the head of people to know whether they would do that or not.

Q. Do you find the distribution of costs have higher or smaller variance than your earlier studies?

A. As stated in the testimony, it is clearly higher than it was in earlier studies.

Q. And is the distribution of costs unimodal or bimodal, and if you could explain in plain words what that means?

A. In the past -- yeah, I'll try my best. When we would see plants, there's always a range of costs, and what you are talking about, when you are talking about what does the distribution look like, a normal distribution would be thin at the tails, which would say there would be very few plants at the very low cost or very high cost, and more of them toward the center.

What casual observation would tell me from looking at these plants now is that we do see more of a bimodal distribution, which would say that plants tend to cluster either toward the lower or the higher end.

Q. Do any plants in your sample have costs of production that's below the current Make Allowance levels?

A. We have some that are very close. Very, very low costs.

Q. Do any plants have costs of processing below Make Allowances requested by Proposal 7 by National Milk

Producers Federation?

A. Yes.

Q. You partitioned your data to low cost and high cost plants.

What insights do you draw from the spread between those two groups?

A. It's a little bit hard to say. There certainly is a size element to plants in those two groups. You can see that from the table, generally reported. But it's not fair to characterize all small plants have high costs and all big plants have low costs. We see some very cost competitive small plants.

Q. And I'm not sure whether you collected this information. Do plants in the low cost category tend to be more recently constructed plants?

A. I don't have that information. And they could be recently constructed or it may be an old structure that's been vastly retrofitted.

Q. Sure.

So for the next question I'm not looking for a number but just general conditions.

When do Make Allowances become stimulated? In other words, when do they encourage further supply of dairy products that is not driven by demand, but rather ability to pass the reduction revenue to producers while keeping stable and profitable profit margins?

A. This is a complex question, and I'm not sure that that can have a simple answer.

If there were enough money in a pool from which to take a substantial draw, it would encourage participation of manufacturing plants, and you might then think, well, we would like to build additional capacity as a result of that. That depends on whether or not you do indeed have that money in the pool, and it also would mean, do we have the milk available to manufacture those products.

So I can't really say that. I mean, in general, if you were going to be building a plant, regardless of what your motives were in doing that, you have to procure the milk to get into the plant to make the products that are there. That means competing for it with other operations. That means paying premiums, probably, that hadn't existed before.

So it's a complicated question that you have asked.

Q. Of course. No. I'm known for that. So --

A. I agree.

Q. -- reading again from the final decision from April 2nd, 1999, on page 16097, I have -- I'm going to be boring a little. You have heard this same set of questions that I asked our colleague Chris Wolf.

So in that final decision, AMS stated: "If the Make Allowances are established at too low a level, manufacturers will fail to invest in plants and equipment and reduced production capacity will result."

So looking back since 2006, so over 15 years, 16 years now, did we -- did we get to a point that our

production capacity is insufficient to meet demand?

A. As an economist, I would say, shame on you. You are using the word demand as though it were a quantity. It's a relationship between price and quantity.

Q. Sure. Maybe I can restate.

Are we not importing a higher share of cheese consumed in the country?

A. I do think that our classified pricing system has allowed us to manufacture more cheese products than would have otherwise been the case without a classified pricing and pooling system in place.

Q. Did the delay in updating Make Allowances distort investment patterns for the last 15 years, or at least the last five, seven years, versus what they would have been in a free unregulated market?

A. It's conjecture, Marin. What I will say is that I do see plant capacity being built in places that really don't care if the plant is pooled or not. So apparently farms in the area are willing to supply milk to plants that are unregulated.

Q. Would you agree or disagree with the statement that the negative consequences of setting Make Allowances too low are not merely as dire as setting Make Allowances too high?

A. I think that one of the problems we can have in a Federal Order system that's establishing minimum prices is establishing a price that's too high. There is a relief valve that's available in this system, and, you know, that

is to depool milk if we get into that circumstance. In other words, don't subject yourself to that minimum price regulation that where you can't be profitable. Fluid plants really can't pull that ejector cord, and that's the danger, I think. So we don't want to set prices where they would be above some mythical P star. We want them to be below that point and let premiums bring the marketplace up there.

Q. So given -- you mentioned Class I milk, and the primary function of the Federal Order is to be -- to secure supply of beverage milk. What criteria should be considered when setting Make Allowances in life that the primary purpose is to secure supply of beverage milk?

A. Okay. Could you just restate that? I want to make sure that I am responding to what I think you said.

Q. Sure. Yeah. So you mentioned that depooling will occur if Make Allowances are too low, if I am restating your words fairly.

But the purpose of the Federal Orders -- we may consider such functioning to be desirable, but at least the legal purpose of Federal Orders is not to make sure everyone is pooled, but to make sure there is sufficient supply of milk for Class I.

So if that is the legal purpose of Federal Orders, how should that influence the criteria we use to -- for setting Make Allowances?

A. Well, I don't have the numbers off the top of my head, but I think that Class I utilization in the country

is something like 27%. And you have to get down and examine that regionally. In some parts of the country, in some months of the year, it's much higher than that. In other regions, it -- it could only aspire to get to 27% --

Q. Sure.

A. -- much lower than that.

If you take a look at Class I relative to all milk in the country, not just the Federal Order regulated milk, it's probably more like 18 or 19%. So I think there's plenty of milk available for Class I needs.

Q. So if the security of milk for Class I was the primary decision criteria in setting Make Allowances, it would follow that maybe not even changing them would not jeopardize security of Class I; would that be a fair conclusion?

A. Could you restate that again? I zoned out for a second.

Q. Let me try again. So if the primary criteria for designing Federal Orders was making sure there is sufficient reserve supply of manufacturing milk for Class I, given that we are at 18% nationwide, or 27% in the orders, do we even -- would we even need to increase Make Allowances to have that objective accomplished?

A. I think that we have plenty of milk available. The question becomes one of hierarchy. Can we get it into a fluid milk plant with some degree of ease when we want and need it, or can it be pulled away or not made available to that fluid milk plant when it is needed? So

that's one of the things I guess I would say.

Q. I think my time is up.

I appreciate your answer on that.

I have a few questions that go a little bit broader than the work you have conducted for -- on Make Allowances, and it is -- the reason I say that's the appropriate to ask you now is because it's really just you and Dr. Wolf that are truly unbiased and disinterested about the outcomes of this hearing, so I'm here to learn.

And -- and I wanted to ask you about the concept of disorderly marketing. I was reading recently when Supreme Court Justice Potter Stewart in 1964 was asked to describe his test for obscenity, he responded, "I know it when I see it." And somehow we landed with the same implicit definition here, that you can point to something and say that it's disorderly marketing, but almost everybody struggles to define it.

Would you like to try?

A. I absolutely would not. It is a term that's been used extensively, and it is a term that we have in literature and history for Federal Milk Marketing Orders. And I do think that, you know, whether you care to make a joke about it or not, disorderly marketing is one of those things that we do seem to know when we see it. But if you could list criteria A, B, C, or D, I think that everyone in this room, including the good folks from AMS, would have a hard time doing that.

Q. Would -- if the changes to regulations disturb

risk management practices, would that fit your understanding of disorderly marketing?

A. If the changes to --

Q. Federal Order regulations --

A. Yeah.

Q. -- disturb risk management practices, by producers or processors, would that be -- would that fit your understanding of disorderly marketing?

A. This is probably going to wound you to hear me say this, but, no, I don't think it would be. I'm not sure that hedgers or speculators should be first and foremost in the minds of Federal Milk Marketing Order personnel. That's not what they're here to -- to do in my understanding.

Q. So now everybody knows that I didn't have a chance to prep this witness, so it's a true arm's length question.

Okay. So I wanted to ask a little bit about the circularity or the lack of circularity when it comes to pricing cheese and the National Dairy Product Sales Report.

Would you agree that the weekly report, the National Dairy Product Sales Report, does not capture all of cheese, dry whey powder, and butter?

A. That it does not capture that.

Q. Yes.

A. It -- the National -- the NDPSR is all about those products.

Q. But of -- would -- does -- does the volume of cheddar cheese, 40-pound block and the 500-pound barrels, reported in NDPSR correspond to the total volume of those products sold that week nationally?

A. Well, you know, let me use an analogy. I feel as though I have got a fever. I go to my physician, and he says, well, let me check. You know, he could check on my forehead; he could check in my ear; he could check under my tongue, my armpit, other places. And he would get different readings. And so he would say, perhaps, you know, is this representative of whether you have a fever or not?

If you understand the relationship between where the measure is being taken and its impact in the marketplace, I believe it's valid.

So the question may be, do 40-pound blocks represent a valid metric or benchmark for whether or not market prices are being moved in the country. To the extent that we have a great deal of cheese volume -- as I understand it, I don't buy or sell cheese -- is priced off of blocks, I would say, yes, we have that. But can we get to a point where we worry about whether or not it's a valid measurement? I suppose so. We got to that point with the Minnesota-Wisconsin price discovery mechanism. We didn't have enough Grade B milk in that area to feel comfortable that it was representative of national markets for milk.

So I don't think we're at that point now with

those products, but always worth examining that and looking at it in more detail. I haven't done that here.

Q. Sure. So the reason I ask is, to increase Make Allowances to say that the cost should be passed upstream to dairy producers, but in the -- one of the classical explanations for why that's necessary is the circularity. If I charge my buyers more for 40-pound blocks, I would have to report it to NDPSR, so I cannot really increase my revenue relative to my obligations, to the pool, if I'm a privately held pooled cheese maker.

However, if the -- if there are a number of ways that I can quote/unquote escape reporting to NDPSR, by forward pricing, having reduced fat, being Halal, or other ways, that circularity is broken, and then I think it's a legitimate question why wouldn't increased costs in manufacturing of various cheeses not be passed to buyers of that cheese rather than upstream to producers.

That's -- would you like to opine on that?

A. Well, I think that there are many ways in which, you know, you need to consider an answer for that kind of question. NDPSR reports a single price every week for butter, for whey, for whatever it might be. I doubt -- I've never been privy to see it -- but I doubt that every survey respondent from NDPSR reported that exact same price. I'm sure there's a distribution of those prices. Every plant does not have a Make Allowance that corresponds to one that's in the formula. There is, as I have reported, a distribution of those things.

If you have a higher cost of production than the Make Allowance in the formula, I hope over the long run that you are actually getting a higher price for the product that you are selling that's included in the NDPSR. Otherwise, you're probably not making money.

Q. Right.

I have a few questions that address other topics in scope of this hearing, and again, I understand you're not here and you would not -- never support one proposal or another. I'm hoping that you can help us think in a deeper way about these topics.

One of the questions is whether barrels should be included in calculations of the monthly announced cheese price, and if yes, then to which extent they should be weighted.

What are -- what is a useful way to think about that issue?

A. Well, I might go back to some of my just earlier comments, you know, and to ask whether or not we're getting representative values about how the market has moved with 40-pound block cheddar prices. My guess would be that if we weren't inclusive of these values, of barrel values in the NDPSR, that we would probably find that the pricing would happen rather quickly that they move to, you know, pricing off the blocks as well. I'd be surprised if that didn't happen.

Q. So to make sure I understood you, you believe that if barrels are removed from the survey, that the pricing

of barrel cheese would be placed on blocks?

A. That would be my -- again, Marin, I have never sold a barrel of cheese in my life.

Q. And it shows.

A. But I -- I have certainly worked in the industry for a fairly long period of time, and -- and I have come to believe that the markets will express themselves one way or another. And if those barrel markets want to be able to protect themselves against price movements or offer their customers such protection, then they are going to need a means of doing that, and they could probably do that more easily through a 40-pound block association.

Q. Thank you, Mark.

My last question is truly open ended. We are -- we find ourselves here 15 or plus years since the last hearing. Importance of fluid milk in our sector is lower than it has been in the past, and you said yourself it's 27% now.

Overall, as the importance of fluid milk decline, how should that guide the decisions regarding maintenance of Federal Orders or modification of -- is there a generic or like some deep principle that you would suggest?

A. Your hands are tied until you have substantial change from Congressional authorization as to what you actually can do and what you can look at and possibly change.

Within the confines of the hearing system that we have today and what's possible to do, we can tweak at the

edges. I don't think we can make the changes that are perhaps radical enough to address all of the things that might be wrong with the dairy industry.

And I might question whether we need to. You know, the markets have found a way to express themselves and survive. It is not ideal, and we can probably improve that. But that doesn't mean that, you know, we need to try to ask what we can't possibly do at this point in time.

DR. BOZIC: Thank you very much.

THE COURT: Further examination of this witness? Other than AMS I meant.

Seeing none, AMS.

MS. HANCOCK: Your Honor, can we take just a couple minute break so we can check our -- do a touch base really quick?

THE COURT: Yes. Let's take five minutes. Come back at 4:15.

(Whereupon, a break was taken.)

THE COURT: On the record.

CROSS-EXAMINATION

BY MS. HANCOCK:

Q. Good afternoon, Dr. Stephenson.

A. Good afternoon.

Q. Do you have Exhibit 178 in front of you?

A. I do.

Q. And I want to start off with looking at -- can we turn to Appendix A which starts on page 16?

A. Yes.
Q. Is this the computer survey that you used for the 2023 survey?
A. Yes.
Q. We bounce around on dates depending on when it was taken and when it was published, so --
A. Yes. Forgive me.
Q. Did you use this for the 2019 survey as well?
A. The same set of questions but in a different application.
Q. Okay. Did it perform the same way where it was a smart program where if you answered that you produced cheese, it would answer questions specific to cheese?
A. Yes.
Q. You just changed applications, but otherwise it functioned the same?
A. I did. The advantage to doing this is that it could be updated much more easily and didn't have to worry about the operating system that people were using.
Q. Okay. And so this Exhibit A (sic) is just you logging in as if you were going to be taking the survey, and then you conduct -- you just did screenshots of each one of the question pages?
A. That's correct. There would be a few screens that did not show up here simply because of the example I picked, you know. So, for example, I think this is a cheese one, and you wouldn't see nonfat dry milk questions showing up here.

Q. Okay. How did you -- so did you send an e-mail invite out to the industry and invite them to participate, or how did the request to participate happen?

A. The request went out primarily as an invitation from IDFA to their members, and we had responses from people and follow-up from there. So it happened, I think, a bit more organically, and it was -- it was done fairly quickly this time around as opposed to the longer time period it took from the 2021 project.

Q. Okay. And when you say "2021," that's the one that you started in 2019?

A. Yes. The 2019 data.

Q. Okay. So -- so the one that went out in -- that is the IDFA-sponsored survey that went out to IDFA membership, did you go beyond the membership for IDFA?

A. I -- all were broadly invited. I can't tell whether everybody was invited. They could have possibly been. But whether they were IDFA members or not, I would welcome them to participation in this. So there was no exclusion that was done.

Q. Okay. And did you also invite folks who were not IDFA members but who had participated in the 2019 survey?

A. There were folks who had declined to participate this time around, but were aware that this survey was being conducted.

Q. Okay. So there were -- other than the -- were there anybody who -- were there any entities who were not -- or I'm sorry -- were there any entities who

participated in the 2019 survey that were not invited into the 2023 survey?

A. I -- not invited is a strong word, very strong phrase. Everybody that had a product that was qualified under NDPSR was invited to participate in this. But there were folks who participated the first time with the 2019 data that didn't participate this time around, and vice versa. There was overlap. We did have plants that participated in both efforts.

Q. And did you try and estimate the percentages that overlapped and the percentages that did not participate?

A. Yes. I do have that. There were -- I can't remember now -- I think 55 plant product observations, and I believe there were 16 or 17 that were overlapping. So whatever that percentage is.

Q. Okay. I just want to make sure I'm clear because I have talked about a couple of different dates?

When you say there are 55 plant product observations, is that for the 2023 survey?

A. Yes.

Q. And when you say 15 to 16 overlapped, you mean 15 to 16 of those plant product observations overlapped with the two thousand --

A. They participated in both.

Q. In the 2019 survey as well?

A. Yes.

Q. Okay. And so do you know how many plant product observations there were in the 2019 survey?

A. I would have to go back and look. I was going to say 57 or 58. It was similar but a little bit more in the earlier one.

Q. Okay. Was it surprising that only 15 to 16 overlapped between the two?

A. I had hoped for greater overlap -- I mean, for more participation, but I understand differences that we see sometimes.

In the 2019 data collection, we had plants that I expected would participate, but for whatever reasons, they didn't. Now, many times that gets down to we're just slammed, you know, we're doing our annual meetings or, you know, we have something else going on, it's too much, and you need to wrap this up pretty quickly, we didn't have time to do it.

I also had some folks who have called to ask after the survey was done and completed, could we participate now? And the truth is, after the report was done, I didn't want to have multiple versions of the report circulating.

Q. Okay. That's fair.

And you had said that the 2023 survey was open for a shorter period of time. Could you quantify that for me just to put it in context?

A. Well, I -- yes. I -- I needed to complete this before we had this hearing and to have people have plenty of time to view the outcomes, you know, of this, so I -- I felt as though this was something that needed to be done

fairly soon. I don't remember exactly how many open days we had, but it was something like two months worth of data collection time period.

So could you get this done in a two-month time period? For most plants, if you have a good data management system, something where you can pull this off, I estimate that it will take a full day to collect and summarize the information. It may be a bit more if you are distant from the plant and need to contact and work with a plant manager to get some of the data questions that are being requested here.

Q. And when you did the 2019 survey, how long was that survey open?

A. That was open for a much longer period of time. I would say, I don't know, four or five months.

Q. And is there an ideal timeframe that a study would -- a survey like this would be open to capture maximum response?

A. I'm not aware that there is, and to some extent, I'm probably guilty of the same kind of thing, under circumstances, that if my time limit is a long time out, I don't get started on it until it's pretty close to the time limit.

Q. I'm guilty of the same.

And then did you have -- in the 2019 survey that was published in 2021, did you have multiple versions of that one with updated data or did you just publish that information once?

A. That information, I'm not aware that it came out at all. I did have earlier results, you know, that I was looking at. But I have learned over the years to try very hard to not get something out that says preliminary draft, you know, not for reproduction, because it will surely find its way out, and you may have slightly different numbers, and then you have to explain why they look a little different.

Q. Were there any material differences in any of those earlier iterations of the 2019 survey?

A. No, not really. It was mostly the addition of, you know, plant members that got data in a little bit later but, you know, were still included.

Q. Okay. And then do you know, when you say 55 plant product observations, do you know what percentage that makes up of the total milk production or the total plants that are available to provide data responses?

A. I would have to take a look. I don't recall exactly. On the last data collection that was done of the 2022 data, the volume of product in there, I think I responded to that question earlier, that it was a substantial volume of the total reported to NASS of all plants for those products.

Q. I think that you, if I recall correctly, I thought you said it was about 50% of the total volume?

A. Of cheese and whey, roughly. And 75 to 80% I believe of the butter and nonfat volume.

Q. But of the number of plants, you don't know what

percentage that makes up?

A. I could look and see, but I don't have that on the top of my head.

Q. Okay. That's fair.

Okay. I just want to take a look at how this survey worked. So I'm on page -- I'm just going to start at page 18 and hopefully just move through these pretty quickly.

So you do collect identifiable information from the participants, but you just let them know that it's going to be confidential information?

A. Absolutely. Yes.

Q. And that's both for the 2019 survey and the 2023 survey?

A. That's correct. In all cases, I'm -- I won't accept data if there's not a contact person identified and contact information on there. On the right-hand side of that page 18 screenshot, you can see that there is a particular plant example shown, but one contact person could enter as many plants as they wanted to. So they could be responsible for four or six or eight or one plant.

Q. So that -- that brings up a good question. So do you fill this out -- if a responder was filling this out, do they fill one survey out per plant?

A. Yes.

Q. And so if they were operating four manufacturing plants, they would fill this out four times?

A. That's correct. The only information that is static, if that's the case, is the left-hand side of that page 18 screenshot.

Q. Is that based on the log-in that they get when they first log in, that's automatically populated?

A. It's not populated. They have to enter it, but that's required, yes. They have a user name and -- and a password. And that user name and password then provides them access to all of the data that they have entered.

Q. And so when you give the total of the number of 55 plant product observations, do you know how many total entities responded to the survey?

A. I do. I believe that was actually in the report. I want to say that it was 15 total plants. But I'm sorry, I didn't look at this to refresh my memory, and I probably should have.

What's the observation -- so just as an example here, on page 10 of Exhibit 178, it indicates that in the 2021 study, which would have been the 2019 data, there were 27 nonfat dry milk plants, while in the 2023 study there were only 15.

Q. Okay.

A. And so you can see what that was for the additional products that were there.

Q. Okay. Sorry, I should --

A. And for the next few paragraphs --

Q. Sorry. Go ahead.

A. I'm done.

Q. Oh, okay. I was going to say, sorry I didn't -- I didn't catch that the first time through, or maybe in the context of what I'm asking now.

And so it looks like you had more plants that responded in the USDA study than in the IDFA study?

A. I did, yes. There were larger plants in the IDFA study and on -- in general, but slightly fewer plants.

Q. Okay. And so then in the -- is it fair to say then in the IDFA study, it was smaller plants and fewer entities?

A. In the IDFA study, smaller plants? No, they were, in general, larger plants.

Q. Oh, I thought we were talking about the 2019 when you said they were larger plants?

A. Oh. No, I -- when you said the IDFA study, I thought you were talking about the 2022 data. So let's be clear about that.

Q. Let's talk about the date. So on the 2021 study that -- for the survey that was conducted in 2019 --

A. Yep.

Q. -- that is -- you had 27 plants that responded?

A. That's correct.

Q. Okay. And then in the --

A. Nonfat dry milk.

Q. Of the nonfat dry milk plants.

And then in 2023, you said there were 15?

A. That's correct.

Q. And was the 2023 study that you said that there

were larger -- larger plants --

A. Correct.

Q. -- who responded?

Okay. So if we go into the data, if we go to page 19, this is where you select the products for each plant that would be -- that would be produced at that plant; is that right?

A. That's correct.

Q. Okay. Did you have a way to verify if you received responses from an entity for all of the plants that they were responding on behalf of?

A. I'm not sure I understand the question. The person on the first page, the contact person, would be responsible for the data in each of the plants that they are responding to. We did have a couple of organizations that had two people that responded for different plants. So one person responded for, say, plant A and B and another person responded for plant F and G.

Q. Okay. My question is if you had an entity that was responding and they provided responses for three of their plants, but you knew that they had four, is that one of the data points that you would evaluate to follow up on?

A. No. It would -- if they didn't offer data for a particular plant, I would not have called and asked them, well, what about, you know, this plant, don't you still have that plant? I wouldn't have done that, no.

Q. You just would have analyzed the data that they

had provided and not worried about the one that they didn't?

A. That's correct.

Q. Okay. And then on page 20, in this example that you were going through, this is providing some information about cheddar cheese production at this hypothetical plant; is that right?

A. Correct.

Q. And so this information is populated specific to information pertaining to the cheddar cheese production?

A. Correct.

Q. And you have an example of a pull-down there under the package size for 40-pound block of cheddar, and then the volume there is a number that can be populated by whoever is filling in the form?

A. Correct.

Q. And then does that automatically populate the monthly totals or is that something that's added --

A. No, the monthly are all entered -- the gray boxes at the bottom are being calculated on the fly.

Just to give you an example on the package size, I'm only showing 40-pound blocks there, but on the second box down, or even the fourth box, it wouldn't matter what, they could have also identified 640-pound blocks at that same plant or 500-pound barrels or something else. So it was still a cheddar cheese product but different package sizes. That would cue me to be asking different package cost questions later on in the survey.

Q. And at the top there the instruction says, "Provide your data for calendar year 2022." That's the period you collected from everyone regardless of whether they were on a calendar year reporting or a fiscal year reporting?

A. No. That's just this particular example. If you go back to page 18, where it says, "What do you want to do?" If you wanted to add a plant -- and you don't see that on here, but the pull-down menu would have "add a plant," then it would also open up additional boxes down there that would say "select the 12 consecutive calendar months that you want to report data for." So in this example, I chose a calendar year, but, you know, it could have been November through October.

Q. And -- and did you provide any guidance to the survey responders as to what time period they should be looking at?

A. I asked them to do the most recent consecutive 12 months that they can report. If it's a calendar year where they have maybe summary data available or a fiscal year that they may have some 12-month summary data available, it could be easier for them to pull that off, and that's okay with me. But I didn't want them to go back two or three years and be providing me data, just the consecutive 12-month time period.

And the reason I asked for monthly data on some things is because I also want to get an idea about just how seasonally this plant is operating because that can

give you some idea about why costs may differ.

Q. And why didn't you just use a calendar year for everyone so that you could compare everybody on the exact same months?

A. I didn't do that because -- this goes back to when I first started doing the computer entry forms. Easy enough for me to allow 12 consecutive months of -- that would be easiest for participants. Since it is voluntary, I don't want to create additional labor and work for somebody. If they can grab data that's already summarized for a fiscal year, then use that data.

Q. Uh-huh. I don't know if it matters. I'm just curious, if they were providing monthly data, would it -- does it matter if they are looking at --

A. They don't provide monthly data for everything. Some things they are providing annual data for. So that was the only reason -- I mean, this was just -- my interaction with industry folks at the time I did the first computer program, we did a lot of debugging and, you know, beta versions, alpha versions, and finally the final product of that. And we had plants that said, well, it would be easier if it was our fiscal year data, which does not coincide with the calendar year.

Q. And do you know what the data ranges that you captured amongst the sample size that you have for your 23 surveys, meaning what's the earliest month that was captured and the latest month that was captured?

A. Yes. There were I think only two plants that did

not have calendar year for 2022, and their fiscal year was one month different or maybe two months difference. So it was a huge overlap with calendar year.

Q. Okay.

A. And by the way, that has been different in the past. In the past, like the 2006 data, I believe, we had a time period that stretched over quite a long period of time. And that was also true for that 2019 data. There was quite a range of plants, you know, the time period they entered data.

Q. So that was going to be my next question. What's the time period that you used then for the 2019 survey?

A. I used all of the data that were submitted at that time. The bulk of observations, the big bulk of them fell within the 2019 calendar year, and that's why I'm characterizing it as 2019 data.

Q. Okay. So the bulk of it fell within calendar year 2019. Did you allow them -- was it the same methodology that you used here, that you allowed them to pick the time period that they wanted to report?

A. Yes.

Q. Okay. And -- and you were able, based on the data you did review, you were able to see seasonal changes and differences?

A. There are some seasonal differences. Some plants operate much more seasonally than others do.

Q. And which product mixes are most affected by those seasonal differences?

A. Off the top of my head, I -- I can think more about individual plants than I can product categories. I should have looked at that, but I didn't. I would conjecture -- and it's only conjecture -- that it would probably be butter and powder operations rather than cheese, although cheese has a very large seasonal component as well.

Q. Okay. And then if we look at the next page on page 21.

This is you capturing what are the ingredients that are being purchased and brought into the plant; is that right?

A. That's correct.

Q. So this is where you can capture if there's any additional ingredients that have been brought into the plant in addition to what they have had for raw milk?

A. Yes. Dairy ingredients anyway.

Q. Dairy ingredients. You capture other costs on other pages?

A. Yes.

Q. If I'm -- I should have said this earlier, but if I look across the top, there's tabs. Is that where they click on those tabs, and they advance through the next category of information you are collecting?

A. Yes. And I -- they are supposed to move from left to right across there. So in other words, fill out the contact information completely before you go on to products, and products before volumes, and so forth.

Q. Is it like TurboTax where you click next and it just moves on to the next screen?

A. It's like TurboTax but not debugged quite as completely. This was put out rather quickly to, you know, be able to get this done in time. And we found that people that can't help but peeking ahead also required me to go back in and delete screen data, you know, because they were entering twice.

Q. Okay. If you -- if somebody was filling it out and they didn't have information on one page, but they did peek ahead and they had some information to enter on the next pages, would it let them go past one page to get to the next?

A. It did in this current version. But then, you know, invariably, the product would hang right there and stop. It wouldn't let them go on. Not by my construct, but, you know, that was just the way that the plant -- or the program was operating. And I would get a call and they would say, I can't get past this screen, can you help me. And then I would go in and look, and I could see where they had jumped ahead. You know, they wanted to look and see what was coming up here on the next screen.

Q. And -- and then you mentioned that in some instances it resulted in duplication of numbers. How did that happen?

A. Well, it happened because, you know, when -- this saves data as you move from one screen to the next, and if you jumped ahead without entering anything in the screen,

then that effectively was a screen full of no data, and that got captured. And when they went back, they may have entered data, and now we had two screens, you know, one with some data and one without, and then the program was confused at that point in time when it should have only had one screen and it stopped.

Q. At the end of each person's survey, when it's sent over to you, do you get one summary report for each plant?

A. No. What I do at that point in time is I will go through the data and look at it and assure myself that the data are complete, that they are filled out, that I don't have questions for it -- or for the entries. And when I'm satisfied that that's the case, then I can begin to run the summaries.

Q. And on this ingredient page, you are not -- are you collecting actual cost for the acquisition of those products?

A. No costs at all for ingredients, whether it is raw milk or, say, nonfat or condensed or anything else. No, no costs for that. I only want to know the cost of transforming those dairy ingredients into the final product.

Q. Okay. You just wanted to take into account any additional volumes so that you knew if your numbers on the raw milk were being distorted in any way?

A. That's precisely right. There were some questions that had been asked about mass balance, and this is one of the pages that helps collect that data for mass balance.

Q. Okay. And then we go on to the next page. You have collected some utility costs from the responder as well?

A. Uh-huh. Yes.

Q. And this is, again, just populated based on they select what type of energy source they have, and then it -- and then it asks questions according to that specific energy source?

A. That's correct. You know, just as an example with electricity, you could have one meter on the whole plant, or maybe you have got six meters. If you have got meters that are specific to product lines, that's really helpful because it allocates that electricity use to a group of products, and so I'm not arbitrarily allocating at that point in time.

The other thing that I do is to give you the opportunity to say whether this particular electric meter is allocated to one of the products that you have got or a group of products or is it unallocated. If it is unallocated, then I do the allocation.

Q. And how do you make that allocation?

A. I make the allocation based on the pounds of solids in the products.

So I'll refine this just a little bit further. If you had two meters in a plant that was making cheese, and you made two kinds of cheese or three kinds of cheese or something like that, and you also made dry whey. Maybe one meter is for the cheese side of the operation, and one

meter goes for the whey drying operation side. That's great. I now know what the electric use is for the whey side.

For the cheese side, I have to allocate it. And it's not based across all your products, only the ones that are accounted for here. So if you said, this is for all of my cheese products, I then allocated by the pounds of components in the cheese products.

Q. What if they had cold storage on site, how would you account for that?

A. Again, this would have been through the meter -- or the allocation on here. I specifically ask people not to include costs of long-term storage. If it's cold storage that's necessary for day-to-day operations of the plant, then that's a legitimate expense.

Q. Okay. And so if they would have selected the allocation on the drop box that would have allocated it, would there have been another column that opened up for them to provide like a percentage of allocation of the total utility for that month toward the production at that plant?

A. No. They could have done that by adding yet another meter in here, and they could have allocated that, but that would have been instructions that most people wouldn't have had. And, you know, so it could be done; it probably wasn't done.

Q. Okay. If you had another opportunity, it's another level of detail you could include at another time?

A. It is a very valid idea, yes.
Q. That's just the first one I have had. Thanks.
A. I doubt that.
Q. Okay. So then let's turn to the next page on job function -- or it says "Job Function" at the top. This is the "Labor" tab. And tell me what you are trying to capture here.
A. I'm trying to capture the total payroll, which is salary and benefits and so forth. And in most cases plants will have some ideas about job functions for those -- there are few plants that basically just have unallocated labor, and they give me one particular number out here. But that -- that's very few operations that do that. Most of them break this down to some degree.
So, for example, if I get hard cheese processing that's shown up here as $80,000, all of that will go to cheese and none of that would go to whey.
Q. Okay. And this is just left for whoever is filling in this form to make the allocation or determination of how much of the labor in their plant is attributed to the -- to the -- I guess the production of these items?
A. Again, when I first began doing the computer program, or even the paper surveys for that matter, working closely with plants, a variety of plants, this was the way that human resource management quite often kept the data for the different centers within the plant. And that's why all of these are here. They don't have to fill

out all of them if they don't have data for it. But if they do, any allocation that they can do helps me to get a better number for the products themselves.

Q. And if they don't know where to put it, they can put it in either laboratory or the general plant labor category?

A. That's correct.

Q. And -- and I think, if -- are these the instructions on the right where it has the three small paragraphs there?

A. Yes.

Q. And so the other pages where it doesn't have instructions, those are just somewhat self-explanatory, and you just let them --

A. I'm hoping so.

Q. You are hoping they are just going to understand their numbers well enough?

A. In some cases there are pop-up help screens that show up that aren't on this example here. So when you get toward the last screen on here where we are, you know looking at the C&E kinds of things, when it's asking for market value of assets, if your mouse hovers over that box at all, then it pops up a fairly large help screen that tries to describe what I'm looking for when I'm doing that, or when I'm asking for depreciation, you know, it says, I don't want taxable depreciation, I'm looking for an economic depreciation, and I describe what that means.

Q. Okay. And is the difference between your decision

to put something embedded on the page as opposed to a pop-up, is the difference there just how much you had to write about it and whether it was always going to be necessary for the instruction?

A. Yeah. I mean, so, for example, on page 23 here where we're looking at job functions, this is a general description of all of the job functions. For some of these things, as I have just talked to you about in that page 26 screenshot, there are specific directions for line items.

Q. Okay. And so if I just look -- so you have asked for the total payroll amount, which includes wages or salary, benefits, FICA, etcetera. So you just want to know what's your total, all-in, sunk cost for labor in each of those categories?

A. Correct. I used to ask for that to be broken out, you know, by wages and -- or salaries, and then the benefits and a few other things. But, again, I found that what I was really interested in was the total cost, you know, for a worker, and there was no reason to ask people for that additional level of detail.

Q. And then the next paragraph asks for information about -- and just lets people know, you don't have to enter data for specific product areas, if they don't have it handy to them, that you will do that allocation for them if they don't provide that breakdown?

A. Correct.

Q. Okay. And then -- and that's just based on your

knowledge of the -- of the processing responsibilities going into each product?

A. No. If you take a couple of examples that are given there, like laboratory, the laboratory is going to be used probably for -- across all products in the plant. So I'm going to allocate a portion of those laboratory worker costs to the cheese products, to the whey products, to, you know, whatever else that plant is producing. And I do that, again, through the pounds of components.

Q. And I think you had said earlier, but I want to make sure I understand. So you collected data about all of the products that they produced at the plant, so that you could estimate out when you were doing these allocations how much to assign to the four categories that you were focusing on for the survey?

A. Correct.

Q. Okay. And so --

A. That is the same way that California -- CDFA had done it.

Q. And is that the same way that you did it in 2019?

A. Not on the initial report. I have since gone back and recalculated. But, you know, only for the purposes of being able to say, here's a consistent comparison between, you know, the 2006, 2019, and 2023 data.

Q. And did --

A. 2022 data.

Q. -- you have enough data inputs from the 2019 survey to do the same apples to apples allocation that you

did in 2023?

A. Oh, sure. In fact, I had a little bit more of the plant product observations there.

Q. And -- okay. And so -- so if someone were to have labor for maintenance, for example, at the plant, and they produced both, you know, powder and cream, how would you make that allocation for maintenance, for example?

A. If those were the only two products from the plant, then depending on the pounds of products in there, the pounds of components in the cream, and the pounds of components in the nonfat dry milk, they would have been allocated that way.

And that's a very good example of where I think the usefulness of the transformation weighting comes in to play. If you are only selling cream rather than churning butter and packaging it there, then your -- I think the term was used yesterday, there's a pretty light touch on the stainless steel for the product going through in cream, so very little cost associated with that.

Q. And do you take into account the age of any of the equipment or the plant in any of those factorings?

A. In the question that's asked about depreciation, or even in the market value of plant assets, yes.

Q. Okay. Let's look at page 24.

And this is where we're looking at -- you're collecting information about the ingredients that were used to make, in this example, it looks like you are making cheddar?

A. Yes.
Q. And, again, this is just information that they would populate based on whatever estimates that they have to include in -- in the response survey?
A. That's correct. And, you know, this is, again, one of those cases that differs a little bit from the CDFA methodology, because here I'm asking you to kind of build up how much product is used in a culture vat, for example, and what the costs of those units are. Then, you know, how many vats can you make out of that culture tank and what are the other ingredients that are going into that. And so, you know, we build it up. And down at the bottom they can get a -- a visual tab on there as to what my calculation of ingredient cost per pound is. This is non-dairy ingredient cost.
Q. Okay. And so as they are inputting data, they have a real life update at the bottom that's allowing them to see what their total ingredient cost per pound of cheese is?
A. Yes. And it is the same with the packaging cast.
Q. So if they didn't have the same breakdown but they knew what their total was, they could kind of retrospectively build it out?
A. If they looked at that and felt like, ooh, that's a number I haven't seen before, then I would hope that they would, you know, go back in to both their methodology and mine and ask themselves why are these different.
Q. Okay. And then let's turn to the next page,

page 25.

And this one looks like we're up to packaging, and so you are estimating costs based on the average of -- starts off with the average volume produced in pounds; is that right?

A. Yes. I -- and that's per typical weight of a block of 40-pound cheddar cheese. It is not 40 pounds. It is almost always going to be a little bit more.

Q. Okay. And so -- and so you are saying -- you are having -- in this example is a 40.15-pound block there with 32 inches of tape used; is that --

A. To seal the box, yes.

Q. Okay. And so -- and so you have tape, you have stretch wrap, and then the number of blocks that are secured on a pallet so that you can calculate the number of pallets; is that right?

A. Well, the number of blocks that are on there. That helps me get down to breaking down what the cost of a pallet or the shrink wrap to hold it on a pallet actually is. I mean, it's a pretty small dollar value, but it's accounted for in here.

Q. And if they don't have these numbers, they are able to just leave it blank and move forward?

A. If you don't actually have it -- you know, so for example, you might not use tape to seal a box, you might lose -- use glue to seal a box, and you can select that, you know, later on to enter that instead of tape. So you -- you are going to have to seal a box with something.

And, you know, I want to make sure on all the entries that they look complete to me.

Q. Okay. And so if someone doesn't want to provide this information, could they skip these and leave them blank and move on?

A. I will come back and ask them for that data. And, you know, this is one of those cases where somebody sitting in an office is unlikely to know how many feet of stretch wrap it takes to secure a pallet, but they will call the plant supervisor, and they will talk to them and ask, and they will say, oh, maybe it's about a hundred feet or something.

Q. Okay.

A. But they would have the information in the office as to what it costs them to buy a box of stretch wrap, so --

Q. Okay. So if -- if there was something that populated on here, at least on this page, this is something that you would make sure you followed up on and said, give me as much detail as you can?

A. If it didn't look like you could package and ship product with what you have answered, then you'd need to explain that to me.

Q. Okay. And were you able to get that for everyone of the responders?

A. Yeah, as far as I can recall. I don't recall having any that were non-responsive.

Q. I want to look at the tab titled "Ledger."

A. Uh-huh.
Q. And this is the ledger where you are capturing what expenses they have for operating their plant; is that right?
A. Not all of them. But, yeah, these are some just line items that they may have in the plant.
Q. Okay. And ideally these would be filled in under either the general plant unallocated or specific to the products that they are producing; is that right?
A. That's correct. And many of the plants will put data values in both the unallocated column as well as a product column.
Q. So where you have an item down here on repair and maintenance, how do you distinguish between this repair and maintenance and the labor maintenance?
A. Oh, the -- yeah, these are more like the equipment, the welding supplies, the, you know, gas, whatever it is, that they are utilizing in the plant for repair and maintenance as supposed to the labor. The labor is captured back there in another spot. But I will say that the labor gets allocated back up here in a different spot, you know. But I've broken the labor out because it typically is paid differently.
Q. Where do you allocate it here?
A. Oh, it's not on this page that it's allocated, but when I'm summarizing, I do.
Q. Okay.
A. So this is meant to be more like the supplies that

a plant would have for repairs and maintenance as opposed to the labor.

Q. Okay. So you have, in this example, market value of assets. What is that referring to?

A. Yeah. This is one where that screen will pop up when you hover over it to explain it. I'm asking plants -- and I will say that this is perhaps one of the most difficult questions that the plants come across in here, simply because they have never thought of their plant in these terms. But I'm asking them, if you were to put this plant up for sale today, what do you think you would receive for the plant and its assets.

The reason that we use that number -- and this, by the way, is not a depreciated value of assets or anything else. I'm asking for the market value, and I -- I explain the difference on that pop-up screen -- is because we want to offer them, when we're building up the costs here, an opportunity cost of capital. So this is the number that that Moody Baa bond value is used for, to provide a return on assets.

Q. Okay. And there's -- you are not verifying this information, you are just asking them to use their best estimate?

A. Use your best estimate.

Q. Okay. And if they haven't marketed it or been in the market for any plant --

A. Most people haven't sold a plant in quite a while, but they have some idea about what they would expect the

value of a plant to be. Whether they could actually achieve it or not is, you know, a different question, but -- this is not -- you know, it is a return for the capital that's tied up in the plant and assets. It is not the biggest portion of costs in manufacturing. But it's one that was allowed by CDFA, and one that I think is applicable to have here.

Q. And then the depreciation, what -- does that have a pop-up box as well?

A. It does. And I ask them to make an attempt to calculate an economic depreciation rather than a gap appreciation, you know, a taxable depreciation. The reason for that is a very old plant, Mr. Bauer was talking about his plant the other day, may be fully depreciated, but it still has value, and if they were to try to sell that plant tomorrow, I'm sure that they could for a non-zero value. I'm also sure that even though the equipment may be fully depreciated from a tax standpoint, it is not used up. This is a depreciation that's meant to capture the consumption of your capital over time. So capital will have to be replaced, but probably not as quickly as the government allows us to write the value off.

Q. So the intent in your survey for depreciation is to capture what their estimate is in that moment based on the remaining useful life of their equipment regardless of whether it's been fully depreciated on their books or not?

A. That's correct.

Q. And so in Mr. Bauer's example, if he had a plant that was fully depreciated, his cost that he's actually tracking for his own -- in his own financials would look much lower than what the cost would be that you would estimate because you would have him assign some depreciation, even though on his books it might be fully depreciated?

A. Yeah. I don't know about the modifier "much" lower, but it would be lower, for sure. I mean, I would provide value, you know, for the capital that's still to be consumed there.

Q. And I say "much" because when I hear the numbers thrown around about how much these plants cost to either build or even just five years left of residual life, it is a considerable sum money. Would you agree?

A. Sure. Plants are expensive.

Q. And so even if you only had five years left on a plant that you estimated, or five years left on a piece of equipment that you were going to try and assign a value to, it could still be a considerable number.

A. And even at that point the salvage value is probably not zero.

Q. Okay. Meaning at the end of that five years, you could still get some additional value in --

A. Even if it is --

Q. -- some way or another?

A. -- scrap metal.

Q. Okay. And why is it that you chose this

methodology to have them assign an economic depreciation as opposed to using some other method?

A. California, CDFA, used to go in and would set up a depreciation for every piece of equipment in that plant. So they would assign what they felt was a useful life, the cost of that piece of equipment, and they would depreciate it themselves. For me, that's beyond the scope of my project. I'm not willing to do that. This is not adding a big value on the total cost out here, but I think it is something that should be accounted for. And so this is the old cost/benefit thing. Not that big of a benefit for me; it would be a big cost to try to do that. So I'm asking for these values to be supplied to get in the ballpark at least.

Q. And to contrast the Mr. Bauer example with someone, I think Leprino talked about building a new plant in Texas, if they were to assign their number, they would actually have their -- the new plant construction number that they could populate in there, it would be a much higher number because they are starting fresh with a fully newly developed plant?

A. Sure. And I don't know what that plant might cost, but let's just say it was half a billion dollars. Okay? Which is not inconceivable for a large modern plant. If you take that kind of value, and the government would let you depreciate equipment over a ten-year time period or something, that's a massive amount of depreciation in those first few years. I think that would

overstate your costs of production. So I'm -- I'm asking you to do something different than that.

Q. Okay. And what would you do in -- what are you asking them to do in that example?

A. Well, in that example I'm asking them to give me an idea about how much you think your capital is actually being consumed in the course of a year. So, maybe it's got equipment that's valuable for a 20-year time period as opposed to ten.

Q. Okay. So you might -- you -- would you do a follow-up call in that example and say, you picked --

A. No --

Q. -- a ten-year depreciation?

A. -- probably not. I would -- you know, I have asked them, try to explain it here. And, you know, unless the numbers that were given to me look just outrageous relative to the body of data that I'm getting from other plants, I probably wouldn't follow up on that.

Q. Okay.

MS. HANCOCK: Your Honor, I do have some more questions, but I know we're after 5:00, just pausing to do a check.

THE COURT: What's the will of the room?

MS. TAYLOR: AMS, at least, will have cross tomorrow, so I think we're fine stopping and carrying this on in the morning, if that's okay with Dr. Stephenson.

THE WITNESS: Uh-huh. But I would love to have a target that got me out of here somewhere, you know, close

to half the day, anyway.

THE COURT: Okay. Let's go off the record.

(Off-the-record.)

THE COURT: Back on the record.

Off the record we went over our witness list -- an aspirational list for tomorrow. With that, I think we can adjourn for the day.

Off the record.

(Whereupon, the proceedings were concluded.)

---o0o---

STATE OF CALIFORNIA)
) ss
COUNTY OF FRESNO)

I, MYRA A. PISH, Certified Shorthand Reporter, do hereby certify that the foregoing pages comprise a full, true and correct transcript of my shorthand notes, and a full, true and correct statement of the proceedings held at the time and place heretofore stated.

DATED: October 7, 2023

FRESNO, CALIFORNIA

MYRA A. PISH, RPR CSR
Certificate No. 11613

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