BEFORE THE SECRETARY OF
THE UNITED STATES DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

In the Matter of Proposed Amendments:  : Docket Number
to Tentative Marketing Agreements  :  : AO-14-A74, et al
and Orders  :  : DA-06-01

National Public Hearing
January 24, 2006
Sheridan Suites
801 North St. Asaph Street
Alexandria, Virginia 22314

BEFORE:

PETER M. DAVENPORT
U.S. ADMINISTRATIVE JUDGE

UNITED STATES DEPARTMENT OF AGRICULTURE
APEARANCES:
On Behalf of United States Department of Agriculture:
Sharlene Deskins
Babak Rastgoufard
Jack Rower
Henry H. Schaefer
Jason Nierman
Erin Taylor

On Behalf of Agri-Mark:
John Vetne
Robert Wellington
Richard Langworthy

On Behalf of National Cheese Institute:
Steven Rosenbaum

On Behalf of Select Milk Producers, Continental Dairy Products and Dairy Producers of New Mexico:
Benjamin Yale
Ryan Miltner
Kristine H. Reed

On Behalf of the Association of Dairy Cooperatives in the Northeast:

Marvin Beshore

On Behalf of the National Cheese Institute:

Steven Rosenbaum
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# E X H I B I T S

1. **Exhibit No. 1**  
   Copy of hearing notice published in the Federal Register on 1/5/2006  
   [MARKED RECEIVED 15 15]

2. **Exhibit No. 2**  
   Copy of appendix referenced in the preliminary analysis contained in Exhibit No. 1  
   [MARKED RECEIVED 15 15]

3. **Exhibit No. 3**  
   Copy of January 4th, 2006 press release regarding hearing  
   [MARKED RECEIVED 15 15]

4. **Exhibit No. 4**  
   Certification of notice given to state governors of hearing  
   [MARKED RECEIVED 15 15]

5. **Exhibit No. 5**  
   Certification of mailing of notice to interested parties known to the Market Administrator of the Southwest Order  
   [MARKED RECEIVED 15 15]

6. **Exhibit No. 6**  
   Certification of mailing of notice to interested parties known to the Market Administrator of the Central Order  
   [MARKED RECEIVED 15 15]

7. **Exhibit No. 7**  
   Certification of mailing of notice to interested parties known to the Market Administrator of the Upper Midwest Order  
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8. **Exhibit No. 8**  
   Certification of mailing of notice to interested parties known to the Market Administrator of the Southeast Order  
   [MARKED RECEIVED 15 15]

9. **Exhibit No. 9**  
   Certification of mailing of notice to interested parties known to the Market Administrator of the Appalachian Order  
   [MARKED RECEIVED 15 15]

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January 24, 2006, 8:30 a.m.

THE JUDGE: Good morning, and welcome to the National Public Hearing. I'm Judge Davenport. The -- this national hearing is being held to consider and take evidence on proposal seeking to amend the Class III and Class IV milk price formula manufacturing allowances applicable to all federal milk marketing orders. Evidence will also be taken at the hearing to determine whether emergency marketing conditions exist that would warrant omission of a recommended decision under the rules of practice.

The purpose of the hearing is to receive evidence with respect to the economic and marketing conditions which relate to the proposed amendments which have been set forth and any appropriate modifications thereof to the tentative marketing agreements and to orders.
Just a few housekeeping things. We are under fairly cramped quarters. We are going to see at the break, in other words, how many folks actually are going to be here and whether or not we can get additional tables or whether we are going to have to leave the seats as they are.

If anyone is going to power up their notebooks, why don't you go ahead do that now. Let me also ask you if you would turn your cell phones either to silent or to vibrate so that you are not disturbing other people during the course of the hearing.

The restrooms are around the corner. We will be taking breaks throughout the day. If there is a need for a break, in other words, if you will communicate that to me.

In the past it's also my desire and expectation that if we have dairy farmers that are present, in other words, and they have time constraints, we try to make sure
that they are heard, in other words, as early as possible so that they can get to back and tend to business. So in other words, subject to that, the schedule may be interrupted here and there.

I'm told that the microphones, all you have to do is power them on at this point. And I'll adjust the one for the witness as well.

Ms. Deskins, I guess I'll call upon you at this time to enter your appearance and introduce the people with you and, in other words, we can start taking, in other words, the standard exhibits which accompany the notice.

MS. DESKINS: Thank you, Judge Davenport. I'm going to try to turn this microphone on.

Maybe that's not going to work.

THE JUDGE: Okay. You want to try again.
MS. DESKINS: It's on now. My name is Sharlene Deskins. I'm an attorney with the United States Department of Agriculture, Office of General Counsel. I represent the Agricultural Marketing Service in this hearing, and I'm going to hand the microphone to my colleague, who will enter his own appearance.

MR. RASTGOUFARD: Babak Rastgoufard, also with the Office of General Counsel.

MR. ROWER: Thank you, Judge Davenport. I'm Jack Rower. I'm a marketing specialist with the Agricultural Marketing Service.

MR. SCHAEFER: Henry Schaefer, Upper Midwest Marketing Area, Minneapolis, Economist.

MR. NIERMAN: Jason Nierman, Agricultural Economist, Appalachian Marketing Area, Louisville, Kentucky.

MS. TAYLOR: Erin Taylor, a marketing
MR. YALE: Your Honor, before we begin, I would like to, first of all, introduce myself. I'm Benjamin Yale on behalf of Select Milk Producers, Continental Dairy Products and Dairy Producers of New Mexico.

We wish to enter an objection to the hearing and the limited notice of hearing to the fact that it is limited only to the price -- Class III and IV milk price formula manufacturing allowances; that the failure of the Department to consider and enter into a recognition of the rest of the formulas, which are the yields and the pricing series, is, in and of itself, an arbitrary and capricious decision, and that this hearing should consider all aspects of the formula, not just the make allowance. We'd just enter our objection on that. It's going to be a continuing objection to the proceeding.
THE JUDGE: Your objection will be noted.

MS. DESKINS: Judge Davenport, would you like us to proceed with the exhibits?

THE JUDGE: Yes, ma'am.

MR. RASTGOUFARD: I have some preliminary exhibits that I would like to enter into the record. These are notification documents pursuant to the -- I would like to enter into the record pursuant to 7 CFR, 900.4(c).

[Handing out documents.]

I will just repeat myself. I have some preliminary exhibits that I would like to enter into the record. These are essentially notification documents that I would like to enter into the record pursuant to 7 CFR 900.4(c). There are 12 such documents.

The first document is a copy of a hearing notice published in the Federal
Register on January 5th, 2006. This is 7 Fed Reg 545.

The second exhibit is a copy of the appendix which is referenced in the preliminary analysis contained in Exhibit 1.

One of our witnesses later today, Howard McDowell, will discuss this analysis later this morning.

Exhibit 3 is a copy of the January 4th, 2006, press release regarding today's hearing.

Exhibit 4 is a certification of the notice given to state governors of today's hearing.

Exhibit 5 is a certification of mailing of notice to interested parties known to the Market Administrator of the Southwest Order.

Exhibit 6 is a certification of mailing of notice to interested parties known to the Market Administrator of the South --
1 excuse me, of the Central Order. I'm sorry.

2 Exhibit 7 is a certification of

3 mailing of notice to interested parties known

4 to the Market Administrator of the Upper

5 Midwest Order.

6 Exhibit 8 is certification of mailing

7 of notice to interested parties known to the

8 Market Administrator of the Southeast Order.

9 THE JUDGE: And Florida.

10 MR. RASTGOUFARD: And Florida.

11 Sorry, Southeast and Florida Orders.

12 Exhibit 9 is a certification of

13 mailing of notice to interested parties known

14 to the Market Administrator of the

15 Appalachian Order.

16 Exhibit 10 is a certification of

17 mailing of notice to interested parties known

18 to the Market Administrator of the Northeast

19 Order.

20 Exhibit 11 is a certification of

21 mailing of notice to interested parties known
to the Market Administrator of the Mideast Marketing Area.

And Exhibit 12 is a certification of mailing of notice to interested parties known to the Market Administrator of the Pacific Northwest and Arizona-Las Vegas Order.

That concludes our list of preliminary exhibits.

[Whereupon, Exhibits 1 through 12 were marked for identification by the judge.]

THE JUDGE: Very well. Exhibits 1 through 12 have been marked.

Are there objections? They will be admitted into evidence at this time.

[Whereupon, Exhibits 1 through 12 were received in evidence.]

MR. RASTGOUFARD: We would like to present our first witness, John Rourke.

Whereupon,

JOHN ROURKE,

called on behalf of the USDA, having been
first sworn by the judge, was examined and testified under oath as follows.

THE JUDGE: Tell us your name and, if you would, spell it for the hearing reporter.

THE WITNESS: My name is John Rourke, R-O-U-R-K-E.

DIRECT EXAMINATION

BY MR. RASTGOUFARD:

Q. Good morning, Mr. Rourke.
A. Good morning.

Q. Can you please state for the record your job title and employer?
A. I am the Chief of the Market Information Branch and Dairy Programs, Agricultural Market Service, USDA.

Q. Thank you. And can you please state your duties in that capacity?
A. I have overall responsibility for the direction of the "National Market News" program and the National Federal Milk Order
1 Statistics program.
2      Q. Can you please describe your
3 background in dairy?
4      A. I have been Chief of the Market
5 Information Branch since 1991, and I have
6 been employed by Dairy Programs and its
7 predecessor organizations since 1970.
8      Q. Thank you. And also for the record,
9 could you please describe your educational
10 background.
11      A. I have a B.S. degree in economics
12 from the University of Maryland, and I did
13 postgraduate work at the master's level in
14 agricultural economics at Pennsylvania State
15 University.
16      Q. And you have testified at previous
17 Federal order hearings before?
18      A. Yes, I have.
19      Q. Testifying at such orders such as
20 the one today is part of your duties?
21      A. Yes, it is.
Q. And in those past hearings, you have been entered information into the record of those hearings?

A. Yes, I have.

Q. Were you asked to prepare any information for the hearing today?

A. Yes, I was.

Q. And did you bring that information with you?

A. Yes, I did.

Q. And can you please describe for everyone what you have brought with you today?

A. Yes. We received a request from the industry to recompute uniform prices for each of our orders using five different sets of make allowance, different sets of make allowances. Each of the offices recomputed their prices using the actual pounds of milk pooled during the months, the utilization percentages and other factors used to
compute uniform prices, and then the -- also using the recalculated class prices resulting from the different sets of make allowances.

And then these offices submitted their information to Washington, and we summarized this information into the documents that I will be presenting today.

Q. The documents and the recalculations that you just described, who prepared the document and recalculations?

A. The documents that I'll be presenting today were prepared under my supervision, the documents that are in the exhibit today.

Q. Okay. Thank you. And the data contained in the exhibits in the tables, can you describe where that data was obtained?

A. The data in the tables came from each of the individual Market Administrator offices. Each office submitted a separate
report, and we summarized them into these tables.

Q. And the data that was submitted, these are official USDA records?
A. That's correct.
Q. And who asked you to prepare this information?
A. The request came from Mr. Ryan Miltner, who is with the Yale Law Office.
Q. And did you have any other requests in conjunction with today's hearing?
A. No, we did not.
Q. And so, the information that you are about to enter into the record is -- excuse me, prepared pursuant to the request that you received from the Yale Law Firm?
A. That is correct.
Q. I understand you prepared a statement that you would like to enter into the record?
A. Yes, I have.
Q. Are you prepared to read that statement at this time?

A. Yes, I am.

STATEMENT FOR THE RECORD BY JOHN ROURKE

My name is John Rourke. I am chief of the Market Information Branch in Dairy Programs of the Agricultural Marketing Service of the U.S. Department of Agriculture. I have been the Chief of MIB since 1991 and have been employed by Dairy Programs and its predecessor organization since 1970.

This testimony is made not in favor of any of the proposals being considered at this hearing. This testimony is prepared in response to a request from a hearing participant as follows. A copy of this request is shown on page 2 of this document.

Each federal milk order Market Administrator received a request to recompute uniform prices for 2004 and 2005 using several make
allowance options. These include the three scenarios in the hearing notice and two more supplied by the requestor. These are shown below. We have labeled these five options Scenarios 1, 2 and 3 to coincide with the scenarios in the hearing notice and the two from the requestor have been labeled Option 1 and Option 2. For each option for each month the plants (class) and component prices were recomputed and the uniform prices were recalculated using these recomputed prices and the same pool pounds, utilization percentages and pool adjustment factors as were in place during the actual pool computation. Each MA office did the calculations for their orders and submitted the results to me. I have provided a standard reporting format and have prepared the attached tables.

Pages 3 through 6 of this document show the recalculated basic class price
information for each of the five make allowance options, along with the actual class price information by month January of 2004 through December of 2005. Also included are two year averages and comparisons. Pages 7 through 16 of this document contain the results of the recomputed uniform prices. Shown for each of the 10 current orders are the actual uniform price and the recomputed uniform price using a make allowances in each of the five options by month for January 2004 through December 2005. Also included are two year averages and comparisons. For the orders that use the component prices system for paying producers, the figures are the statistical uniform price which is the sum of the Class III price and the producer price differential. For orders that use the skim milk butter fat system, prices system for paying producer, the figures are the sum of
the uniform butter fat price times 3.5 and
uniform skim milk price times 0.965.

This concludes my prepared
statement.

Q. Thank you. Can you also walk us
through the tables that are attached?

A. Yes, I can. Page 2 is a photocopy
of the e-mail request from Mr. Miltner
requesting the computation recomputation of
the uniform prices.

Pages 3 through 6 show the
recalculated basic class price information
using the five different sets of make
allowances, as well as the actual prices. If
you look at page 3, again, the figures shown
on this table are in dollars per
hundredweight, 3.5 percent butter fat.

January 2004, for example, the actual Class I
base price was $11.85. Under Scenario 1 the
Class I base price would have been $11.64;
der under Scenario 2, $11.49, et cetera, across
At the bottom of the page we have the two-year averages of the actual Class I prices in each of the Class I prices resulting from the five make allowance options. Those two-year averages are simple averages. The last row of information is a statistic that we have labeled the difference, and that is the difference between each of the make allowance options and the actual numbers. So, for example, under Scenario 1, the two-year average was $14.48, which was 21 cents lower than the actual Class I base price.

Similar information is shown on the following pages for Class II, Class III and Class IV.

Beginning on page 7 through 16, we have shown the recomputed uniform prices for each of the 10 orders currently in effect, one page per order. Again, we show the
actual uniform price computed for the month and what the uniform price would have been for the month under each of the five make allowance sets of options. These figures, again, are in dollars per hundredweight, 3.5 percent butter fat and for the principal pricing point of the order.

Looking at January 2004, the actual uniform price was $13.58 per hundredweight. Under Scenario 1, the uniform price would have been $13.33; Scenario 3, $13.23, and so forth across the top of the table.

At the bottom of the table, again we have a two-year average. These, again, are simple averages of the actual uniform price for the two-year period and each of the uniform prices computed under the five sets of make allowances.

We also have a statistic labeled a difference, and this again is the difference between the uniform -- two-year average
uniform price for each of the five sets of make allowance options compared to the actual uniform price two-year average. For example, for under Scenario 1, the two-year average would have been $15.81, which would be 26 cents lower than the two-year average of the actual uniform prices.

Similar information is then shown on the following pages for the other nine orders.

Q. Thank you. Is there anything else you would like to add about these recalculations?

A. Not at this time.

MR. RASTGOUFARD: If I may, I would like to move this document into the record as Exhibit 13.

THE JUDGE: So entered.

[Whereupon, Exhibit No. 13 was received in evidence.]

BY MR. RASTGOUFARD:
Q. Mr. Rourke, with your analysis which is now in the record as Exhibit 13, was it submitted for or against the proposal that's been proposed to the Secretary?

THE JUDGE: That's contained in the statement, counsel.

MR. RASTGOUFARD: Okay. I have no further questions.

THE JUDGE: Cross? Mr. Vetne?

Mr. Vetne, if you would, enter your appearance and spell your last name for the hearing reporter.

MR. VETNE: My name is John Vetne. V-E-T-N-E. I'm an attorney. My office is in Newberry Port, Massachusetts. I represent the proponent Agri-Mark and Northwest Dairy Association.

EXAMINATION

BY MR. VETNE:

Q. Mr. Rourke, I note that these recalculation are for the same pool pounds
that were originally reported. You are aware that, particularly in 2004, there was considerable volume of milk that wasn't pooled during some months, but it was pooled during others. Am I correct that, in recalculating, you made no attempt to capture the milk that wasn't pooled nor to analyze whether such milk would have been pooled under the revisions?

A. That is correct.

Q. And although the -- under the recalculation, although the classified price for Class III and IV products changed as well as Class I and II, you made no effort in your recalculation to analyze or identify any market response to those pricing changes; is that correct?

A. That is correct.

Q. And when you refer to the uniform price or the statistical uniform price in your testimony, you are, based on the
recalculations, without market response, you are only referring to that portion of producer revenue that is derived from regulated prices?

A. That is correct.

Q. There is also producer revenue that -- information that your office gathers that is not part of regulated prices; is that correct?

A. That is correct.

Q. Mailbox prices?

A. Correct.

Q. And mailbox prices are reported and published by the Dairy Programs?

A. That is correct.

Q. And the mailbox prices include the uniform price plus whatever premium is paid. Does the -- is that correct?

A. And other things.

Q. And other things. Describe the other things that are in there so we know.
A. Mailbox price is the price received by farmers at their farm gate, which would include any over-order payments, premiums, as you called them, and less any cost incurred in marketing their milk, such as hauling charges, co-op dues, et cetera.

Q. So the reported mailbox price represents the total price received minus the hauling cost charged to producers?

A. And other marketing --

Q. And other things as well?

A. Yes.

Q. Okay. And the uniform price does not reflect a subtraction for the producer's hauling cost from farm gate to plant?

A. That is correct.

Q. And the difference between the uniform price and the mailbox price varies from market to market and month to month; is that correct?

A. That is correct.
Q. Were you asked to make or attempt to make any conclusions with respect to the impact of the proposals on the mailbox price received by producers in the average market as reported by Dairy Programs?

A. No, we were not.

Q. You refer to these proposals in your uniform price exhibit as applying to the principal pricing point. What is the significance of that limitation?

A. The normal point at which we publish prices is the -- each order has a -- referred to as a principal pricing point. The uniform prices vary across the orders, depending on the -- prices vary across the orders based on the pricing point of the milk. So we report -- we uniformly report the prices that -- at a point that we call a principal pricing point in the order, and those are specified in the order.

Q. Okay. Let's look, for example, at
the Northeast on page 7 of the tables. All of the numbers in the first column of numbers, which is headed, Actual, are uniform prices at the principal pricing point?

A. That is correct.

Q. And the principal pricing point in the Northeast is --

A. Suffolk County, Massachusetts.

Q. Which is Boston?

A. Boston.

Q. And most of the milk is produced outside of Suffolk County?

A. I assume that to be correct.

Q. You also gathered data on where milk is produced that is pooled?

A. Yes, we did.

Q. And most of it is produced in Vermont, New York and elsewhere, at some distance from Boston, correct?

A. That is correct, although it may be marketed in Boston.
Q. It may be marketed in Boston, but it is priced at the plant its first received, correct?
A. Correct.
Q. Does it make a difference to anybody where the pricing point is for purposes of the line labeled, Difference?
A. I would think that the figures shown under Difference would be the same regardless of the pricing point.
Q. All right. The numbers under the uniform prices may be different from your table, but the actual versus Scenario 1, whatever, should be the same?
A. I would expect so.
Q. In your endeavor, did you observe or attempt to observe whether the relationship between the uniform prices and the new class prices would tend to either encourage or discourage voluntary repooling so that the numbers pooled would be different from what
1 you viewed?
2   A. No, we did not.
3 Q. Are you familiar with the economic
4 premise that when prices for a good drop,
5 consumers tend to respond by buying more?
6   A. Yes, I am.
7 Q. And in each of the scenarios, the --
8 this regulated portion of the price for
9 product dropped. Did you attempt to observe
10 or make any observations of the impact of
11 increasing consumer demand as a result of the
12 price drop?
13   A. No, we did not.
14 Q. And are you also familiar with the
15 economic premise that when -- in response to
16 a demand increase, prices go back up again?
17   A. Yes.
18 Q. And again, no observation or attempt
19 to make an observation of that was
20 incorporated in your data?
21   A. No, it was not.
THE JUDGE: Mr. Yale.

Mr. Yale, please identify yourself again.

MR. YALE: Sure. Ben Yale on behalf of Select Milk, Continental Dairy Products and Dairy Producers of New Mexico.

EXAMINATION

BY MR. YALE:

Q. First of all, Mr. Rourke, I want to thank you for putting this information together on such short order and also, I guess, indirectly, to all the Market Administrators who did that. Thank you very much.

Mr. Vetne asked you some questions about the mailbox price. This is one of the statistics that is put together by the Department; is that correct?

A. That is correct.

Q. And it is made available to the public on a monthly basis -- several-month
lag, but on a monthly basis?

A. Yes, sir.

Q. We have -- I don't have them stapled together. There are two different documents we would like to have marked as an exhibit.

THE JUDGE: Would you like them separately marked or --

MR. YALE: Let's mark them separately because we don't have them stapled.

THE JUDGE: Very well. They will be Exhibits 14 and 15.

MR. YALE: And we have a number of copies here. We'll try to accommodate as many as we can.

The first one, Exhibit 14 is the -- 14 is the 2003-2004 mailbox price. And then 15 would be 2005 through October -- or September. I'm sorry.

THE JUDGE: That will be marked as 15, or 14.
1  MR. YALE:  Yes, that's 14.  Here's
2  15.
3  
4  [Whereupon, Exhibits No. 14
5  and 15 were marked for identification by the
6  judge.]
7  BY MR. YALE:
8  Q.  Mr. Rourke, let me represent, I
9  printed this off.  You can see it is prepared
10  by the Mideast Market Administrator's
11  Office.  These are published at various --
12  they are online at various sites; is that
13  correct?
14    A.  Yes, they are.
15  Q.  And does this look like the
16  information that is put together by the
17  USDA?
18    A.  Yes, it does.
19  Q.  Now, you -- in answer to a question
20  of Mr. Vetne's, you tried to explain what
21  this reflected.  And that is explained in
22  Footnote No. 1 on both of these tables, is
it not?
A. That is correct.

MR. YALE: Your Honor, we would move for the admission of Exhibits 14 and 15.

THE JUDGE: Objection? There being no objection, 14 and 15 will be admitted into evidence at this time.

[Whereupon, Exhibits No. 14 and 15 were received in evidence.]

BY MR. YALE:

Q. Now, Mr. Rourke, you also indicated the methodology to determine these uniform prices. And as explained in the regulations, behind these uniform prices are individual class prices. And each of those individual class prices are based upon various component prices, depending on the order. Is that correct?
A. Yes. Class I prices are dependent upon the order, yes.

Q. Right. And the Department -- first
of all, is part of your responsibility also
the website that USDA has with the
information that's presented, or is that
somebody else's -- under AMS Dairy --
A. Under Marketing Order Statistics web
page, yes.
Q. Okay.
A. That part of it, yes.
Q. All right. And does that include
the link that provides for the price
formulas?
A. Correct.
MR. YALE: Your Honor, we'd like to
have marked as Exhibit No. 16 the pricing
formulas.
[Whereupon, Exhibit No. 16
was marked for identification by the judge.]
BY MR. YALE:
Q. Mr. Rourke, I have put in front of
you what's been marked as Exhibit 16. Have
you had a chance to look through that?
A. Yes, I have.

Q. And what is Exhibit 16?

A. Exhibit 16 shows by year the price formulas that are in the -- each of the orders for establishing the minimum class prices and component prices under the order.

Q. And this -- these are the formulas that were used -- well, first of all, let's look at these formulas. And the key ones I want to point out are Class III and IV. I mean, you would agree with me, would you not, that Class I and II are the III or IV formulas plus some factor for Class II and the --

THE JUDGE: Mr. Yale, excuse me for interrupting.

MR. YALE: Yes.

THE JUDGE: In other words, why don't you have him identify for what years.

BY MR. YALE:

Q. Okay, yes, would you please
identify what years this represents, each of these pages.

MR. YALE: Thank you, Your Honor.


BY MR. YALE:

Q. Thank you.

Let's look at the Class I formula that's indicated on -- for 2006, this is a function, a direct function, is it not, of either the Class III or Class IV price formula, depending upon which is the higher?

A. That is correct.

Q. And Class II is a direct function of the formula used to derive the Class IV formula; is that correct?

A. That is correct.

Q. So by that, I mean, if you were to raise by just a discrete amount, say, a penny or a dime, either the Class III or
Class IV price, you would see a corresponding increase for that penny or dime exactly in the Class I and Class II formulas. Is that correct?

A. Well, I would point out that the time period used for the prices is different between the Class I skim milk and butterfat and Class II skim milk and from Class III and IV. So assuming that the one cent occurred in both time periods, that would be correct.

Q. Right. Thank you.

Now, so with that in mind, looking at Class III, you will notice that we have -- it is derived from three components, is it not?

A. Correct.

Q. And there is a separate formula for each of the protein, the other solids and butterfat prices?

A. That is correct.

Q. Okay. Now, part of this formula for
The protein price is the cheese price; is that correct?

A. Correct.

Q. And what is the cheese price that's used for this part of the formula?

A. The cheese price that we use is the -- we use both a price -- the prices are collected by the National Agricultural Statistic Service. They collect weekly prices. The two products that we use are -- for the cheese price are the price for a 40-pound block and 500-pound barrels, the U.S. average.

Q. And this is a weighted average that is computed for each month; is that right?

A. Right. NASS reports weekly prices, and we compute monthly averages based on four or five weeks, depending on the time period.

Q. And then for the Class I and Class II -- Class II. You don't use Class III.
1  But for Class I, if it's involved, you just
2  look at two of these, right?
3  A. That is correct.
4  Q. All right. And then there is a --
5  this next number, it says minus 0.165. What
6  is that .165?
7  A. That is the make allowance.
8  Q. Okay. And then what is the --
9  A. I'm sorry, 165 -- yes, make
10  allowance. Yes.
11  Q. And then there is a 1.383. And what
12  is that number?
13  A. That's the yield factor.
14  Q. Okay. And we see again a cheese --
15  same cheese price, right, used in the next
16  part of the formula that you just described,
17  as we proceed to the right, as we go across?
18  A. That is correct.
19  Q. And then we have it again, that 165
20  again, is that the make allowance?
21  A. That is correct.
Q. And then we have, what, another yield?
A. That is correct.
Q. Do you know what the difference between why -- what the two different yields are?
A. I think the second yield has to do with the -- I believe it has to do with the yield of the cheese from butterfat.
Q. Okay. And then the first one would be the yield of cheese from protein? I'm not trying to put you on the spot.
A. It's from milk. Yes.
Q. Okay. And then we have the butterfat price. And we'll talk about that in a minute, because that's what relates down here to the third component in this, right? Isn't that correct?
A. Correct.
Q. All right. And do you know what the .9 represents?
A. I believe that is the recovery of butterfat in cheese.

Q. Okay. And if you know the answer to what the 117 is, that's fine.

A. I don't recall what that is.

Q. Okay.

Now, let's got to the next -- the other solids price, a little bit simpler formula. We have a dry weight price. At what -- what is the dry weight price?

A. Again, that is a price series collected by NASS, weekly price that we weight to a monthly average.

Q. Okay. And then the .159?

A. That's a make allowance.

Q. And the 1.03?

A. I believe that's a factor to adjust for whey solid. I don't recall what that's for.

Q. Okay. And then we move down here to the butter price, butterfat price, and we
1 have butter price. And what is that?
A. Again, that is a monthly average of
2 the weekly prices collected by NASS.
3 Q. And the .115?
A. That's the make allowance.
4 Q. And then the 1.20?
5 A. That's a conversion factor from
6 butter to butterfat.
7 Q. Could that also be considered the
8 yield of butter, how much butter one gets
9 from --
A. Butterfat, yes.
10 Q. Now, because these -- we have these
11 formulas in here, you would agree, would you
12 not, that any change in the cheese price --
13 because it does change from day to day, week
14 to week; is that correct?
A. Generally.
15 Q. Yes. So any change in that would
16 have a change in the protein price?
A. Correct.
Q. All right. And similarly, any change in the make allowance would have an impact in the change in the protein price?
A. Correct.
Q. And any change in either of these yields would have a change in the protein price; is that correct?
A. Correct.
Q. And then looking down here at the other solids, we have the same situation. A change in the dry weight price could change the other solids price, correct?
A. Correct.
Q. And a change in the make or yield would have a similar impact in changing that price; is that right?
A. Would have a change in price, yes.
Q. Right. And we could say the same for the butterfat, right?
A. Correct.
Q. Okay. Now, going back to the
1 exhibit that you presented with the various
2 scenarios and options, and you asked people
3 to make changes in their formulas -- or not
4 people. You asked the Market Administrators
5 to recompute class and uniform prices. Which
6 of these factors for Class III was changed to
7 derive those particular formulas? Do you
8 know?
9 A. The make allowance of parts of each
10 of the formulas is what was changed.
11 Q. There was no change in the cheese
12 price?
13 A. Correct.
14 Q. And there was no change in yields?
15 A. Correct.
16 Q. Or any of the other prices, dry whey
17 or butterfat or butter price, right?
18 A. Correct.
19 Q. Now, moving down here, then, to
20 Class IV, and we come down and it's a
21 function of the nonfat solids price, and we
see nonfat dry milk price. What is that?
A. Again, that is a monthly average of
the weekly NASS prices computed by AMS.
Q. And the .14 is?
A. Make allowance.
Q. And then the .99?
A. The conversion factor from -- of
nonfat solids.
Q. And the same question again, when
you asked them to recompute the Class IV
price, what change did you ask them to -- did
those various options and scenarios, what did
they change?
A. The only factor that was changed was
the make allowance.
Q. Okay. And, of course, this would
then have an impact on the Class II or Class
I prices based upon these changes in the
formulas in the same way; is that right?
A. That's basically correct, based --
based on the time --
Q. Right.
A. -- period, but these are average product prices.
Q. Now, if you would, turn to the formula for 2002 as an example. And if you would, if you can, maybe get them so you can compare that to the one that we just talked about for 2006. And I want to look down here at the protein price.
And, unfortunately, these things are numbers one of two, one of two, one of two. So it is the one labeled 2002 compared to the 2006. And I want to look at the protein formula. And you will note, would you not, that the make allowance is the same, but there is a difference in the yield there from 1.383 to 1.405; is that right?
A. Correct.
Q. And the same thing over there between the 1.572 in 2006 and 1.582 for 2002; is that right?
A. Correct.

Q. And other changes, there is no factor .9 on the butterfat price, and the 1.28 is different than the 1.17, right?

A. Correct.

Q. So there are changes that are made, there have been made to these formulas other than the make allowances, is that correct, over a period of time?

A. That is correct.

Q. Now, you indicated, I think, during your direct examination, that you are involved in the publication of "Dairy Market News"?

A. That is correct.

MR. YALE: Your Honor, we would like to have marked as Exhibit 17, and it is the week of January 9 through 13, 2006, "Dairy Market News," Volume 73, Report No. 2.

[Whereupon, Exhibit No. 17 was marked for identification by the judge.]
BY MR. YALE:

Q. Do you have in front of you, Mr. Rourke, Exhibit No. 17?

A. Yes, I do.

Q. And could you identify that yourself?

A. This is the weekly report generated by the operation of the Market News Program that's put together in the field office in Madison, Wisconsin.

Q. Could you explain for the record what the "Dairy Market News" -- first of all, how often is it published?

A. This particular report is published weekly. The information in the report, generally, is also weekly information, although for some prices, it's more than weekly.

Q. Okay. And this is a report routinely produced by the Department?

A. Yes.
Q. And it is used by the Department and the dairy industry as reliable information for whatever purposes that they use in dairy?

A. Yes, sir.

Q. Now, I would like to go through -- there are a couple parts of this that I would like to pay particular attention to. If you would, look at pages 7 through 8. And if you could, please explain what these pages are.

A. These pages are monthly averages for each month of 2005 of the various weekly price series that are collected under Market News.

Q. And ordinarily, this would be published each week, is that correct, for the week, the information for that particular week in the particular issue?

A. Correct.
Q. And ordinarily, it's done on a weekly basis?

A. The averages for a month are published in one of these weekly reports.

Q. Okay. Thank you. And then, also, I would like you to look to page 13. Could you identify that, please.

A. Another data series that we collect.

In the Market Information Branch is a data series on announced cooperative Class I prices for various city markets in our Federal milk orders. We would publish a monthly price, again, in these various weekly reports, and this particular table is the -- where we show the annual averages of those monthly prices.

Q. This is in response in part to one of the questions of Mr. Vetne, that there are additional monies that milk is sold for in addition to minimum prices; is that correct?
A. This would be one measure of that, yes.

Q. Now, this isn't an actual weighted average of what plants actually pay for milk. This is based upon the announced prices by the cooperatives?

A. That is correct.

Q. I want -- sorry, I want to go back -- or not -- let's go to the beginning.

There are a couple of other points I just want to identify into the record of interest that we are developing.

If you look at the bottom of page 2, and do you -- what is that table?

A. The bottom table, it's identified as NASS Dairy Product Prices. These are the actual weekly prices that were collected by the National Agricultural Statistical Service for the week ending January 7th and would have been released on January the 13th, actual prices for that week.
Q. And these are the prices that we had talked about earlier dealing with the product formulas, right? These are the prices that go into those formulas or they contribute to them?

A. That would be correct, although they may be -- actual prices used for this week may not be those that are shown on this page, depending on what was published the next week.

Q. There are revisions from time to time?

A. Right.

Q. And I think you note down here that the final revisions are found on a particular website; is that correct?

A. Correct.

MR. YALE: And, in fact, Your Honor, we would like to have judicial notice taken of the website listed at the bottom of page 2, and particularly for the years 2004 and
2005. This is information provided by the National Agricultural Statistical Service and is used as part of the formulas that are going to be in discussion at this hearing.

THE JUDGE: Mr. Beshore.

MR. BESHORE: Marvin Beshore, representing the Association of Dairy Cooperatives in the Northeast. I think we need more precision if we are going to be taking official notice of any publications on web pages. And I think Mr. Yale's statements was just, you know, of a web page cited at the bottom of that. And it changes daily or frequently. So we need more precision if we are going to be asked to take notice of such publications.

MR. YALE: In response to that, Your Honor, it is my understanding that the ones that would be at this website with a back slash 2004 and back slash 2005, I believe, is correct. Or is it -- I may have to
modify that, but there are two specific 

website pages, although dairy will get you 
to all the years since 1998. BY MR. YALE:

Q. Do you recall, Mr. Rourke, what that 
address is? I mean, any more specific?

A. No, I don't.

MR. YALE: It may be DPR 2005, but 
I'll get you that specific one to allow for 
that notice.

THE JUDGE: All right. Why don't you 
Let me a very specific reference --

MR. YALE: We'll do that.

THE JUDGE: -- and then we'll take it 
from there.

BY MR. YALE:

Q. Now, was there any other --

MR. YALE: I want to change topics 

here a second. We are done with Exhibit 17 
which, by the way, we would move to admit 
Exhibit 17.

THE JUDGE: Objection?
MR. YALE: And we'd also move to admit Exhibit 16. I don't think I moved that in. That's the formulas.

THE JUDGE: Exhibits 14 through 17 will be admitted at this time.

[Whereupon, Exhibits No. 14 through 17 were received in evidence.]

MR. YALE: And at the same time, Your Honor, we would request that official notice be taken of the publication, "Dairy Market News," for each of the weeks of 2004 through the briefing period that would be -- after this hearing is ended.

THE JUDGE: Mr. Vetne.

MR. VETNE: John Vetne representing Agri-Mark. I don't have an objection as to the reliability of information reported in the "Dairy Market News." It contains its own qualifications and footnotes.

However, I do have a problem with official notice of the -- I mean, we just
have one week here, and we are looking for
104 publications over two years. It's a lot
of information.

Without identification of the
specific data series that Mr. Yale is
interested in, I would object, because I
don't want to have to guess what to use, what
to look for here, when I write a brief.

MR. YALE: Your Honor, this
information has routinely been allowed into
the Federal orders. It is information,
public record. It's published by the
Department referencing the situation going on
in the dairy industry.

I mean, I can -- you know, we have
identified several schedules in here, but
there are other tables in here that are
going to be relevant and may be identified
as the hearing progresses.

THE JUDGE: I agree that this
information is generally available. It's
generally considered to be the type of
information that the secretary can look at
for whatever weight he wishes to give it. So
at this time, I'll take notice of the
fact that the publication does exist and may
be drawn upon during the briefing portion.
Yes, sir?

MR. RASTGOUFARD: I just wanted to
object to the inclusion of future
publications, i.e., those publications that
have not yet been published and not taking
judicial notice of anything that doesn't yet
exist.

MR. YALE: We'll take it up through
the -- there will be a publication yet this
week, I think, through the 14th. I mean,
there will be -- this one is through the
13th. There will be one more publication
this Friday. Huh? Well, the hearing is
still on.

The question was whether it would be
future, but that's still -- the hearing is still on, Your Honor, so if we could at least bring it through the -- the report, I believe -- would that be Report 04 or 03?


And we'll end it there. We won't go anything beyond that.

THE JUDGE: Very well.

THE WITNESS: Actually, it will be Report 4.

MR. YALE: Okay. I thought so. I pulled this off Thursday.

BY MR. YALE:

Q. Moving on, then, I want to change topics to another issue dealing with information that is also available out there. There is also made available, produced by NASS, information regarding the herd size by state and the production and number of operations in various -- in some
of the states. Are you aware of that?

A. Yes, I am.

Q. But that's not information put together by AMS?

A. No, it is not.

Q. From time to time, you report summaries of that information in "Dairy Market News," do you not?

A. That is correct.

Q. Now, prior to this hearing, you got a request from our office for this table to be prepared, which we appreciated. You got also another request, did you not, from us that you were unable to comply with because of the time constraint?

A. Yes, that is correct.

Q. And what was that?

A. The request was for -- another dated series that's collected is producer of milk marketed under the orders by state and county. We normally assemble that
information for the months of May and December. I believe you requested that information for May and December of 2000 through 2005.

You also requested information on the -- by -- by county for producers that were smaller than 5 million pounds of milk marketed during the month, I think, for the most recent time period that might be available. And then you also asked for copies of annual summaries of Federal milk orders, the statistics for 2000 through 2005.

Q. Let's talk about that last one. You indicated that that information is available on the web, is it not?

A. Yes, the complete summaries for 2000 through 2004 are available on the web, on our website. The complete summary for 2005 is not completed, but most of the statistics are out there, and the general
format, that would be an annual summary.

Q. And what is the title of each of those documents?


MR. YALE: Your Honor, we would request, then, official notice be taken of the federal milk order statistics for 2004 and 2005 as they are on the website, and we could have official notice taken of those statistics, the annual summaries.

THE JUDGE: There appears to be no objection.

BY MR. YALE:

Q. And then one final issue that I wanted to discuss with you. Mr. Vetne asked you a hypothetical, that if there is a change in price, there will be a response in production and -- or in supply and demand,
is that -- that's kind of basic economics, right?

A. Yes.

Q. Now, over the years, you have -- you observe -- you just don't report these documents. You observe them and start to kind of, you know, absorb what they are telling you, do you not?

A. I attempt to, yes.

Q. Because part of your job is also to give information to other people within the Department that may make policy decisions and other decisions and reports; is that correct?

A. That is correct.

Q. Now, if prices -- producer prices are to drop, what is the expectation that the response would be on supply?

A. If producer prices were to drop, then you would expect supply to drop, milk production to drop.
Q. And how does milk production drop?
Is this done in a uniform basis or is it done in, you know, bits and pieces throughout the country or patchwork? How would you describe it?
A. I don't know if I have done that much of an analysis, but I would not expect it to be the same across the country.
Q. And does it tend to be more in response by smaller or larger producers?
A. I have not made that kind of observation.
Q. There was one other area I forgot that I did want to point out. When you look at Exhibits 14 and 15 again, as well as the exhibit that you prepared at our request, these are done by individual marketing areas, are they not?
A. The mailbox prices are for reporting areas in Federal milk orders.
Q. Right. And this does not include
the entire nation?

A. That is correct.

Q. Approximately what percent of

the milk is reflected in these Federal order

statistics that's produced nationwide?

A. In the normal pooling under the

orders, it would be somewhere in the

neighborhood of -- on the average, 65 to 70

percent, depending on pooling of all the

milk.

MR. YALE: Your Honor, I have no

more questions at this time. Thank you very

much. And again, thank you, Mr. Rourke, for

cooperating with those exhibits.

THE JUDGE: It is about quarter

of 10:00. This might be a logical time to go

ahead and schedule our morning break. It's

-- what's your pleasure, 15 minutes? Very

well. Let's resume at 10 o'clock.

[Whereupon, the hearing

recessed at 9:46 a.m. and reconvened at
10:08 a.m.]

THE JUDGE: We are back in session. Is there other cross of Mr. Rourke? Mr. Beshore.

Ladies and gentlemen, if you will go ahead and take your seats. Let's give them just another second.

MR. BESHORE: Marvin Beshore.

EXAMINATION

BY MR. BESHORE:

Q. Mr. Rourke, you are familiar with the MILC program, the lost contract program?

A. Yes.

Q. Is the income the dairy farms receive when that program is applicable and months when it is respected, is that reflected in the mailbox milk price series, Exhibits 14 and 15?

A. Those payments are not included in the mailbox prices.

Q. Are they included in the uniform
1 price calculations in Exhibit 13?

2 A. No, they are not.

3 Q. Do you have an FMLS annual?

4 A. Yes, I do.

5 Q. Could you possibly identify the tables if they are -- if they are in that -- in the annual, and I think they may be, which -- which would give us the utilization factors and other factors that you used in recomputing uniform prices in Exhibit 13?

6 In other words, at the bottom of the first page of Exhibit 13, you indicated in summary how those prices were recalculated.

7 But there would have been for -- in each order, the class utilization percentages would have been part of that calculation, I assume?

8 A. That is correct. The additional factors that were used in the computation, recomputations that would appear in the annual summary would be the class
utilization percentages.

Q. But what table is that?

A. The 2004 summary. Class I is on Table 14. Class II is Table 18. Class III is Table 22. And Class IV is Table 27.

Q. So the percentages reflected in each of those tables for each order would have been utilized at the uniform price recalculations?

A. Well, they would have used actual pounds of milk. So the actual pounds of milk used in the political classes are also shown in those tables.

Q. Are they in the same numbered tables?

A. Actual pounds of milk are on Tables 13 for Class I; 17 for Class II; 21 for Class III; and 26 for Class IV.

Q. And those are the -- in the 2004 annual, correct?

A. That is correct.
Q. Now, if we wanted to find the same numbers for the 2005 months that were used in making the calculations on Exhibit 13, where would we find that information?

A. Those would be on our milk marketing or the statistics web page. If you look under the 2005 annual summary, make some statement about it being under development or something along those lines, and there would be similarly numbered tables having the information for 2005.

I don't know for sure if it's the exact same table number, but the information would be there.

Q. Okay. So that -- although that full publication is still under construction, those -- the information in those tables is available on that web page?

A. For all of 2005, yes.

Q. For all of 2005.

MR. BESHORE: I would like to
1 request that official notice be taken of
2 those series that Mr. Rourke has just
3 referenced.

4 THE JUDGE: Very well.

5 THE WITNESS: None of the other
6 factors that were used in the calculations
7 would be in our annual summary.

8 BY MR. BESHORE:

9 Q. What other factors are there other
10 than those enumerated on 13?
11 A. There are other factors such as
12 location adjustments, overages and things.
13 One-half of the unobligated balance is part
14 of the pool computation.
15 Q. So in calculating 13, your staff, or
16 Market Administrator staffs, actually
17 recalculated the pool, in essence, in each
18 order?
19 A. Well, they recomputed the uniform
20 price, using actual information that was
21 resulting of the pooling process for the
Q. I would like you to look at Exhibit 316 just for a minute. And I call your attention to the formula for Class III that Mr. Yale took you through these numbers somewhat, took you through this calculation. I do not see anywhere in the Class III price formula the advanced Class III skim milk pricing factor. Am I missing it or is it just not there?

A. If you look up under Class I, there is a note there that talks about the advance pricing factors and the formulas that they used.

Q. But it is a different number than any calculation in the Class III formula itself, isn't that correct?

A. The result of running a formula will generate a different number.

Q. And the same thing for Class IV,
when you calculate the Class IV price, you do not calculate an advanced Class IV pricing factor, correct?

A. When we compute the Class IV price, we do not compute an advanced pricing factor for Class IV skim milk. That is correct.

Q. So when you recalculated Class I and Class II prices in Exhibit 13, you had to -- didn't just use the recalculated Class III and Class IV prices, you had to make an additional assumption, and that is that -- or make an additional calculation. You had to calculate the advanced Class III and IV and the advanced butter fat pricing factors that are part of the Class I and Class II formulas, correct?

A. That is correct. All of the formulas were rerun for the 2004 and 2005 period, using the 5 cents make allowances.

Q. Thank you.

THE JUDGE: Mr. Vetne?
EXAMINATION

BY MR. VETNE:

Q. Just a couple of follow-up to other cross.

Mr. Rourke, Ben Yale asked you a question concerning producer supply response to lower prices, do you recall that? And your answer was, well, Economics 101, if prices are lower, supply would drop.

A. I recall that.

Q. Okay. Rather than freezing the frame at that point, when supplies drop, what, under Economics 101, do you expect to happen to prices thereafter?

A. Well, when supplies drop, depending on what happens to demand, if the demand stays the same or grows up, increases due to lower prices, and eventually milk production will increase.

Q. And that is the cycle that you have observed in dairy, is that not correct?
Prices drop, supplies drop, and because supplies drop, prices increase, production goes up?

A. That would be correct. I have observed that.

Q. Couple questions about the mailbox prices here. You indicated that these do not include the milk -- the co-op payments to producers. Do the mailbox prices that you report include or not include cooperative dividends checks, thirteenth checks, that kind of thing?

A. They do not include thirteenth checks, cooperative dividends.

Q. Okay. And those are two terms for essentially the same thing, thirteenth check and dividends, or similar things?

A. I probably would not agree with that.

Q. What is the difference? They both are not included. What is the difference
between a thirteenth check and a dividend?

A. A thirteenth check, I believe, is,

from previous observations, I haven't

observed that much of late, would be a --

generally a payment resulting from

cooperative operations during the year.

Q. All right.

A. I don't know if a dividend is

necessarily the same thing, but --

Q. In any event, it doesn't include the

-- the mailbox prices don't include those?

A. That is correct.

Q. So if someone wanted to convert the

mailbox prices to the gross receipts of

producers for milk produced, one would have

add dividends or thirteenth check, one would

also have to add hauling, and one would have

to add dues and other things to come to a

figure of gross revenue for the sale number?

A. That is correct.

Q. Are there any data sources that you
Q. Good morning. Steven Rosenbaum for the National Cheese Institute. I just have a couple follow-up questions about the formulas that Mr. Beshore asked you about. And this is, I guess, with respect to Exhibit 16. Now, the formulas are set forth -- are correctly set forth for Class III and Class IV on this page, correct? Those are the formulas in effect today, correct?

A. Yes.

Q. For 2006?

A. Yes.

Q. So that was a yes?
A. Yes, for 2006.

Q. And when it comes to pricing Class I and Class II, I'm oversimplifying slightly, but you look at what the Class III price and what the Class IV price, and you add a differential on top, correct?

A. We use the Class III and Class IV prices for the -- computed for the advance pricing term period based on two-week averages.

Q. Okay. And what I want to focus in on is that the formula that is used for determining the advanced pricing is the same formula as set forth here for Classes III and IV except that you use a different time period for determining the skim milk price, the protein price, the other solids price and the butterfat price; is that correct?

A. Correct. We use a different time period for the product prices that are used in the formulas.
Q. But the formulas themselves are otherwise exactly the same, correct?
A. Correct.

MR. ROSENBAUM: That's all.

THE JUDGE: Mr. Yale.

EXAMINATION

BY MR. YALE:

Q. I want to follow up on the question about the revenue. Do you understand the MILC program, how it is computed?
A. Yes, I do.

Q. And how is that computed?
A. They compare the Class I price in Boston or in the principal pricing point of the Northeast Order, Class I price in Boston, compared to a target level, which is, I believe, 1694. They take that difference, and under the old -- the program that has expired, they would multiply that difference by 45 percent and pay it out to dairy farmers who have applied for payments
based on their pounds of milk --

Q. At this point, the renewal of that has not passed; is that correct?

A. That is correct.

Q. Now, in addition to the -- you know, the 45 or whatever the percentage may be, there is also a limit to how much money a producer can receive, right?

A. I'm not aware of --

Q. There is a cap of the amount of -- you are not aware of a cap on production in excess of 24,000 hundredweight or anything like that?

A. Yes. I'm aware of that, yes. I thought you meant payment.

Q. No. I'm sorry. I guess I misstated it. The cap on the pounds that are eligible for payment?

A. Correct.

Q. All right. Now, in the Federal order program, the uniform prices that you
have given us in your Exhibit 13, is there anywhere in there in which that a producer reaches a point, if his production gets so high, that he is not eligible for that uniform price?

A. No.

Q. And there was a question about the revenues from co-op dividends, I think, or thirteenth check, or however Mr. Vetne -- that there was some additional revenues from the co-ops as separate from the production, payments for the production, right, or whether co-ops sometimes make those payments, right?

A. It’s separate from their normal monthly payment.

Q. Right. And do you see information regarding those payments and how those payments are made and the like? Are you aware, generally, of the basis of those payments?
A. I see anecdotal information. It certainly would not be representative of the whole population.

Q. But in that anecdotal information, first of all, could you answer yes or no whether or not a payment from a co-op, whether it goes only to its members or those who it's purchased milk from, or does it go to everybody in the marketing area?

A. It would be my understanding it goes to their members.

Q. And their members only?

A. That would be my understanding, yes.

Q. And are you also aware of whether or not the distribution of the profits is based upon the producers production or a formula that might include ownership or some other factor other than production for that year?

A. I don't recall using the word profits, but I think the payment is based --
my understanding is it's based on production.

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

THE JUDGE: Other questions? Very well, Mr. Rourke, you may step down.

MS. DESKINS: Mr. Davenport, our next witness is Dr. Charles Ling.

THE JUDGE: Very well. Dr. Ling, will you come forward.

Whereupon,

DR. CHARLES LING,
called on behalf of the USDA, having been first sworn by the judge, was examined and testified under oath as follows.

THE JUDGE: Please be seated and give us your name and spell your name for the hearing reporter.

THE WITNESS: My name is Charles Ling, L-I-N-G.

EXAMINATION
BY MS. DESKINS:

Q. Dr. Ling, it is my understanding that your statement is being passed out?

A. That is correct.

Q. Dr. Ling, you have prepared a statement today?

A. Yes.

MS. DESKINS: Your Honor, could we have that marked as -- I believe we're --

THE JUDGE: It's No. 18.

MS. DESKINS: Yes, sir.

[Whereupon, Exhibit No. 18 was marked for identification by the judge.]

BY MS. DESKINS:

Q. Would you like to read from that statement now, Dr. Ling?

A. Yes, okay.

STATEMENT FOR THE RECORD OF CHARLES LING

My name is Charles Ling. I am an agricultural economist with Cooperative Programs of Rural Development. I have served
as its program leader for dairy, livestock and poultry since 1988. Five years prior to joining Cooperative Programs in 1978 I was an agricultural economist with the Federal Milk Order No. 2 Market Administrator's office in New York. I received my BS degree from National Taiwan University and master's and Ph.D. from University of Connecticut, all in agricultural economics.

I am testifying for the record at the request of the Agricultural Marketing Service regarding the results of a technical assistance study of the cost of manufacturing dairy products at a number of dairy cooperative plants for 2004. After publishing dairy product manufacturing costs at Cooperative Plants, ACS Research Report No. 34, in 1983 a group of cooperatives requested the then Agricultural Cooperative Service, ACS, to conduct an annual confidential technical assistance
The cooperatives promised to provide data from selected plants to ACS for the use in for use in developing a database of cost information from large cooperative milk manufacturing plants. ACS would provide each cooperative with the report comparing particular cooperative's plants with other similar plants without disclosing individual plant data to others. Participation in the study is voluntary and is open to all dairy cooperatives. The 2004 plant cost study was the 20th year of the technical assistance project.

Cooperative programs is authorized by the Cooperative Marketing Act of 1926 to conduct technical assistance studies. Section 3(b) of the act directs it, To make surveys and analyses if deemed advisable of the accounts and business practices of representative cooperative associations upon
their request; to report to the association so surveyed the results thereof, and with the consent of the association so surveyed to publish summaries of the results of such surveys together with similar facts, for the guidance of cooperative associations and for the purpose of assisting cooperative associations in developing methods of business and market analysis.

That's in section, that is 7 USC section 453.

For the plant cost comparison technical assistance project, dairy products studied are butter, nonfat dry milk, usually called powder cheese and, if data are available, whey and other dairy products. Only in-plant costs are included.

The following instructions were given to the cooperatives for report cost data on butter-powder plants.

No. 1. Scope of cost information.
In-plant costs of moving milk from the receiving deck to the product delivery deck. Exclude milk procurement costs, transportation, administrative costs, plant, office plant manager and corporate overhead, interest and cost associated with facilities for prolonged storage or off-site storage.

No. 2. Milk received at the plant incurred as a receiving cost. Cream and skim separated in the plant incur the costs of receiving and separating milk. Condensed skim incurs an additional evaporation cost. If milk, cream, skim or condensed was shipped out of the plant, please ensure the accompanied receiving, separation or evaporation and shipping costs are taken out of plant manufacturing cost.

3. If cream, skim or condensed was received at the plant for further processing, allocate a cost to the that product as if it had been separated or
condensed at the plant. Cost incurred at the receiving bay should be noted also.

4. For direct cost items such as direct labor, electricity and fuels, please ensure the dollars and physical units reported correspond with each other.

For reporting cost data on cheese plants, these two instructions replace the previous items 2 and 3:

1. If cream, skim, condensed, skim or condensed whey or other intermediate product was received at or shipped out of the plant please make sure the product is allocated a processing cost. Costs incurred at the receiving bay for receiving/shipping the product also should be noted.

2. Do not include the cost of processing whey and whey product in cheese manufacturing costs.

Nine cooperatives submitted 2004 cost data on 17 cheese plants, 8 butter plants
and 16 powder plants. However, due to data incompatibility, one butter plant and two powder plants were not included in the database for preparing the final report. A set of nine reports was prepared; each participating cooperative received a report comparing its plant cost with the average of all plants making the same product. These reports, like all technical assistance reports, carry this disclaimer:

This technical assistance report was prepared for the sole use of, name of (cooperative). Its board of management may make any use of the report they deem appropriate but cooperative programs will treat it as confidential to the extent provided for by law.

With the consent of the participating cooperatives, the results of study are summarized and presented in the accompanying table. Simple average plan costs were
14.267 cents per pounds of all cheeses,
17.019 cents per pound for 40-pound block cheese, 6.721 cents per pound of condensed whey solids, 11.545 cents per pound of dried whey, 18.137 cents for pounds butter and 
21.417 cents per pound of powder. Using each plant's product volume as the weight, the weighted average costs were 13.295 cents per pound of all cheeses, 15.136 cents per pound of 40-pound block cheese, 6.549 cents per pound of condensed whey solids, 11.409 cent per pound of dried whey, 16.588 cents per pound of butter and 16.816 cents per pound of powder.

In reviewing these cost data, several factors have to be kept in mind.

1. Cost analysis does not consider differences in product quality. Products of higher quality conceivably would require higher quality ingredients and more effort by labor.
2. Cost allocation procedure for multi-product plan may not be uniform among the participating cooperatives; therefore, two plants having exactly the same operations and same total costs may show different unit product manufacturing costs.

3. The nature of a plant might affect its cost. A plant used strictly for manufacturing purposes tends to have a relatively constant milk volume and is operated at a high rate of capacity. It is likely to have a lower cost than a plant for balancing milk supply.

4. There are regional differences in input costs such as wages, electricity and fuel rates. It is possible that an efficiently operated plant in one region might have a higher per unit manufacturing cost than a less efficient in another region.

5. The proportion of butter in bulk and print forms may affect a butter plant's
6. When categorizing various in-plant expenses into cost items for this study, different plants may have grouped them differently. Although this should not affect the total cost, care should be used in reading the individual cost items.

This concludes my statement.

BY MS. DESKINS:

Q. Dr. Ling, the last page of your statement consists of a table; is that correct?

A. That is right.

Q. Did you prepare the table yourself?

A. That is right.

Q. Is it correct, to the best of your knowledge?

A. That is right.

MS. DESKINS: Your Honor, I would move for the admission of Exhibit 18.

THE JUDGE: Very well, it will be
[Whereupon, Exhibit No. 18 was received in evidence.]

MS. DESKINS: And I have no further questions for the witness.

THE JUDGE: Very well. Questions of this witness? Mr. Yale?

EXAMINATION

BY MR. YALE:

Q. Good morning.

A. Good morning.

Q. I was afraid somebody wouldn't say anything and you would be down without cross. Couldn't let that happen.

Dr. Ling, in this report, you indicate that you have been working with cooperatives; is that correct?

A. That is correct.

Q. So by that, I would understand that any proprietary plant that produces cheese or butter or any of these other things would
not be included in this study?

A. That is correct.

Q. Can you give us the names of the cooperatives that are involved?

A. Yes. That's public information.

Q. Okay.

A. They are Agri-Mark, Inc.; Associated Milk Producers, Inc.; Dairy Farmers of America.

THE JUDGE: Dr. Ling, if you would, slowly. Our hearing reporter is trying to take this down.

THE WITNESS: Do I have to repeat it?


That's nine cooperatives.

BY MR. YALE:

Q. Now, can you also tell us what plants were involved, because I think you
indicated that there were -- and whether they are all the same plants or if there is some overlap, I don't know, but you indicated here somewhere in the neighborhood of about 40 or 41 plants. Can you identify, you know, for, like, Agri-Mark what plants are involved in that study?

THE WITNESS: Do I have permission?

Okay.

MR. WELLINGTON: Of course, you do.


For butter powder, it's West Springfield, Massachusetts.

BY MR. YALE:

Q. And what about for AMPI?

A. AMPI, I don't have the name. I have the plant location here, but --

Q. If you can --
A. The powder plant, South Dakota.

Freeman, South Dakota. Sorry. And six cheese plants.

Q. Okay.

A. I believe it is Blair, Wisconsin.

Paynesville. Paynesville, Wisconsin.

Dawson, Minnesota. Rochester, Minnesota.

Sanborn, Iowa.

You have to help me.

Q. There is one more, I think. Well, you said six.

A. Did I say Sanborn, Iowa?

Q. Yes.

A. All right. Rochester, Minnesota.

Dawson, Minnesota. Paynesville, Wisconsin.

Blair, Wisconsin. That's six.

Q. And the name, again, is what? What was the name of the plant?

A. Paynesville, Minnesota.

MEMBER OF THE AUDIENCE: Paynesville.

THE WITNESS: Yes, Paynesville,
Minnesota. The sixth one --

BY MR. YALE:

Q. I think you have got six now, don't you?

A. That was six.

Q. What about DFA?

A. DFA. For butter, it's Goshen, Indiana; Winnsboro, Texas. For powder, it is Goshen, Indiana. It's Wellsboro, Pennsylvania, and Middlebury, Pennsylvania. Winnsboro, Texas. Fort Morgan, Colorado.

For cheese, whey plants, it's New Mexico.

MEMBER OF THE AUDIENCE: Lovington.

THE WITNESS: Lovington. Lovington, New Mexico. Zumbrota, Minnesota. And Monett, Missouri. BY MR. YALE:

Q. Okay. And then is that all? Did they have any butter plants for Agri-Mark that we didn't mention?

A. Yes, Agri-Mark is West Springfield,
Massachusetts.

Q. Okay. And AMPI, were any of these powder plants also butter plants?

A. No.

Q. And DFA, any of these powder plants also butter plants?

A. It is Goshen, Indiana, and Winnsboro, Texas, have butter plant.

Q. And we'll come back to those separately.

A. Foremost, what plants were those included in?

A. Lancaster, Wisconsin.

Q. That's it?

A. That's it.

Q. And is that a cheese or butter powder plant?

A. That's a cheese plant, yes.

Q. Does it have a butter powder operation in this survey?

A. No.
Q. And then what about Land O'Lakes?
A. Land O'Lakes, one butter plant, Carlisle, Pennsylvania, which is also part of operation.
Q. And that's all that's from Land O'Lakes?
A. Cheese plant from Wisconsin is Kiel, Wisconsin.
Q. Any other -- and that's all of it for Land O'Lakes, those two plants?
A. That is correct.
Q. Okay. Three plants? Two plants?
A. Two.
Q. MMPA?
A. Michigan Milk Producers, that's two butter and powder plants. One is in Constantine, Michigan. The other one is Ovid, Michigan.
Q. That's O-V-I-D?
A. O-V-I-D.
Q. And Northwest Dairy Association?
A. That's -- Northwest Dairy Association is one butter plant in Issaquah, Washington. Four powder plants in --

Q. And they are?

A. They are Lynden, Washington.

Q. Okay.


Q. Sunnyside?

A. Yes.

Q. And Tillamook Creamery?

A. Tillamook Creamery has two cheese plants. One is in Tillamook, and the other one is in Boardrman, Oregon.

Q. And the Tillamook is also in Oregon, right?

A. That is correct.

Q. And they don't have any powder plants or anything. Did they have a powder plant?
A. Not that I know.

Q. Not in your study. You just had the two cheese plants?

A. Yes.

Q. All right. UDA?

A. UDA is one butter powder plant in Tempe, Arizona.

Q. Okay. And that's all that they had?

A. That is correct.

Q. Now, in terms of the whey operations, who had the whey operations?

A. You mean in the -- in my report?

Q. Yes, in your report. Who contributed to the whey data?

A. You are talking about condensing or drying?

Q. Let's talk about the condensed whey, and then we'll talk about the dried whey. Can you explain the difference between condensed and dried whey? Do you know the difference?
A. Well, before you dry the whey, you have to condense it first.

Q. It's just a little less water, and the dry is a whole lot less water. Is that --

A. That is correct.

Q. Okay. So the condensed whey, what plants were -- participated in that?

A. I don't have the data right in front of me, so -- but my recollection is Cabot, Chateauguay, Keil, Wisconsin. Paynesville. And Sanborn. How many is that?

Q. I have got one, two, three, four, five.

A. I believe Zumbrota, and I think Monett, or Lovington.

Q. Lovington. L-O-V-I-N-G-T-O-N? Is that what you mean?

A. Uh-huh.

Q. Okay.

A. And this plant, I don't recall but
might have the condensed and drying separate.

Q. So these ones that you said condensed also have dry as well?

A. Some plants, just condense and -- condense the whey and ship it to other plant for drying. And the dry plant usually have to condense and also dry.

Q. And which ones are dry? What plants have dry?

A. Kiel plant, Kiel, Wisconsin.

Sunnyside. Tillamook. Blair. And Dawson. That's six?

Q. I have got five.

A. Five.

MEMBER OF THE AUDIENCE: Your Honor, Jim Falls, Wisconsin.

THE JUDGE: Thank you.

THE WITNESS: Oh, Jim Falls, Wisconsin, yes.

BY MR. YALE:
Q. Very good. So I think we have covered all the plants, right? And I'm impressed, by the way, that you can remember this. That's a tremendous help. Now --

A. By the way, that Jim Falls, Wisconsin, plant should also be counted as an AMPI cheese plant.

Q. Okay.

THE JUDGE: Yes, sir.

MEMBER OF THE AUDIENCE: Your Honor, to fill in the condensed whey information, Lancaster, Wisconsin, reported condensed whey.

THE WITNESS: That is correct.

Lancaster, Wisconsin. Sorry.

BY MR. YALE:

Q. So, hopefully, some of those individuals from some of these companies will be up and be able to tie that down further.

Now, do you know if -- well, first of
all, these products, was there any
limitation on the type of cheese that could
be produced at these plants, or was it all
cheeses?
A. The project main product was Cheddar
cheese, and same thing might produce other
cheeses.
Q. But the plants were required to
isolate the cost for the Cheddar or they
reported the cost for all cheeses produced
at those plants?
A. I asked them if they can do it, to
the extent possible, Cheddar cheese. But
cost allocations can be a very different
task. So if they report some amount of
other cheese, they can include them in the
cheese produced.
Q. So that I understand, if they
produced, for example, Monterey Jack cheese
in addition to the Cheddar, then if they
reported that number and didn't break it out
at the plant, you didn't try to break it out?

A. No. I had no basis to do it.

Q. When they gave you volumes of cheese produced at the plant, did they give you the volumes of cheeses by types or just total volumes of cheese?

A. It is usually by type.

Q. Did they provide you any information regarding the yields, that is, the pounds of cheese produced per a hundred pounds of milk received?

A. They did not. But I tried to collect it based on the pounds of cheese they made and the milk that goes into the -- or milk or creamery that goes into the cheese production.

Q. But you didn't report that in this study?

A. It's -- it is on the table.

Q. On the table? Okay.
And this is all cheeses; is that right? And then you broke out for the 40-pound blocks of Cheddar?

A. That's correct.

Q. Now, what happened if -- if you didn't know, if the plant did not provide the breakdown between the types of cheese, whether it was block or barrel or Cheddar or something else, did you just not include that in that number? How did you handle that?

A. I asked for type of cheese they make. So if they report 40-pound blocks, then it's 40-pound block. If I cannot make -- if the plant has several type of cheese and 40-pound block is not predominant cheese, I don't include them in the 40-pound block.

Q. But if it was predominant, you did?

A. Pardon me.

Q. If it was predominant, you did?
A. That is correct.

Q. So that number might include 640s or 500-pound barrels, right?

A. You mean for all cheeses?

Q. For the 40-pound block cheese total.

A. No.

Q. It's pure 40-pound block?

A. Yes, pure 40-pound blocks plus some other special cheeses.

Q. Now, again, talking about the cheeses that we have, I noticed on Note 1, on page 3, that the cost analysis does not consider differences in product quality.

A. That is correct.

Q. All right. Now, do you know -- let me kind of try to set up a background to see if you understand this. Do you understand that NASS, the National Agricultural Statistical Service, reports weekly the sales of 40-pound block and 500 pound Cheddar cheese. Are you aware of that?
A. That is correct.

Q. All right. But it is a very -- would you agree that some of these plants produce a Cheddar cheese that is of a different quality than that that would be reported on NASS?

A. I don't have any idea.

Q. Do you know if any of these plants report the sales of their cheese to NASS?

A. No, I don't.

Q. Okay. Are you a purchaser, a user of cheese yourself?

A. That is correct.

Q. And you would recognize, some of these have some pretty high -- not disparaging the others, but a couple of these have some very high names, do they not, for the quality and their type of cheese?

A. That is correct.

Q. Such as Tillamook or Cabot?
A. That is correct. And I pay for them.

Q. Pardon?

A. I bought them, and I pay for them.

Q. Right.

A. So no freebie.

Q. That's because extra quality has a price, right?

A. That is correct.

Q. But your study doesn't account for the fact that they might be producing a different quality cheese than another plant?

A. That is correct.

Q. Do you know what the volume, does your report give us the volume of cheese that these plants represent?

A. If you look at the table --

Q. Yes.

A. -- toward the -- that item there called pounds of product per plant --

Q. Right.
A. -- you take all cheeses --
Q. Okay.
A. -- 62 million pounds, you time that by 17 plants.
Q. Okay.
A. That will get you a little bit more than the one million pound of cheese.
Q. Okay.
A. And for other products, you can do the same thing.
Q. So then, for the 40-pound blocks, it would be six times the 69 million?
A. That is correct.
Q. Did your -- I noticed that your statement says it is from receiving deck to shipping deck. So you don't have any knowledge or information regarding what the plants actually paid for milk?
A. No.
Q. On page 3, again, of your statement, item No. 3, you indicated a -- there is a
1 comment there that talks about a plant
2 that's in the production mode has a
3 different cost than those that are used for
4 balancing, is that correct?
5 A. That is correct.
6 Q. Do you know which of any of these
7 plants are balancing plants that you have
8 named?
9 A. I would say most of them are
10 balancing plants, but the powder, are
11 balancing plants.
12 Q. Now, in doing the cost analysis, did
13 you request or do you know if they included
14 any offsetting income to any of those costs?
15 A. No.
16 Q. They --
17 A. It is -- the project is strictly
18 cost incurred inside the plant.
19 Q. So if a plant, for example, a
20 balancing plant, had a contract with some
21 other entity in which they were paid to have
that plant available for balancing to offset some of their labor costs to keep the labor during the low production months, that would not reflect in here?

A. No.

Q. Were any -- this is -- you say it's totally voluntary. You did not do any audit function to determine the accuracy of this data yourself?

A. That is correct.

MR. YALE: I think at this point, Your Honor, I don't have any other questions.

THE JUDGE: Very well. Other examination?

MR. WELLINGTON: Good morning. Bob Wellington for Agri-Mark Dairy Cooperative.

THE JUDGE: Very well, Mr. Wellington.

EXAMINATION

BY MR. WELLINGTON:
Q. Charlie, first of all, thank you for conducting this study. It's always been very helpful to the co-ops around the country. This time around with this study, were the number of plants that were surveyed typical to the number in the past or was it greater or less than?

A. It is greater than in the past.

Q. A significantly greater number, to your knowledge?

A. Yes.

Q. Thank you. When you were asking for information on the condensing operations, in particular, were you asking for any information about the particular type of condensing operation? By that, I mean removing just the water, keeping all the milk solids, or removing the water and separating out the milk solids like protein and lactose. Did you break out those types of plants?
A. I have a page specifically for condensing costs. If they indicated that it's for -- if they indicate the cost involved filtration, I did not include the plant.

Q. Thank you. Are the costs of handling cheese beyond the point of when cheese is manufactured and put in its whatever original form, whether it be a 40-pound block, paper package or a barrel or whatever, are the costs of handling that cheese after that point, is that included in your --

A. No.

Q. No? Are the costs of aging the cheese included?

A. No.

Q. No? Are the cost of any retail packaging, packaging or anything else that's involved?

A. No.
Q. Or marketing any products?
A. No.

Q. So you had said that you agreed with Mr. Yale that the extra quality comes with a higher price. But would you agree that the extra quality also comes with a higher cost than reflected in your study?
A. That is correct.

Q. Thank you.

THE JUDGE: Mr. Schad. Would you identify yourself and spell your name for the hearing reporter, please.

MR. SCHAD: Yes, my name is Dennis Schad. S-C-H-A-D. May I have -- I would like to put two exhibits in. May I have the exhibit numbers?

THE JUDGE: They will be 19 and 20.

Mr. Schad, are you here today for Land O'Lakes?

MR. SCHAD: I am.

[Whereupon, Exhibits 19 and
20 were marked for identification by the
judge."

MR. SCHAD: Charlie, Dr. Ling, thank
you for coming, and thank you for what
you've done for --

THE JUDGE: Just for clarification,
Exhibit 19 is 1998 Dairy Product Plant Costs
USDA/Cooperative Programs Technical
Assistance Project. Exhibit 20 has that
label with paren, California plants not
included.

EXAMINATION

BY MR. SCHAD:

Q. I would ask you to turn to Exhibit
19. And would you identify Exhibit 19.
Have you seen this before?

A. That's the result of 1998 dairy
product plant cost study I did, and I
believe was entered into the 2000 hearing
record.

Q. You are correct. It was entered as
an exhibit within the 2000 Class III-Class IV hearing. Would you -- and I call your attention only to the columns for butter and powder. Would you read for me the simple -- okay, strike that.

Would you also go to Exhibit 20. Would you identify that exhibit.

A. Exhibit 20, it's the same study without California plants included in the calculation. Two butter powder plants were excluded.

Q. And 2005, did I come to you and point out to you that there were two California plants that were included in the 1998-1999 survey that was put into evidence in the last hearing?

A. That is correct.

Q. Did you subsequently run the same numbers but exclude the California plants in your calculations?

A. At your request, I did that after I
got permission from the cooperative that owned the two butter powder plants.

Q. And Exhibit 20 reflects that -- the 1998-1999 cost without the two California plants?

A. That is correct.

Q. So if we go across, I would like to point a the couple places where there are differences between the two exhibits. Is it true that the simple average butter price, when you have seven plants, was 13.603, and it was -- when you only had five, it was 14.938?

A. That's for the simple averages, correct.

Q. Right. And also, the butter -- the butter cost also increased when you took the two California plants out?

A. That is correct.

Q. If you looked at the pounds per product per plant, which is a measure of
plant size, loosely, I would assume?
A. Correct.

Q. Would you agree with me that the original exhibit that was given to USDA had 23.8 million pounds butter plant, and it decreased to 19.6 million pounds?
A. That is correct.

Q. And also, on the powder side, you also saw a 38.8 million pound average plant -- average production size to 29.1?
A. That is correct.

Q. And if we go down to the weighted average cost, the weighted average cost for butter originally submitted was 10.6. It is now 11.2?
A. That is correct.

Q. That's -- if you did the math, that would be a 6 percent increase in cost?
A. All right. If you say so, yes.

Q. Okay. And also, the powder cost, originally submitted at 12.7 cents, it is
now 14.5 cents, rounded. That would be also, if you did the math, a 14 percent increase in cost?

A. If you say so, yes.

Q. Would you want to comment on the significance of the differences a person -- given your role as a -- collecting these costs from cooperatives, would you say that this is a significant result?

A. It depends on how you define significant. That's a very -- my job is to present effects, and I don't pass judgment on the numbers I present.

Q. Thank you very much.

A. You are welcome.

THE JUDGE: Other questions of this witness? Mr. Beshore.

EXAMINATION

BY MR. BESHORE:

Q. Marvin Beshore. Dr. Ling, just a question or two. Was the methodology that
you used in your 1998 study reflected in Exhibits 19 and 20 the same methodology that you used for your 2004 study?

A. That is correct.

Q. And was the information that you requested of the cooperatives the same in 2004 as in 1998?

A. The co-ops request -- made the request to me were the same as in 1998. So everything stayed the same as in 1998.

Q. Okay. And as we can observe, the cost categories were the same from year to year as well?

A. That is correct.

Q. Okay. Thank you.

THE JUDGE: Mr. Rosenbaum. Just identify yourself again, please.

MR. ROSENBAUM: Yes, sir. Steve Rosenbaum for the National Cheese Institute.

EXAMINATION

BY MR. ROSENBAUM:
Q. Dr. Ling, I just want to -- maybe --

I would like to get a little more detail

about some of the costs that are excluded

based upon your survey methodology, what you

list on the bottom of page 1 of your

statement. So maybe if you could just take a

look at that, on the first page of Exhibit

18.

A. Page 1?

Q. Yes, the first page at the bottom.

And you state that you have excluded milk

procurement costs?

A. That is correct.

Q. And you had done that with respect

to the survey as to what you testified back

in the 2000 hearings as well, correct?

A. That is correct.

Q. And so that, for example, if the

cooperatives that participated in this survey

have field men who go into the field and

help participate in the procurement of milk,
those costs are excluded in the calculations that are set forth on the table to your exhibit, correct?

A. That is correct.

Q. And you would agree with me that that's a necessary cost of an operation, correct?

A. That is correct.

Q. It is simply beyond the scope of your survey?

A. That is correct.

Q. And then another issue you identify as being excluded from your survey is administrative costs, correct?

A. That is correct.

Q. And you helpfully provide, at the top of page 2, some further detail that administrative costs in this context include plant office, plant manager and corporate overhead, correct?

A. That is correct.
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1 Q. And so, once again, you would agree
2 that these are costs that are necessary
3 costs of operations, correct?
4 A. That is correct.
5 Q. But they are excluded from your
6 survey and, therefore, not included in the
7 costs that are set forth on the last page of
8 your exhibit?
9 A. That is correct.
10 Q. Once again, that's the same thing
11 you did back in 1998?
12 A. That is correct.
13 Q. Another issue that you note as being
14 excluded from your survey is what you term
15 interest, correct?
16 A. Yes.
17 Q. Now, obviously, it takes capital to
18 purchase a plant and the equipment in a
19 plant, correct?
20 A. That is correct.
21 Q. Which might hypothetically be raised
1 by borrowing, correct?
2 A. That is correct.
3 Q. And in that context -- and that's
4 the context in which you are using the
5 phrase interest here. Is that right?
6 A. That is correct.
7 Q. Would you agree you could also
8 describe that as capital costs?
9 A. That is correct.
10 Q. And once again, that is excluded
11 from your survey and, therefore, excluded
12 from your numbers that appear on the last
13 page of the exhibit, correct?
14 A. That is correct.
15 Q. And then one issue that you didn't
16 mention explicitly but, I mean, I think it
17 is probably implicit, is marketing costs
18 with respect to the finished product,
19 correct?
20 A. That is correct.
21 Q. That is an item that is not covered
1 by your survey, correct?

2    A. That is correct.

3 Q. But nonetheless, a necessary cost of
4 the plant operation, presumably?
5 A. That is correct.

6 MR. BESHORE: That's all I have.
7 Thank you.
8 THE JUDGE: Other questions of Dr.
9 Ling? Mr. Vetne. Just identify yourself
10 again.
11 EXAMINATION
12 BY MR. VETNE:
13 Q. Good morning, Dr. Ling. John Vetne.
14 I'm an attorney for Agri-Mark.
15 Could you look at page 2 of your
16 statement, please. The middle of the page
17 you say, "For reporting cost data on cheese
18 plants, these two instructions replace the
19 previous Items 2 and 3."
20 My question on that is, did the
21 previous Items 2 and 3 apply to prior cost
A. That is correct.

Q. And the replacement applied to the '04 study, the replacement instructions?

A. Yes, that is correct.

Q. So there was a little bit different instruction in '04?

A. No, the instruction is exactly the same, maybe some area change.

Q. Okay. If a cheese plant in your study received some condensed or concentrated milk, do you know whether your study would include the costs of condensing or concentrating that milk off-site as part of the cheese make cost?

A. No, I do not. I don't have the number.

Q. Was there an instruction that would allocate a cost off-site, maybe a third party, to the concentration or condensing of milk before it hits the cheese plant?
A. Oh, I told them if they received condensed for putting in the milk, they should do it. But whether they do it or not, I have no way of knowing.

Q. Okay. Was your instruction that they do it based on their own condensing costs or somebody else's?

A. It is up to them.

Q. Your instructions also do not include -- intentionally do not include any shipping or transportation costs, is that correct?

A. That is correct.

Q. There are a number of cheese plants that do not process their own whey into dry weight products; is that correct?

A. That is correct.

Q. And the cost information that you elicited does not include the costs for those cheese plants of loading, transporting and unloading either whole or condensed whey
from Cheese Plant A to whey processing Plant B?

A. Well, I think in my instruction I said, if you receive whey or receive product before the processing, you should include the receiving cost in there. That's on the --

Q. That's on the receiving end?

A. Yes.

Q. But on the cheese side, on the cheese plant that does not make a whey -- dry whey product, the cost of -- the cost of loading the liquid whey or condensed whey and transporting the liquid whey or condensed whey for further processing into dry whey, those costs are not included?

A. That is correct.

Q. And in the 2004 data that you reported today in Exhibit 13 -- is that what it is? Exhibit 18. Those data do not at this time include any California plants; is
1 that correct?
2      A.    That is correct.
3      Q.    In response to a question by Mr.
4 Yale about balancing, you responded most of
5 the plants balance?
6      A.    The powder plants.
7      Q.    Pardon?
8      A.    Butter powder plants.
9      Q.    The butter powder plants are the
10 primary balancers; is that correct?
11      A.    That's most of them.
12      Q.    Okay.
13         MR. VETNE:  That's all I have.
14         THE JUDGE:  Other questions of Dr.
15         Ling?
16         Very well, Dr. Ling.
17         Excuse me. Mr. Miltner.
18         MR. MILTNER:  Ryan Miltner on behalf
19 of Select Milk Producers, Continental Dairy
20 Products and Dairy Producers of New Mexico.
21         EXAMINATION
BY MR. MILTNER:

Q. Dr. Ling, this survey that's been done now for 20 some years did not originate as a survey to set make allowances, is that correct?

A. That is correct.

Q. Until 1998, it was never used to set make allowances; is that correct?

A. Say that again.

Q. Until 1998 or 1999, the data was never relied upon to set make allowances?

A. That is correct.

Q. And you answered in response to a question from another participant that participation in the survey in the most recent year was much higher than in the past; is that correct?

A. For 2004.

Q. Yes.

A. That is correct.

Q. Was the participation significantly
higher than in the past, the number of plants participating?

A. Again, it is depending on what --

how you define significant.

Q. Okay. It is probably in the data,

but can you give us some numbers as to

historically how many plants participated

and how many participated in 2004?

A. I noticed that 2004 numbers are

higher, but for previous year I have to look

at the numbers to tell you.

Q. But it was enough of a change that you noticed it?

A. I have to do more work, we have more

plants, so I notice it.

Q. Thank you. And this survey is voluntary, right?

A. That is correct.

Q. The cooperatives are not obligated

to participate in the survey?

A. That is correct.
Q. The nine cooperatives who did participate in the survey in 2004, do you know if those cooperatives submitted data for all of their Class III and Class IV plants?

A. To my knowledge, yes, but I'm -- I am not one hundred percent sure.

Q. But you do believe that those cooperatives didn't pick and choose among their plants, they submitted data on all of them?

A. That is correct.

Q. The cooperatives that participated, they consented to you releasing the information you have included in Exhibit 18?

A. That is correct.

Q. Did they consent to you releasing the ranges of data in each of the categories on Exhibit 18?

A. I asked them to -- they gave permission to me to testify and explain my
Q. Okay. If we asked you to provide the highs and lows, the ranges for each of the categories and the summaries, would that be information you would be able to provide for us before the end of the hearing?

A. You want the range?

Q. Yes.

A. For the specific cost items or just the average?

Q. I would like it for each number on the chart. Not right now, obviously, but if that data is available to you and you can compile it for us before we all scatter across the country, that would be appreciated, without disclosing, you know, the individual plants, of course.

A. The highs and lows range?

Q. Yes.

A. I would think so, if so requested.

Q. Yes, I would like to make that
request. And if you can provide that for us, we appreciate it.

A. If there is no objection from the cooperatives participating.

MS. DESKINS: As long as you are not disclosing any information that you need to keep confidential due to agreements with the co-ops.

THE JUDGE: Sounds, Mr. Miltner, like it is a qualified yes.

MR. MILTNER: Yes. Thank you.

BY MR. MILTNER:

Q. I just want to touch on one question that Mr. Yale asked. He confirmed with you that these numbers are not audited?

A. That is correct.

Q. What assurances do you have that the data provided to you is accurate?

A. It is -- I was requested to do it for purpose of comparing their operations for their management purposes. On that
basis, if they have to spend time and cost in correcting the data and submit it to me, I -- that's my assurance that they want the numbers accurate and correct.

Q. So you rely on the good faith of those participating in the survey?

A. That is correct.

Q. Have you ever found yourself in a situation where a number didn't add up or you had a question about the data that was submitted to you?

A. If I do, I will go back to them and figure out why the number is incorrect.

But, no, no, I think what you are getting at is probably funny numbers in there. The answer is no.

Q. You usually -- if there is a question in your mind, that's usually resolved to your satisfaction?

A. That is correct.

Q. I don't want to bring up a whole lot
of what happened several years ago, but in your testimony at the last hearing on this issue, there was a question similar to the one I just asked, about problems with numbers that you thought may have been out of line. And I would be paraphrasing, but did you say something to the effect of when you follow up and the response you get from the cooperative is cool, you just run with the numbers you have?

A. That would depend on my judgment at the specific time, whether it is -- if it is justified or not.

If it is not, I kick them out of the report.

As I stated in my -- as I stated in my Exhibit 18, this year I didn't include one butter plant, I took powder plant out of the report.

Q. Okay. Do you ever find yourself in a situation where you are trying to follow
up and verify numbers and you don't -- you
are unable to satisfy yourself as to the
accuracy or validity of the numbers?

A. If that happens, I don't include them in my report.

Q. Okay. The data that you collect, is there any information provided by the participants on the profit or loss of their plant?

A. I don't understand your question.

Say it again.

Q. Sure. A plant provides you information on its costs. Do they also provide you with any information as to the profitability of that plant for making that specific product?

A. No.

MR. MILTNER: I don't have any other questions. Thank you, Dr. Ling.

THE JUDGE: Mr. Vetne.

EXAMINATION
BY MR. VETNE:

Q. John Vetne for Agri-Mark.

To add some clarity to your answer to the last question, the -- in the case of Cheddar in 40-pound blocks, for example, the product that you are studying for cost of making is 40-pound blocks off the cheese vat, ready to do something else with, correct?

A. That is correct.

Q. If the product a plant is making is cheese for aging and the plant makes -- you know, ages the cheese, that's not the product that you studied. You studied fresh Cheddar off the vat?

A. That is correct.

THE JUDGE: Other questions of Dr. Ling? Mr. Yale.

EXAMINATION

BY MR. YALE:

Q. Dr. Ling, do you recall what plants
reported in 2004 that did not report in 1998?

A. I have to go through the list to --

Q. Could that be provided later, I mean, in just a list? I mean, I don't know that it -- I would just like to have the information in the record. I don't have any follow-ups specifically.

A. I believe I can do it.

Q. And the other -- when the letter went out -- do you send the letter out to all cooperative plants requesting them to participate?

A. No, they send the request letters to me.

Q. So you don't know if there was any kind of an effort to increase the number of participates in 2004 by any organization or official or otherwise to get greater participation?

A. That is correct.
Q. Now, also, if you would look at Exhibit 20 and compare that to Exhibit, what was it, 18, I believe, is the cheese in Exhibit 20, the column, is that reflecting the same cheese as all cheeses in Exhibit 18 or is it reflecting any different types of cheeses?

A. It is all cheeses.

Q. Okay. And there was not only a difference in cost but there was also a difference in the yields, was there not, that you had implied?

A. That is correct.

MR. YALE: I have no other questions.

Thank you.

THE JUDGE: Very well. Mr.

Wellington.

EXAMINATION

BY MR. WELLINGTON:

Q. Bob Wellington at Agri-Mark.

Charlie, I understand now you are
going to be providing high and low ranges?

A. That is correct.

Q. When you provide those high and low ranges, is it going to be likely that there is going to be a zero as a low range for many of the categories?

A. Many of them will be zero. As I stated in my statement, you know, the -- it is page -- probably the third page.

Q. Okay.

A. The last point I made, when they -- when plants categorize the expenses into cost items, they -- different plans might do it differently. And sometimes, if they have no way of breaking out, they would put a zero there and assign it to something else. And so the low will be a lot of zeros, yes.

Q. But wouldn't that also affect the high in other categories where it went --

A. That's right.

Q. -- where that cost was put into?
1      A.    That is correct.
2      Q.    So it isn't necessarily a fact that
3 if a number shows up as zero, for example,
4 you look at cleaning supplies, it doesn't
5 mean a plant doesn't use any cleaning
6 supplies?
7      A.    That is correct.
8      Q.    But if you also look at a number and
9 it's very high for something like
10 miscellaneous, it could be because they put
11 that plant -- put those cleaning costs into
12 that category?
13      A.    That is correct.
14      Q.    Thank you.
15      THE JUDGE: Other questions?
16      Very well. Dr. Ling, it looks like
17 you may step down.
18      MS. DESKINS: Thank you for
19 testifying, Dr. Ling.
20      THE WITNESS: You are welcome.
21      THE JUDGE: Ms. Deskins, it is about
20 till. Do you want to start another
witness or do you want to take a break at
this time?

MS. DESKINS: Judge, I think we could
start. I have two people that want to
testify together. They could at least read
their statements. It's fairly short. Maybe
we could take them.

THE JUDGE: Very well. This is a
joint testimony?

MS. DESKINS: Yes. And the witnesses
are Kelly Krug and Venetta Reed.

THE JUDGE: This will be Exhibit 21,
Ms. Deskins.

[Whereupon, Exhibit No. 21
was marked for identification by the judge.]

[Whereupon, the witnesses
were duly sworn by the judge.]

THE JUDGE: Please be seated, and
if you would, Mr. Krug, and then Ms. Reed,
give your name to the hearing reporter and
spell your last name.

WITNESS KRUG: My name is Kelly Krug. K-R-U-G, K-E-L-L-Y.

WITNESS REED: My name is Venetta Reed, R-E-E-D. First name, V-E-N-E-T-T-A.

EXAMINATION

BY MS. DESKINS:

Q. Mr. Krug, it is my understanding that you have a prepared statement?

A. Yes, I do.

Q. Would you like to read that?

STATEMENT FOR THE RECORD BY KELLY KRUG

A. Kelly Krug. I'm Director of Marketing Services for the California Department of Food and Agriculture. Thank you for the invitation to give a statement regarding the California Department of Food and Agriculture's use of manufacturing cost allowances. With me is Venetta Reed, Supervising Auditor from our agency who is
prepared to give a more detailed summary and overview of the process of acquiring and posting manufacturing cost data for California manufacturing plants.

One of the functions within our division is to collect cost data from California manufactured milk processing plants on a voluntary basis. The level of cooperation from plants is very high and the studies cover nearly all the production of the intended products in the analyses we perform. California's end product diary pricing formula starts with the wholesale price for Grade AA butter, nonfat dry milk, and Cheddar cheese and subtract a manufacturing cost allowance to determine the value or the price for milk. It is customary for the Department to hold hearings generally in response to industry petitions to consider adjustments to pricing formulas including the values of the
1 manufactured cost allowances.
2
3 A key factor for Department determinations that may adjust the
4 manufacturer's cost allowances for the Class IVa and 4b pricing formulas is the
5 Department's work of conducting annual
6 manufacturing cost studies to ascertain
7 processing cost for butter, nonfat dry milk
8 and Cheddar cheese. The Department has a
9 longstanding history relying on processing
10 cost study data combined with relevant
11 economic supply and demand factors to
12 update the manufacturing cost allowances for
13 butter, nonfat dry milk and Cheddar cheese.
14 Additionally, in 2003, for the first time the
15 Department also added a make allowance
16 factor for dry whey. At public hearings,
17 interested parties are given an opportunity
18 to provide testimony and evidence regarding
19 manufacturing cost data and any relevant
20 economic factors that should be considered in
evaluating appropriate level of the manufacturing cost allowances.

Toward the goal of keeping the Department's cost studies as relevant and accurate as possible in 2002, we employed a private accounting firm with experience in the field of cost accounting to review the work of our dairy manufacturing cost unit. Following an extensive examination, the firm determined the methodology the Department has been using is sound and follows customary cost accounting techniques.

And at this time, if it's your pleasure, Venetta Reed is prepared to provide a more detailed summary of how we conduct dairy manufactured cost studies.

THE JUDGE: Ms. Reed's statement has been marked as No. 22.

[Whereupon, Exhibit No. 22 was marked for identification by the judge.]
STATEMENT FOR THE RECORD BY VENETTA REED

WITNESS REED: My name is Venetta Reed. I am Supervising Auditor of the Manufacturing Cost Unit for the Dairy Marketing Branch of the California Department of Food and Agriculture. I have worked in the dairy cost accounting for 20 years.

The Department has been responsible for collecting and publishing manufacturing costs on butter, nonfat dry milk powder and cheese for over 35 years. Due to changing trends in the dairy industry the Department started skim whey powder cost collection in the 2003 cost study period.

The criterions for product costs are for cheese 40-pound blocks of 500 pound barrels, butter 25kg and 68 pound blocks, nonfat dry milk powder is 25kg bags and 50-pound bags, and skim whey powder is 25kg bags. The Department categorizes costs in the following line items: processing labor,
processing nonlabor which includes costs such as utilities repairs and maintenance, supplies, depreciation and rent, packaging other ingredients, general and administrative and also return on investment.

The published costs are compiled from manufacturing plants on a voluntary basis.

These are not mandatory audits. The 2004 cost study by period represented 99.9 percent of butter production, 98.5 percent of Cheddar and Monterey Jack cheese production, 99.17 percent of nonfat dry milk powder production and 79 percent of skim whey powder production in California for the year of 2004. Information is gathered annually from manufacturing plants to cover the prior 12-month period. The areas covered in the cost study are:

RECEIPTS IN USAGE:

The receipt portion is all raw milk and other dairy products into the plant from
all sources which is used in the manufacturing process. Receipts of milk products include the total pounds, butter fat pounds and solids nonfat pounds. The usage section is an account of all products processed from the received milk for the period covered.

The records used are the monthly Milk Pooling branch 800 report, or the companies work papers used to compile the 800 report. For finished product information we use the plant's production records.

PAYROLL:

Labor is a major factor of processing costs. Therefore, the auditor must ensure that all labor costs are included in the study. This will include the confidential payroll and bonuses of the executive staff. Total gross wages must be picked up for each employee including
vacation, holiday, sick, jury duty, et cetera, to reflect the entire process period. Payroll taxes and fringe benefits such as pensions, health and life insurance are computed on the basis of the most current rates available at the time the field work is conducted. The expenses recorded in the company's general ledger for fringe benefits and payroll taxes are adjusted out and replaced by the more current computed amounts. The most current rate and experience factor for Workers' Compensation insurance is used unless the company is self-insured. For a self-insured company, the expense found in the trial balance is allocated based on the number of employees in each payroll category.

FUNCTIONAL ANALYSIS:

A tour of the plant is made prior to compiling the functional analysis. During the plant tour, various operations are noted,
including the different types of machinery,
their production capability, number of
staff required to run each machine and the
number of days and hour in which they
operate. To determine and distribute each
employee's percentage of time, a list of each
employee for the period of the study is
forwarded to the plant manager or one of the
direct supervisors to distribute the
employee's percentage of time spent in each
Department.

DEPRECIATION:

It is the policy of the dairy
marketing branch that all cost studies should
use the straight line method for computing
depreciation expenses. The policy requires
the use of acquisition date and the original
cost of the asset with no salvage value.
However, for the 2005 year studies, a
salvage value of 10 percent of the original
cost will be retained. The records received
are a complete listing of the plant's assets.

RETURN ON INVESTMENT:

The return on investment allowance represents how much interest income the company could earn if their capital was not tied up in land, buildings and equipment. All long-term interest expense is adjusted out of the company's books. The return on investment allowance replaces long-term interest. However, short-term interest remains on the company's books as an interest expense. A remaining book value figure for each asset is calculated by subtracting accumulated depreciation from the original cost of the asset. The remaining book value is then multiplied by a weighted annual Moody's BAA Bond Index rate to arrive at a return on investment allowance.

GENERAL LEDGER:

The general ledger section of the
1 cost study includes all of the expenses
2 incurred by the handler during the cost
3 study period. It is composed of an audited
4 trial balance, a schedule of adjustments, an
5 analysis of those accounts determined by the
6 auditor for certain consideration. A report
7 of general ledger accounts and amounts for
8 the study period are forwarded to the
9 auditor usually by the CFO or the senior
10 accountant. Utility invoices are also part
11 of the record collection for the general
12 ledger.
13 RAW PRODUCT:
14 The raw product component is
15 included in the cost study but it is not a
16 part of the total processing costs except
17 for nondairy ingredients. The milk portion
18 of raw product cost is computed using the
19 component pricing for butter fat and solids
20 not fat on an average for the year published
21 by the dairy marketing branch.
PACKAGING:

Packaging expenses are set up in the cost study as a separate component cost for each product broken down by individual sizes. Thus, packaging supplies expense is eliminated from the general ledger.

Packaging costs are determined based on the latest available invoice price, plus freight, less discounts, if any. Total cost include all nonreusable items used in the packaging of the product such as boxes, bags, cartons, liner, tape, glue and stretch wrap.

Now, these are compiled summary pages but also a part of cost study.

PROCESSING LABOR:

The processing labor section allocates to finished products the total wages, payroll taxes and fringe benefits of all plant employees. These labor costs are brought forward from the payroll and functional analysis section to the labor
distribution schedule.

PROCESSING NONLABOR:

Processing nonlabor costs include all direct and indirect plant expenses except those pertaining to payroll cost. The analyses of these expenses are contained in the general ledger, but the final expense allocation to the various products is usually completed in the processing nonlabor section.

GENERAL AND ADMINISTRATIVE COSTS:

General and administrative costs include all the expenses incurred at the direction, control and management of company. Included in those costs. I'm sorry -- included in those expenses are all payroll costs associated with the administration of the business such as office clerical wages and executive salaries. Examples of other G&A expenses are office supplies, short-term interest, dues and subscriptions, accounting
fees and headquarter charges.

The final schedule in the cost study called a summary of unit cost. It combines all the various costs from other sections of the cost study into final cost figures for each dairy product.

MS. DESKINS: Judge Davenport, I have one more exhibit that I would like to have marked and have Ms. Reed identify.

THE JUDGE: It will be Exhibit 23, Ms. Deskens.

[Whereupon, Exhibit No. 23 was marked for identification by the judge.]

BY MS. DESKINS:

Q. Ms. Reed, could you identify what Exhibit 23 is.

A. Yes, it's the information that we put out at the end of each cost study period to inform everyone of the cost for each product, and it includes butter powder, cheese and whey powder.
Q. And this is available on your web page?
A. Yes, it is.
Q. I only have four copies of this. So what I would like you to do is read what the heading is of each table so people know what the document is.
A. Okay.
Q. Just start out with the one I handed you that's been marked as Exhibit 23.
A. Okay.

THE JUDGE: Just as a suggestion, Ms. Deskins, she might also read into the record at this time the web page.

BY MS. DESKINS:
Q. Yes. Could you give the web page where this statistical information is available.

WITNESS KRUG: The website is www.cdfa -- www.cdfa.ca.gov/dairy.
Q. And just for the record, can you tell us what CDFA stands for?

WITNESS KRUG: California Department of Food and Agriculture.

Q. If you could read what the caption is for each table so that people will know what it is.


The next table is, Butter Processing Costs, Released November 2005.


Cheese Processing Costs, Released November 2005.

And Skim Whey Powder Processing Costs, Released November 2005.

Q. Now, the first page of Exhibit 23 is
a letter from you to all interested parties?
[The following answers were made by Witness Reed.]
A. Yes.
Q. Regarding the information that's attached?
A. Right, yes.
Q. Has there been any updates to the material that's contained in Exhibit 23?
A. Yes, there has.
Q. Could you please tell us what it is?
A. Yes. There was an update to the powder processing cost page. There was a change on -- in the processing labor area and the general administrative areas.
Q. Can you tell us what -- what would be the caption of the page in Exhibit 23 that they would refer to?
A. Nonfat Powder Processing Costs. And on yours, it will say, Released November 2005.
Q. And this is the first table, is that correct?

A. No, it is not. It is the powder -- it would be the third.

Q. Okay. And can you -- now, the update is available on your web page, is that correct?

A. Yes, it is.

Q. And can you just tell us for the record how it changes the information that's in Exhibit 23?

A. Okay. The first change will be on the -- at the bottom of the page, under Processing Labor, on the low cost line, yours currently says .0327. The change is .0291.

The next change would be on that same row, under General and Administrative. Your copy says .0099. The correct number now is .0089. That would then change the weighted average cost under Processing Labor from
.0364 to .0342, and it will change the weighted average line under General and Administrative from .0112 to .0106, which would then change the total weighted average cost from .1571 to .1543.

Oh, and also on that same line, under Total Cost, on the low cost line, it was .1419, and it is now .1373.

Q. Everything contained in Exhibit 23 other than, of course, your first page, which is the letter, are statistics that are maintained by the California Department of Agriculture?

A. I'm sorry. Could you repeat.

Q. Everything that's contained in Exhibit 23 except for, of course, the first page, are statistics that are maintained by the California Department of Agriculture?

A. Yes.

MS. DESKINS: Your Honor, at this time, I would move for the admission of
1 Exhibits 21, 22 and 23.

2 THE WITNESS: There will be also a
3 change on the weighted average manufacturing
4 cost of the first report.

5 BY MS. DESKINS:

6 Q. Okay. And that's in Exhibit 23?
7 A. Yes, the very first one titled,
8 Weighted Average Manufacturing Costs for
9 Butter, Nonfat Powder, Skim Whey Powder and
10 Cheddar Cheese, 1989 through 2005. The
11 change would then be in the powder, the
12 nonfat powder, because that's the cost per
13 pound. And on yours, it is going to say
14 .1571. It is now .1543.
15 Q. Again, these updated figures are
16 available on your web page?
17 A. Yes, they are.
18 MS. DESKINS: Your Honor, at this
19 time, I would move for the admission of
20 Exhibits 21, 22 and 23.
21 THE JUDGE: There appears to be no
1 objection. They are admitted into evidence
2 at this time.
3 [Whereupon, Exhibits No. 21, 22 and 23 were received in evidence.]
4 MS. DESKINS: I have no further
5 questions of these witnesses. I do
6 appreciate their testifying at this time.
7 THE JUDGE: It does appear that the
8 noon hour is upon us. What is everyone's
9 pleasure for the length of time that you all
10 would like for the lunch break?
11 MEMBER OF THE AUDIENCE: We need at
12 least an hour and a half.
13 THE JUDGE: An hour and a half has
14 been suggested.
15 Mr. Beshore, is that okay with you?
16 MR. BESHORE: That's fine.
17 THE JUDGE: Mr. Vetne.
18 MR. VETNE: Yes.
19 THE JUDGE: Anybody else? All right.
20 We'll be back at 1:30, then.
[Whereupon, the hearing recessed at 12:03 p.m. and reconvened at 1:27 p.m.]

THE JUDGE: Mr. Krug, Ms. Reed, you are still under oath. Is there any examination of these witnesses? Mr. Yale?

MR. YALE: Yes.

THE JUDGE: Mr. Yale, as before, if you would, please identify yourself one more time.

MR. YALE: Benjamin F. Yale on behalf of Select Milk Producers, Continental Dairy Products and Dairy Producers of New Mexico.

THE JUDGE: Thank you, sir.

EXAMINATION

BY MR. YALE:

Q. Good afternoon.

[The following questions were answered by Witness Reed.]

A. Good afternoon.
Q. It's nice to be able to ask questions instead of having to answer them.
I've got a couple questions regarding the study that you do. The comment is made is that it's voluntary, the plants can choose or not choose to participate in the program. Is that correct?
A. Yes, that is correct.
Q. But once they choose to do so, your office does a very thorough audit to make sure those numbers are correct?
A. Well, we do a cost study.
Q. Okay.
A. But the figures that we use in our cost studies have been audited by their auditors prior to us using the figures.
Q. And in that process of doing that cost study, do you have a program to make sure that, whether inadvertent or intentionally, that numbers are added or subtracted from their -- the numbers that
they give you? In other words, do you have a process to make that you see all the information?

A. Well, yes. We see everything that is needed to reconcile the figures for the information that we are gathering, yes.

Q. When you do this -- you used the word reconciliation. Do you do a reconciliation to their audited numbers?

A. In some instances. In some instances, there are other areas of the cost study where we look at, for instance, utilities, where we look at invoices and we audit back to the actual cost, not what is in their general ledger. So there are areas that are -- where we take their audited figures and reconcile back, and then there are those that we do not.

Q. I guess to come back to a point, you mentioned this report, and I think it was an MP800 or some kind of report that they
prepare. You do some verification to ensure that those numbers are correct?

A. The milk pooling branch does audits, and they audit those figures to make sure that those figures are correct before we go, yes.

Q. Now, I notice in your -- I guess this is directed to Mr. Krug.

Mr. Krug, your -- you make the comment, and I think it is also part of the report, that -- I guess it is in your -- it mentions Monterey Jack. Could you explain or, maybe it is, you, Ms. Reed, that needs to explain the difference -- you know, you include Monterey Jack in the analysis, as well as cheddar. How does that factor into the numbers?

WITNESS REED: Well, in the production, if the plants have Monterey Jack cheese, also, it is accounted for in the number for the -- you know, for the total
production of the cheese.

So basically, the way that -- the reason that they do -- that we do that is because the process is basically the same. And that's why it's included in the total production when it comes to cheese cost. So they -- but they might have other types of cheese, but none of those would be accounted for in the total production of cheese.

Q. Is the Monterey Jack included in your yields or in your total production of cheese that shows up on the report?

A. That's just cheddar.

Q. That's just cheddar?

A. The yields.

Q. So the assumption is, is that if you are making Monterey Jack or you are making cheddar, the cost is the same?

A. That is right. Yes, that is right.

Q. Are there any other cheeses that you considered in this process? Are those the
only two?

A. Those are the only two.

Q. Now, do any of these plants produce cheeses in addition to those American style, these cheddars and Monterey Jacks?

A. Yes.

Q. And how do you separate those out?

A. Well, we get all of production records, so we have to account for anything that is produced, because we have to account for the usage of the milk.

So basically, after we have given an amount to -- you know, to -- of how much milk was used and gone to those types of cheeses, they are not costed out, but they are shown on the usage portion of the receipt in usage just to account for where the milk went.

Q. And so you say -- you started talking about -- do you do a mass balance?

Do you know what I mean by the term mass
balance?

A. No, you can explain it to me.

Q. Well, if you don't know what it is, then I'm not going to follow up on the question now. Maybe later I could explain it, though.

So, in other words, you look at the plant and you do a process to determine the amount of milk that goes into non-American style cheeses, separate that out and then also try to ascribe the costs that are associated with that process?

A. Yes. Yes, the cost will go to those, also. Like I say, we don't cost them out, nor are they on the exhibit, but we do follow the cost all the way through because, you know, the dollars will be allocated to those types of cheeses as well as the Cheddar and Monterey. But we are only interested in costing those two types of cheese.
Q. Now, I think you indicated that all but just a small portion of the cheese produced in California of cheddar and Monterey Jack is subject to this cost analysis; is that correct?

A. Well, yes. We accounted for 98.5 percent of the Cheddar and Monterey Jack produced in California.

Q. Are these all cooperative plants?

A. No, they are not.

Q. Do you know what the percentage is that's cooperative and what percentage is proprietary?

A. Not off the top of my head, no.

Q. I think your testimony was you actually make an inspection. So you physically have reviewed the plant to see to it how the process works so you can tie that into their costs?

A. Yes, that is correct.

Q. Now, I kind of want to change
subjects here a little bit and kind of talk about the California system. You also, not necessarily you, personally, but CDFA also does an analysis of producer cost as well, do you not?

WITNESS KRUG: Yes, we do.

Q. And is that number considered in the process of making the decision of what the make allowances would be?

WITNESS KRUG: It is setting the formulas that's considered but not necessarily the make allowance.

Q. Right. In other words, you have a make allowance that you determine based on the audit. But the make allowance within the formulas that you use, that decision is based upon factors other than just what these audited make allowances are. Is that a correct statement?

[The following answers were given by Witness Krug.]
1 A. Yes.
2 Q. And what are some of those other factors?
3 A. Supply, demand, relationship between classes. There are many factors that are considered.
4 Q. So it becomes a policy decision at some point. Is that correct?
5 A. Yes.
6 Q. It is not a mechanical process?
7 A. Correct.
8 Q. Now, in California, do the cheese plants have to pay the state minimum prices that you guys set by your formulas, the state minimum prices?
9 A. For market milk, they do.
10 Q. For market milk? And what is market milk?
11 A. Market milk is milk that is used in the higher classes but can also be used in all classes of milk. There is a distinction
with Grade B or manufactured milk, which is -- has restricted use in lower class.

Q. Market milk is equivalent to our Grade A?

A. Similar to Grade A.

Q. Similar to Grade A. So a cheese plant in California doesn't have the option to purchase milk under these minimum prices if it wishes to?

A. Yes, they do if they use manufacturers' milk.

Q. But if they -- market grade milk, they don't?

A. That is correct.

MR. YALE: One second.

BY MR. YALE:

Q. In the -- have you also done a study to analyze the actual prices at which producers sell -- or not producers, plants sell their product for?

A. We do many studies. Maybe you could
be a little more --

Q. I believe there was a report that was presented not too long ago where you compared it to the CME, prices at which the plant was selling some of the cheeses?

A. Well, that possibly could have been done with the last make allowance hearing that we did.

Q. And the reason for that study was what?

A. Well, I don't have in mind the exact study that you are referring to. I am generally aware that we have done studies like that at times when we have had our hearings open for make allowance for Class IV before A. And I think the ones I am familiar with have to do with, you know, transportation issues. Anyway, just general formula levels and some of the other considerations that were taken into account for policy setting reasons.
Q. Now, the -- at this website that you mentioned today, there is a link that would take one to the price formulas that you used in your current minimum pricing; is that correct?

A. Yes. The website was just updated, and I haven't looked at it. Since it was updated, I assume it has a link to the formula explanation.

Q. And in your cheese formula, do you have a yield for all the cheese or do you have a yield like you do in the federal, where they look at the butter and the protein? Do you just do all the solids, not fat, or do you break it down between butter and protein?

A. We have a butter component and a solids component.

Q. And is that butter component just for the whey butter?

A. I believe it is not. I believe it
is for -- it covers the fat portion of the
formula.

Q. You take so much a yield for the
protein and the yield for the butterfat and
--

A. Right.

Q. Okay. Now, on your exhibit of the
California numbers, rather the cheese
processing costs -- I think it's Exhibit 23
-- you have specific yields that you have
averaged out. I think it is noted in
footnote No. 8. Do you see that?

A. Yes.

Q. Now, that -- first of all, my
question is, that's strictly cheddar cheese?

A. Yes, it is.

Q. And you also indicate that that's
with a 4.02 percent fat and a 9.05 percent
solids nonfat in the vat?

WITNESS REED: Yes.

Q. Now, does your formula -- are you
recognizing the fact that whey butter and butter is recycled in the processing system for your formulas for this yield?

[The following answers were given by Witness Reed.]

A. Well, the formulas that -- the yields that are referred to on here are yields that come from information that we get from the plants. It is not a part of the formula or anything else like that. We get information from the plants on the finished yields for all of their different cheeses, basically.

Q. But you work this out for just the cheddar?

A. Yes, that is right. That's all that is.

Q. Now, you also note there, in paragraph or note No. 7, that 62 percent of the cheese was processed at a cost less than the manufacturing cost allowance?
A. Yes.

Q. Now, when you say manufactures cost allowance, is that the same thing as the total cost in the columns below?

A. The -- the 171, you are asking?

Q. Or the .1769?

A. Yes, that's the weighted average, total cost.

Q. So you are saying 62 percent of cheese is processed at a cost less than that?

A. At a cost less than the 171.

Q. The 171?

A. Yes.

Q. Okay. And which includes administration and return on investment; is that right?

A. Yes, it does.

Q. Do you do a profit and loss analysis of the plants to determine whether they are profitable or not?
A. No, we don't.

Q. Now, in your footnote 5, you talk about packaging costs that you use to adjust for the 500-pound barrels for the 640-pound blocks, okay. First of all, for those two, do you do an adjustment for the moisture that's in the cheese for the 500 pounds and the 640s?

A. No, there is no adjustment made.

Q. For moisture?

A. No.

Q. Okay. And how do you come up with the -- how do you make this adjustment? I assume that what you are saying here is you are taking the cost to produce 500-pound barrels and you are trying to equate it to what that would be if it was a 40-pound block. Is that right?

A. Yes, exactly. Basically, if the plants do not make 40-pound blocks and only make 500-pound barrels or whatever, all of
the other expenses are basically the same for a 40-pound plant or a 500-pound plant except the labor and packaging. So what is done is a weighted average of all those plants that do 40-pound blocks for processing labor and then also for packaging expenses. And then those figures are put into the expenses for the 500-pound plants, and then that is how we get a 40 pound price for that plant, okay.

Q. Would you be able to state what the range is from the smallest to the largest plant in this survey besides the cheese? I don't need to know the name of the plant, but the production of the smallest to the largest.

WITNESS KRUG: Only if it happened to be what the lowest is on our sheet. We are not going to go into any more detail than what we have presented in the exhibit.

Q. Now, how do you handle whey within the plant?
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WITNESS REED: Well, you need to maybe clear that up a little bit.

Q.  Let's back up. In the process of making Cheddar cheese, one of the by products is whey. Is that correct?

WITNESS REED: Yes.

Q.  And historically, or in the past, whey was a disposal issue; is that right?

WITNESS REED: Yes, it was.

WITNESS KRUG: In some cases.

Q.  In some cases. In some cases, it is still disposed. In others, it's turned into a product, a raw product or a finished product. Is that right?

WITNESS REED: Yes.

Q.  So how do you handle dealing with whey in this cost analysis?

[The following answers were given by Witness Reed.]

A.  Okay. If a plant does not process anything from its whey and it is just
disposed, then those costs are captured in their disposal fees, usually. They will have higher disposal fees, so that will be a nonlabor. Also, that plant loss will be then reapplied in receipts and usage. The plant loss would be reapplied to the cheese, low fat and solids nonfat.

In plants that process whey products, then there is usually very little disposal, and -- but they still have some, but there is little disposal fees, but those disposal fees still are, you know, applied in nonlabor.

And then the butterfat and solids nonfat associated with those products are tacked onto those whey products, not thrown back in the cheese if they are, you know, viable products.

Q. Like you did on the barrels, you know, the block barrels and 640s to the 40-pound blocks, do you do any adjustment between plants that have purely disposal of
whey to those who process whey?

A. No.

Q. I'm not familiar with California's environmental issues, but disposal of whey can be a very expensive process; is that right?

A. Extremely.

Q. Can you give us any percentage of plants in this study that dispose of their whey as opposed to process it?

A. Not without looking it up, no, I am not sure. They all have some, but not anything like it used to be.

Q. Looking at this whey, the skim whey processing cost, when you talk about skim whey powder, what is the percentage of dry matter that's used for that process? Do you know?

WITNESS KRUG: I'm not sure.

WITNESS REED: I'm not sure, either.

Q. Do you know what percent of that is
whey?

WITNESS KRUG: No.

Q. Now, in your nonfat dry milk processing, how do you account for dried buttermilk? Or do you account for dried buttermilk?

[The following answers were given by Witness Reed.]

A. If they make it, then we account for it. It would not be included in the nonfat dry milk powder; it would be separate. And we -- the same processes that we do nonfat dry milk powder, you know, it's from their production records, butterfat and solids nonfat. We get that information from them, and then costs are allocated to that, also, so that it is not put onto regular nonfat dry powder. But it's just the same way.

Q. So these yields or these prices are strictly and purely for the --

A. Nonfat dry milk powder only, yes.
Q. Now, in California, I notice you use the CME for your cheese, but how do you do -- what pricing series do you use for the nonfat dry milk?

WITNESS KRUG: We use a California weighted average price.

Q. And how is that computed or derived or collected?

WITNESS KRUG: Survey of sales from plants.

Q. And what percentage of sales are included in that?

WITNESS KRUG: Very high. I don't know the percentage, but it is -- it would be the vast majority of the market.

Q. I want to switch back over to the cheese operations. How do you deal with aged cheeses, aged Cheddars? Are those separated from these cheddars for shredding or are they all the same?

[The following answers were]
given by Witness Reed.]

A. They are basically all the same, because once they are made, we don't carry it out. I mean, we are not costing for the time that it sits in a warehouse and all that. So they are all basically the same.

Q. But you don't separate out the processing -- if it is cheddar, even though it is going to be made for aging, you treat that as if it's -- all cheddar is the same?

A. Yes.

MR. YALE: At this point, I don't have any questions. Thank you.

THE JUDGE: Very well. Other examination? Mr. Vetne.

EXAMINATION

BY MR. VETNE:

Q. Good afternoon. I'm John Vetne, attorney for Agri-Mark and Northwest Dairy Association.

In response to questions from Ben
Yale, the two of you, in dialogue, used the word disposal in relation to the whey byproduct produced by cheese plants.

My question is, when you were answering those questions, did you, in your minds, consider disposal to be land spreading or other disposal as waste or simply removal of the whey from the plant?

WITNESS REED: I didn't think of it either way. Disposal, basically, I consider it being removal of the whey from the plant.

WITNESS KRUG: Disposing of it.

WITNESS REED: Disposing of it.

Q. So in response to both questions, you were referring to cheese plants that do not process their own whey but do something else with it, correct?

[The following answers were given by Witness Reed.]

A. Well, I'm -- what I'm talking about is when they, in the past, disposed of it,
they did not sell it to anyone or anything.
They would just simply dispose of it in the sewer.

Q. Down the drain?
A. Yes.

Q. Currently, though, are you aware that there are plants in California making cheese but do not produce any whey products, that dispose of their whey by trucking it some place, either in whole or condensed form?
A. I know that there are plants that do not make whey products, yes, but what they do with it, I cannot answer.

Q. All right. Let me ask you this. Of the plants included in the whey survey, and there were three plants, are all of those plants plant that produce both cheese and a whey byproduct?
A. Yes.

Q. There were no -- you did not survey
any stand-alone whey plants?

A. No, I didn't.

Q. You didn't survey any milk drying plants that produce both nonfat dry milk and buttermilk powder and whey products?

A. No.

Q. Mr. Yale also asked you some questions from your survey. I think he referred to some questions about yield and the percentage of solids not fat and fat in the vat.

I wanted to ask you some questions about the vat numbers reported. Is it not the case that cheese plants in California receive milk that is either fortified with solids not fat or concentrated in some way delivered into their vat?

A. Well, they fortify them themselves, I know of. I don't know about receiving the milk. Some do receive some fortified milk, yes. I'll take that back.
Q. So the milk in the vat that is reported in your survey, and for the solids not fat percentage, 9 percent plus, would include the results of fortification, whether it was by the plant operator or by receiving concentrated milk?

A. Yes.

Q. And the 4 percent plus butterfat of milk in the vat would reflect receipts of cream?

A. Yes, it can.

Q. The average of -- in excess of 4 percent butterfat and combined with an excess of 9 percent solids not fat is higher than the yearly average component contents of producer milk, correct?

A. Yes.

Q. The survey data reported in exhibit -- what is the survey?

THE JUDGE: Exhibit 23.

BY MR. VETNE:
Q. Exhibit 23. Are all those costs as well as the bottom line data surveyed for the calendar year 2004, but reported in 2005?

A. Yes, the bottom line is for that only, for 2004.

Q. In the middle of the cover letter to interested parties, there is a notation, "In addition, the weighted average manufacturing for whey is shown for 2004 and 2005." How does 2005 enter into the survey when the release was made before the end of 2005?

A. One of the plants is not on a calendar year. We take 12 months, but it goes into the next year, basically. But we are going to change that for the future.

So that's just a -- they were a new startup plant, and we had to start where we could with collecting the information, basically.

Q. Okay. So one of the three months
was surveyed for 12 months, and the last --
and the twelfth month occurred in 2005?
A. That is correct.
Q. Do you know what month of 2005 that
was?
A. Let me read this again, okay? Hold
on. Okay. Just one second.
[Reviewing.]
It's November through -- would it be
February? I'm not sure. I'd have to think.
I'm not sure. I don't have it here. I'm
not positive. I'm not sure what the dates
are for that one particular place.
Q. You don't know what the last
reporting or last survey month is?
A. No, I don't because I don't have it
on here. I know which plant it is, but I
don't have the dates on here.
Q. Okay. Do you have any feeling on
how much time lapsed between the gathering
of that information from that plant and the
publication of the report? Do you have a range? I mean, how quickly would you be able to produce the numbers after you had the data?

A. Well, we gather the information -- like this year, we'll start probably in February or March, whenever they have their records available to us. And then the information is usually released, and I -- this might be in error. I need to really check this out. The information is then released in November of that year. So from March to November, basically.

Q. Okay. So it is usually released in about the middle of the fall. And when those numbers reveal a change in manufacturing costs, what is the lag between the release of that data and the implementation of that new cost information into the pricing scheme?

WITNESS KRUG: That really varies,
depending on the interest level, depending on
the size of the difference. The information
was released in November for the 2004, the
most recent year. Our Department hasn't
been petitioned to hold a hearing on this
matter at this point, about two months later.
So it really varies.

Q. So tell me if I'm correct, Mr. Krug.

Although CDFA gathers surveys, gathers and
reports the manufacturing costs information,
it is not automatically incorporated into
the pricing formula unless there is a
hearing?

WITNESS KRUG: A hearing would have
to be held. It's not automatic.

Q. Okay. And what is the ordinary time
between the close of a hearing and the
implementation of an amended price formula in
California?

[The following answers were
given by Witness Krug.]
A. It is approximately two months.

Q. And that includes consideration of posthearing briefs?

A. Yes.

Q. And it includes a panel making a recommendation to the policymaker, correct?

A. Yes.

Q. And then the policymaker takes that recommendation and either adopts it, modifies it or rejects it, correct?

A. That is correct.

Q. So it is the --

A. And it includes a 10-day notice to the affected handlers.

Q. A 10-day notice from the decision of the policymaker announcing a change?

A. Yes, from the close of hearing until implementation.

Q. There was reference to the 800 report by Mr. Yale or -- is that the California report of receipts and utilization
1 by regulated handlers?

2 WITNESS REED: Yes, it is.

3 I can answer your other question now.

4 I needed a few seconds to refresh my memory.

5 Q. The question being, what was the

6 last date of survey included in the whey?

7 [The following answers were

8 given by Witness Reed.]

9 A. Exactly. What this letter refers

10 to, it says, In addition, the weighted

11 average manufacturing for whey is shown for

12 2004 and 2005. These years are the years

13 that they are released, but the information

14 is for the prior year. So if it says 2004,

15 that's 2003 information. If it says 2005,

16 that's 2004 information.

17 So none of the information for whey

18 is of information from 2005, but it is

19 released in 2005. I just wanted to make that

20 --

21 Q. Okay. So it is all survey and cost
information predating January 2005?

A. Yes.

Q. As I recall, the gathering of the whey cost information started in the middle of -- not at the beginning of 2003. So it is not 24 months of whey data, but it is more than 12?

A. Well, each year -- 2004 represents 12 months, and 2005 represents 12 months, also.

Q. Talking about just the whey component of the cost studies and surveys. Did that not start --

A. Right.

Q. -- some place other than --

A. Yes, it is; 14 months, I think, on this particular one.

Q. Okay. I'm looking at page 2 of the 1989 to 2005 manufacturing cost summary. And I refer you to the 2001 release which has a footnote 2, which indicates a utility
cost adjustment being made for energy costs in August of 2001, which was probably about two or three months before the data was released.

As I read that footnote, maybe I should -- it would be -- I think it -- if it's what I think it means, it means for the year 2001, you used cost surveys through, what, 1999-2000. But for that one component, which is part of one of the lines, you made a very recent, current update. Is that correct?

WITNESS KRUG: Yes, it is.

Q. Okay. And that same process was used again -- let's see. It looks like footnote No. 4, which would be the 2002 release, cost data through December 2001, except for utility which, again, you drew a more recent number to reflect current utility costs.

WITNESS KRUG: And I believe, also,
wages, payroll, taxes, fringe benefits.

Q. Oh, you added a couple more -- again, more current updates of line items.

WITNESS REED: Yes.

Q. Was there anything happening in California to utility costs during those two reporting periods or release periods which caused you to isolate utilities to make a more current adjustment?

WITNESS KRUG: There was a lot of interest in especially energy costs changing rapidly, escalating rapidly.

Q. There was a hearing on make allowance in 2003, correct?

WITNESS KRUG: I don't have my dates exact, but I believe that is correct, yes.

Q. And there was a more recent one in January of 2005?

WITNESS KRUG: Correct.

Q. And in both of the two recent hearings, make allowances in the formula
1 have been adjusted as a result of the hearing, correct?
2
3 WITNESS KRUG: Yes.
4
5 Q. And in both cases, the pricing formula was put into effect within 60 days after the close of the hearing, correct?
6
7 WITNESS KRUG: Yes it was.
8
9 MR. VETNE: I very much appreciate your being here.
10
11 Oh, I do have one thing, Your Honor.
12 During the luncheon break, I went and made copies of the update, which I think would be helpful to have a physical record. I distributed, actually, these, along with the November release, broadly to the room.
13
14 So if I could have the update marked as the next consecutive exhibit --
15
16 THE JUDGE: It will be Exhibit 24.
17
18 MR. VETNE: Maybe you can just verify that that's the right thing.
19
20 [Whereupon, Exhibit No. 24
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1 was marked for identification by the judge.]

2 BY MR. VETNE:

3 Q. Can you verify that that's --

4 WITNESS REED: Yes, it is.

5 MR. VETNE: Your Honor, I ask that

6 Exhibit 24 be received.

7 THE JUDGE: Exhibit 24 will be

8 admitted.

9 Other examination of these witnesses?

10 DR. CRYAN: I'm Roger Cryan. I'm

11 with National Milk Producers Federation.

12 I actually have some copies of the

13 update, including the cover letter that

14 arrived in the mail yesterday. And I wanted

15 to -- if that's okay, I would like to offer

16 that. I don't have very many copies. This

17 is a little redundant but a little more

18 complete.

19 THE JUDGE: Very well. It will be

20 marked as Exhibit 25.

21 [Whereupon, Exhibit 25 was
1 marked for identification by the judge.]
2
3 DR. CRYAN: And I would ask if Ms. Reed would confirm that that's the accurate update.
4
5 WITNESS REED: Yes, this is correct.
6 DR. CRYAN: Thank you very much.
7
8 BY DR. CRYAN:
9
10 Q. Ms. Reed, obviously, you guys do a very good job putting together a very detailed and closely controlled study.
11 I have some -- I understand when you do a survey, some of the details that you collect from the plants, although they are not in the normal publication of the data, is detail on fuels and electricity costs. Is that correct?
12
13 A. By special request, it would.
14
15 Q. I'm sorry. Gas and electricity.
16
17 Okay.
18
19 A. Yes.
DR. CRYAN: And I have another paper I would like to offer. I only have a few, but I could bring more tomorrow. This is a two-sided sheet of paper. On the first side is the table.

THE JUDGE: Why don't you ask her if she can identify it first.

DR. CRYAN: I'm going to explain it and then ask her if she confirms that that's what it is. Is that all right?

THE JUDGE: All right.

DR. CRYAN: Thank you.

BY DR. CRYAN:

Q. On one side, the first -- one side is labeled, Sent by Venetta Reed, CDFA, to Neil Gulden, AMPI, by E-mail January 20, 2006. And I apologize for misspelling your name on the heading.

A. That's all right.

Q. But below that heading, would you identify that table?
A. I'm just checking the numbers real quick.

[Reviewing.]

Q. The one identified as by e-mail, is that the one you are looking at? Or are you looking at the other side?

A. Yes, I recognize this one as accurate.

Q. Thank you. So that is the table you sent to Neil as the electricity and gas costs for low cost, medium cost and high cost groups of powder producers, low cost and high cost groups of butter producers, and low cost and high cost groups of cheese makers?

A. Yes.

Q. And are those groups, those high cost and low cost and medium cost groups, are those -- do those represent the same groups that are broken out in the exhibit, the previous exhibit?

A. Yes.
Q. Thank you.

On the other side of the sheet, the heading is, Provided by Venetta Reed, CDFA, to Neil Gulden, AMPI, by Phone, and it's dated January 20, 2006.

There are four sets of numbers there that -- all the numbers there in -- the numbers that are not in italics are the numbers that I understand you offered and you gave Neil over the phone. The number in italics is the number that I have calculated from the previous table.

And first of all, I would like to ask you whether you can identify those numbers.

A. Well, yes, I can. And actually, I was going to ask where the .0043 came from myself, because I have the .0078 that you have italicized.

Q. Okay. So that was a transcription error --

A. Yes.
Q. -- probably on my part?
A. Yes.

Q. So if we cross out the .0043 --
A. Yes.

Q. -- you would identify those numbers
as the same numbers as you -- as your numbers
respecting electricity and gas costs for the
four categories of plant?
A. Yes.

DR. CRYAN: Okay. Thank you very
much. That's all I have. Thank you very
much.

Oh, I'm sorry. I have got one --
could I ask that that --

THE JUDGE: Exhibits 25 and 26 will
be admitted into evidence.

DR. CYAN: Thank you.

[Whereupon, Exhibits No. 25
and 26 were received in evidence.]

THE JUDGE: Mr. Beshore.

No. 26 is the two-sided one, which is
information provided by Ms. Reed. And the
other one is the same thing as 24 except with
the cover letter.

EXAMINATION

BY MR. BESHORE:

Q. Marvin Beshore.

Ms. Reed, I have just a couple of
more questions about Exhibit 26 which Dr.
Cryan just inquired about.

A. Okay.

Q. First of all, is the -- what year is
the year in which these costs figures were
derived from? Is it from 2004 data?

A. Yes, it is.

Q. And taking the first page, 26, the
information relating to electricity and gas
costs, are those costs per pound of commodity
in each case?

A. Yes, it is.

Q. Going to the second page, then, the
back page, is this also from 2004 cost data?
A. Yes, it is.
Q. And the electricity and gas costs are, in each case, per pound of commodity?
A. Yes.
Q. These figures were from the same database of information from which your more complete processing costs released, this 23, 24 and 25, were produced?
A. Yes.
Q. Thank you very much.
A. Thank you.
THE JUDGE: Other examination?
Mr. Yale.
EXAMINATION
BY MR. YALE:
Q. In the -- first of all, Benjamin Yale for Select Milk, Continental Dairy Products and Dairy Producers of New Mexico. On the cheese processing cost of your exhibit -- and I believe that's 23 -- you have the volume in the group below cost and
the volume in the group for high cost?

[The following answers were given by Witness Reed.]

A. Yes.

Q. And the average that -- is this volume -- this is an annual volume?

A. Yes, it's for the 12-month period.

Q. And I would note that, you know, if you divide that out, that you come up with an average plant of about 209, give or take, million pounds per year on an average of those three plants versus about a little less than 50 million for the one below that. Does that look right for the high cost in terms of the average size of the plants?

A. No. Not necessarily, no.

Q. Okay. What do you mean by not necessarily? What do you mean?

A. I mean that the low cost plants don't -- each one of them don't necessarily
make two hundred and some odd million pounds of cheese.

Q. But the three of them average do?
A. Yes. If you are doing just a simple average, yes.

Q. All right. My question is, do you see generally a correlation between size of operation and the cost to produce product?
A. Definitely.

Q. And the much larger ones tend to produce at the lower cost?
A. Yes.

Q. The other part, you do not do any studies of any plants outside of California?
A. No, we don't.

Q. And you don't make any representation that this is what the cost would be to produce cheese in any other part of the country?
A. No, we don't.

MR. YALE: That's all I have.
THE JUDGE: Other examination of this witness?

Very well. It looks like you may step down.

Ms. Deskins.

MS. DESKINS: I just wanted to thank the witnesses for coming. We appreciate your testimony about the cost studies from California.

MR. RASTGOUFARD: Babak Rastgoufard, USDA. I would put on our last witness, Howard McDowell.

THE JUDGE: Mr. McDowell.

[Whereupon, the witness was duly sworn by the judge.]

THE JUDGE: Please be seated and tell us your name and spell your last name for the hearing reporter.

THE WITNESS: My name is Howard McDowell. M-C-D-O-W-E-L-L.

EXAMINATION
BY MR. RASTGOUFARD:

Q. Good afternoon. Can you please state for the record your job title and employer?

A. I’m a senior economist in the Economic Analysis Staff, Dairy Programs at USDA.

Q. And your duties in that capacity?

A. A variety of responsibility in the area of economic analysis of dairy issues and, in particular, certain Federal order of proceedings and other dairy issues in the Department.

Q. And also, for the record, can you please describe your educational background?

A. I have a bachelor’s and a master’s degree from Virginia Tech and a Ph.D. in agricultural and applied economics from the University of Minnesota.

Q. Thank you. I understand you have a prepared statement that you would like to
enter into the record. I have copies of that.

THE JUDGE: It has been marked as Exhibit 27.

[Whereupon, Exhibit No. 27 was marked for identification by the judge.]

THE JUDGE: Counsel, do you want to also mark the Econometric Baseline Model Documentation?

MR. RASTGOUFARD: Sure. Might as well.

THE JUDGE: That will be 28.

[Whereupon, Exhibit No. 28 was marked for identification by the judge.]

BY MR. RASTGOUFARD:

Q. Can you enter your statement into the record at this time?

STATEMENT FOR THE RECORD BY MR. MCDOWELL

My name is Howard McDowell. I am the Senior Economist on the Economic Analysis
1 Staff in Dairy Programs of the Agricultural Marketing Service of the United States Department of Agriculture. I have been the Senior Economist since 1999 when I joined Dairy Programs.

The preliminary analysis reported in the hearing announcement was done by the Economic Analysis Staff under my supervision. The analysis was done using Dairy Programs Baseline Econometric Model and the model was calibrated from the baseline that USDA published in February 2005. In addition to the summary tables published in the hearing notice, an Appendix including more details tables and a documentation of the model have been posted on the Dairy Programs website and, I understand, entered as an exhibit here. I am here to answer questions that you may have concerning the preliminary analysis.

Q. And just for the record, the
appendix which was just referred to has been entered into the record as Exhibit 2.

And also for the record, just to be clear, when you refer to the hearing announcement, you are referring to the federal register notice that came out on January 5th, 2006 --

A. That is correct.

Q. -- marked as Exhibit 1.

Were you asked to prepare any information for this hearing?

A. We were asked to do this preliminary analysis, and we proceeded to do that.

Q. And can you please explain why this analysis was prepared?

A. Executive order 12866 requires that for significant -- for federal regulatory actions that have significance defined as over a hundred million dollars of impact, there shall be a preliminary analysis done. It appeared that that might be the case, so
we proceeded with it.

Q. And so, this analysis was just for illustrative purposes?

A. That is correct.

MR. RASTGOUFARD: I would like to move both, I guess, Exhibit 27, the statement, and 28, the baseline model, into the record.

THE JUDGE: Objection? There being none, 27 and 28 will be introduced or admitted at this time.

[Whereupon, Exhibits No. 27 and 28 were received in evidence.]

BY MR. RASTGOUFARD:

Q. Is there anything else you would like to add regarding either the analysis or the baseline model?

A. No, sir.

Q. Thank you. No further questions.

THE JUDGE: Very well. Questions?

Mr. Vetne.
EXAMINATION

BY MR. VETNE:

Q. John Vetne, representing Agri-Mark.

I tremble when I ask questions of witnesses who use words and symbols that I don't know. That might also be helpful.

I just -- I went to the last page.

Table 7, page 10. The title of Table 7 is, Class I Over Order Payments All Milk Price. What does that intend to capture? What does that title mean?

A. Several equations in that table right there, the last of which is the equation that we are using to estimate the all milk price. As a portion of the all milk price, we are also -- in that equation is the -- our estimate of Class I over-order payments.

So what we are doing in this table is, first, showing you the equation that we use to estimate over-order payments, which
1 is a function of cheese production and fluid milk per capita consumption.

Q. Stop right there. The Class I over-order payments are a function of cheese production? How?

A. We generally think about over-order payments being the amount that processors pay over and above minimum Class I price.

Q. Would include milk processors?

A. That is correct. And one of the variables that's involved in that is how scarce milk is. And so, in many cases, the over-order payment is directly related to the give-up charges that need to be paid to primarily cheese makers in order to free milk up.

So it is a -- this equation is trying to reflect the market balance of milk.

Q. What does the word intercept mean?

It's used in several places in your exhibit.

A. The equations that we are estimating
here will include key parameters. In this case, the key parameters, or the key variables, rather, are total cheese production and fluid milk per capita consumption.

And then, whenever you are involved in estimating equations with linear regression, you have to have an intercept usually, or you can specify there is no intercept. And so, that helps to position the curve in space.

Q. What is the function of the intercept -- sorry. Can you explain it to me as though I'm in fourth grade, or maybe eighth.

A. These squares regression fits a line through a scattering of points. You can think of it on a piece of paper with the vertical axis being the Y axis.

Q. Actually, those points, yes.

A. Okay. And the horizontal would be
the X axis.

Now, what the statistical procedure does is minimizes the square differences between the fit line and all the points. And in order to fit that line through X, Y space, you bring it back against the Y axis, and that is an intercept.

Q. All right.

A. And that's why sometimes it can be a negative, and sometimes it can be positive.

Q. Okay. Now, does it -- somewhere on this table, are -- any of the numbers show your estimated impact on Class I over-order premiums?

A. No.

Q. No, it doesn't? Okay.

A. It's a specification of the equation that is in the model.

Q. Okay. And does Table 7 show a bottom line impact on all milk prices?

A. No, sir, it does not. The final
equation there is the equation that is used in the model to estimate the all milk price as a portion of everything else that is going on in the model.

Q. Okay. Is there someplace else in the exhibit where your projections translate to either absolute or relative impact on milk price?

A. This particular exhibit that you are looking at is a specification of the model. In it is a listing of all the equations that are in the model and a brief explanation of how they are put together. The impacts are in other documents.

Q. Oh, that's the other document that was published -- posted on the Internet?

A. This is the model that you used to derive --

Q. Yes.

A. And there are some more detailed
tables that --

Q. I got it. I got it. Now, I understand the function of this Exhibit 28.

All right. I don't have any more questions about Exhibit 28, but I may need to take another look at the analysis that was published. Thank you.

THE JUDGE: Other questions?

Mr. Miltner?

EXAMINATION

BY MR. MILTNER:

Q. Ryan Miltner on behalf of Select Milk Producers, Continental Dairy Products and Dairy Producers of New Mexico.

Dr. McDowell, I have a quick question on Exhibit 28, the only question I have on that exhibit for the moment.

A. Which one is 28 now?

Q. The econometric baseline model. And I'm looking at page 5, Table 2, and the footnote there, in particular. It says,
"For years when the Milk Income Loss Contract program is in operation, the average MILC payment is added to the all milk price."

Is that a historical note or, in your model, does that forecast into the future at all?

A. It does not forecast in the future with this model because the MILC program was slated to go out of existence prior or after -- I think the date was December 1st. But certainly after 2005, it was supposed to go away. So they are included historically, but not into future with respect to this particular model and this baseline.

Q. Okay. So the forecasts that are in the appendix to your preliminary analysis and in the preliminary analysis that's contained in the hearing notice, the all milk prices that are reported in that analysis do not include any MILC payments
A. That is correct.

Q. Okay.

I guess I have one other question on Exhibit 28. Just so I can clarify in my own head and follow up on what Mr. Vetne had asked, exhibit 28 is a summary of how your econometric model works, is that correct?

A. That is correct.

Q. There is nothing in Exhibit 28 itself that describes the actual impacts of any of the scenarios listed in the proposed rule?

A. That is correct.

Q. Okay.

Moving to what I think is Exhibit 2, which is the appendix to the preliminary analysis, I'll start with page 2, Table A-2. Can you describe for us what this table is meant to portray?

A. Yes. First of all, we have three
1 different scenarios that we started off
2 with. This particular table relates to
3 Scenario 1. Okay?
4 Q. And that's the same Scenario 1 -- I
5 don't mean to interrupt, but the same
6 Scenario 1 that's on page 547 of the Federal
7 Register Notice?
8 A. That is correct. In the Federal
9 Register, we published, in the tables there,
10 six-year averages. I understand that should
11 have been five-year averages. I think there
12 is an errata statement that's somewhere.
13 Q. The beginning of Exhibit 2?
14 A. Right. And so, what this appendix
15 is intended to do is to provide the
16 year-by-year results that were reported in
17 the summary tables in the Federal Register.
18 Q. So if we start at the top of Table
19 A-2, what this is showing for -- where it
20 says 2005-06, that's for the federal
21 government fiscal year '06, so October 1 '05
1 through September 30, '06, correct?
2 A. [The witness nodded.]
3 Q. You are going to have to say yes or no.
4 A. Yes. I'm sorry.
5 Q. That's okay. She can't take down the nod so well.
6 A. Yes. Thank you.
7 Q. That's okay. So in the first -- in fiscal year '06, the first column, you are expecting, according to your model, that the Class I price of 3-1/2 percent butterfat to fall 16 cents a hundredweight?
8 A. That is correct.
9 Q. And that continues across. So the following year, you are expecting a 2 cent reduction from the baseline, not from the previous year, correct?
10 A. That is correct.
11 Q. And then that proceeds through all the classes. And then three lines from the
bottom, where you are showing a negative impact of 8 cents a hundredweight on the all milk price at test --

A. Where do you see that again?

Q. I'm looking at the column that's '05-06, and all the way down at the bottom.

This is the third line from the bottom.

A. I'm with you.

Q. Okay. All milk price at test minus 8 cents a hundred. Can you explain exactly what that 8 cents is a reduction from and what the all milk price consists of for this table?

A. Okay. In terms of what it is being reduced from, if you look on Table A-1, the preceding page, the corresponding baseline price for '05-06 is 14.75. Okay. So it is an 8 cent reduction from that.

Okay, now, as I understand the question, what you would like for me to do is to relate the decline in the Class III
1 and IV prices and then come all the way down
2 through this table to the bottom line, 8
3 cent reduction in the all milk price.
4 Q. Well, I guess initially what I
5 wanted you to state for us is, what is the
6 all milk price on this table?
7 A. The all milk price on this table is
8 -- is an attempt -- our attempt at
9 estimating the NASS reported all milk price.
10 Q. So that would include -- the all
11 milk price includes over-order premiums?
12 A. Correct.
13 Q. If there were a milk payment,
14 historically, would that have been included
15 in the all milk price and the MILC payment?
16 A. I'm not sure how -- I'm not sure how
17 that's handled at NASS.
18 Q. Okay. Let me just see if I can
19 summarize. The all milk price represents --
20 is that equivalent to a mailbox for all
21 producers?
A. No, it is not. I would refer you back to Mr. Rourke's testimony this morning.

The NASS all milk price is an FOP plant price. It is the price that plants are paying for milk delivered to the plants.

Q. Okay.

A. The mailbox price includes other types of payments such as was referred to this morning as thirteenth check. And I forgot the other term, but -- dividend from cooperatives. Thank you.

Q. It is also different from the Federal order blend price which you have listed about a third of the way down the page?

A. That is correct.

Q. And Table A-2, you are forecasting a blend price reduction of 13 cents a hundred?

A. That is correct.

Q. Did you have a chance to look at or review what I believe is marked Exhibit 13?
That was information that I had requested from my clients from the various Market Administrator's offices.

A. I am familiar with it. I haven't looked at it.

Q. I believe I brought a copy up here.

THE JUDGE: No. 13 was Mr. Rourke's statement.

MR. MILTNER: Attached to it is a number of charts which were admitted with this statement.

BY MR. MILTNER:

Q. I'll gave you my copy of Exhibit 13 and I'll work off my notes here. If you can turn to what is marked as page 7 to that, I think that's the first table summarizing blend price or recalculation of the pool. I think that's probably Order 1.

A. I have it.

Q. If you look in the column that's labeled Scenario 1, for 2004 and 2005 they
show a difference in the blend price or
statistical uniform price of 36 cents a
hundredweight. And on your Table A-2, you
have blend price impact of 13 cents a
hundredweight. And I realize this is just
Order 1. I'm sorry, that's 26 cents a
hundredweight. And I think the range, if
you look at the other orders, is 23 to 26
cents under Scenario 1.

How do you account for the difference
between what the Market Administrators have
calculated the impact on the pool to your
calculation of impact on the price?

A. The -- what the Market
Administrators have done is to go back -- my
understanding is that they have gone back
and recalculated the -- all the class prices
and the uniform price, given the different
make allowances that they were given to work
with, and compared that against what
historical fact was. And in so doing, I
believe it is the case that they held constant the butter, nonfat dry milk, the cheese, the dry whey prices, the NASS prices that are used in formulas.

Somebody might tell me whether that's correct or not.

Q. I can't tell you whether that is correct or not.

A. I believe that's correct. Well, what our analysis does -- let me add, I think that what they have done is accurate.

I think that's -- I have no reason to question these numbers.

In our analysis that we have done with the econometric model, on the very page that Mr. Vetne was referring to is where the all milk price is generated. And if you -- we think that the -- we estimate that the all milk price will fall with a reduction in the blend price.

But the other factors that are
involved in that all milk price estimation
are the NASS prices for dairy products,
namely, cheese, butter, nonfat dry milk, dry
whey. Well, the all milk price falls, we
start getting a supply response. As less
milk is being produced, the dairy product
prices go back up a little bit.

In fact, if you look in the table
there, the product prices, cheese goes up by
-- in this scenario, cheese goes up by a
penny and a quarter; butter, a little over 3
cents; and so on and so forth. So that is
the moderating effect that's taking place in
the market as a result of less milk being
produced. You carry that on out further, and
that's why the results attenuate year by
year as we go through.

Q. Did -- when you plugged in these
make allowance changes into your model, what
month did you begin with? In other words,
when did you anticipate the rules would
change and the make allowance calculations would change?

A. FY05-06, I -- I'm not sure. I'm not sure when we did that. Hang on just a second. Let me refer to what we did here.

Q. Sure. Take your time.

A. May I have permission to ask one of my colleagues exactly when we started with that?

Q. I have no problem with that at all.

[Whereupon, the witness conferred with a colleague.]

THE WITNESS: Okay. That's what I thought. We began it in October of '05. So we began it with the beginning of that fiscal year 05-06.

BY MR. MILTNER:

Q. Okay. So you are assuming, then, that the rules have already taken effect?

A. We -- first of all, we did this for illustrative purposes, and we had to begin
1 sometime.
2
3 Q. I understand.
4
5 A. And instead of breaking up a year,
6 we didn't know exactly when the rules would
7 take effect, so we began with the fiscal
8 year.
9
10 Q. Okay. But in the model, October 1,
11 2005, make allowances change, and then you
12 ran your model under those assumptions --
13 A. Right.
14
15 Q. -- under those formulas going
16 forward?
17
18 A. That is correct.
19
20 Q. Okay. So may I ask, then, the blend
21 price difference from baseline, the all milk
22 price difference from baseline reported for
23 fiscal year 05-06, is that figure for the
24 blend price for the final month of that
25 year, or is that a blend price and all milk
26 price for the average of that year?
27 A. Average cost that year. This is an
annual model.

Q. And it takes the average for that annual period?

A. That is correct.

Q. Under your model, how quickly are the changes in supply, how quickly does the market respond to those changes in price, and how is supply affected as a function of the milk price, the class price?

A. There is a very small change in the first year, then there is a lag effect. If I may refer you to page 5 of the documentation exhibit --

Q. Would that be --

A. Line documentation.

Q. Okay. Go ahead.

A. You see, when we estimate milk supply, we have -- we estimate the number of milk cows, and we also estimate the milk per cow. And in both of these equations, there is a significant lag component. So we get
an initial effect in the first year, and then
we get a bigger effect that takes place the
following year.

Q. By looking at the numbers here in
table 2, can you tell us what that lag is in
terms of days or percentages of the year?
A. Everything on here is in terms of
annual average.

Q. Okay.
A. And so, milk cows, first thing --
the first thing that determines whatever the
number of cows is, it's 97 percent of the
last year. That's down in about the fourth
variable.

Q. Okay. Lag, parenthesis, milk cows?
A. Right. And so, you get the initial
shot on the milk price, and then you -- then
it carries through, because it's -- you get
the first shock, and then it's -- it carries
through because next year is 96 percent of
this year. So it carries through until a
point when it dissipates out. After about three or four years, it is over.

Q. So for -- October of 2005 is T-1 or T-0?

A. Right.

Q. Is the number of milk cows at T-0 97 percent of the number of milk cows at T-1?

A. 98 percent.

Q. Okay. So you are assuming two percent of cows are instantly culled? Is that --

A. No, plus these other factors.

Q. Okay.

A. And it is not October 1st. This is an annual model, so it is the average across 2005-2006.

Q. If we had -- I guess so I can understand, if you add a hundred cows in the country on October 1, 2005, or let's say September 30th, 2005, how many cows would be in your model on October 1?
A. This is an annual model. The number of cows that are in the model for FY05 is the average number of cows as reported by NASS for '05.

Q. Okay.

A. And so, there is going to be deviations around that average in most months. And the same goes for '06. So this is an annual model.

Q. Okay.

A. So if we can talk about it in terms of the annual averages, when we go from one year to the next, 2006, the number of milk cows is going to be about 97 percent of what last year's was, '05. And then, in addition to that, you can multiply the all milk price by this other estimated parameter that's 75, okay, and that adds a few cows.

And then there is also a feed price variable in there with a negative sign on it. So as feed prices go up, number of cows
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1. goes down. And similarly with slaughter
2. price. As the slaughter price goes up, the
3. number of cows goes down.
4. And then there are a couple of
5. additional factors in there that are
6. correcting for the buyout program and some
7. other factors that we can't estimate.
8. Q. So I guess to ask the question a
9. different way, is the impact of the change
10. in the make -- the change to the make
11. allowance, is the increase in make
12. allowances reflected in a fewer number of
13. cows beginning with fiscal year '06?
14. A. We didn't report the number of cows
15. in here, but that is correct. We have both
16. Federal order marketings and United States
17. marketings going down, and that would be
18. with regard to both fewer cows and lower
19. milk per cow.
20. Q. You run up the other factor in
21. decreased production, which is less milk
produced per cow.

Can you explain to us how your model takes that into account and, also, if you could again, the lag in timing of that change.

A. It's a very similar -- a very similar equation. Milk per cow is highly related to what it was the year before. And it is positively related to the milk feed price ratio. So milk per cow is approximately 98 percent of last year's, previous year's milk per cow. And then that gets adjusted by the milk feed price ratio. As milk price goes up, milk per cow would go up. As feed price goes up, milk per cow would go down.

Q. So assuming that you held feed prices and milk prices constant, you would assume that, on an annual basis, we would produce 98 percent of the milk per cow that we produced the year prior?
A. And add to that the intercept, which is a positive number. So we would expect it to usually grow.

Q. Okay. Have you had chance to test your model against actual producer reactions to increased prices or decreased prices and see if the lag is reflective of actual on-farm decisions regarding cull rates and breeding rates and feeding and production decisions?

A. To the extent that all those decisions are reflected in the NASS collection of data, the answer is yes. We do not have any sample of data on farms except as it comes through NASS. And so -- so the answer is yes as it comes through us in official USDA data.

And I might add that probably among our equations that we strive to estimate, the fit is probably as good here as you'll find anywhere else. So we are explaining
almost all of the variation through the
sample that we have with these equations.

THE JUDGE: Mr. Miltner, how much
longer do you think you are going to go?

MR. MILTNER: Maybe 10 or 15 minutes
at the most. If you want to take a break,
Judge, that's fine.

THE JUDGE: I was thinking we were
maybe at appropriate time to take a break.
That also might give you a chance to sharpen
up your remaining questions.

MR. MILTNER: If I could ask one
follow-up on this issue before we take our
break.

THE JUDGE: All right.

BY MR. MILTNER:

Q. Is it correct, then, your last
answer that your model takes NASS data and
then all of these numbers, your intercepts
and your coefficients, I suppose, are the
result of the multiple regression analysis?
A. That is correct.

Q. So the only input you have is the various NASS data and the other factors, and then you run your multiple regression to develop your model?

A. That is right. And we -- well, you may imply this, but we run a lot of different equations to come up with what seems to be the best.

MR. MILTNER: Okay. We can take a break.

THE JUDGE: Let's take 15 minutes at this time, and let's be back by, oh, 22 after.

[Whereupon, the hearing recessed at 3:06 p.m. and reconvened at 3:21 p.m.]

THE JUDGE: Dr. McDowell, you are still under oath.

MR. MILTNER: Thank you, Your Honor.

BY MR. MILTNER:
Q. Dr. McDowell, before the break, we were talking about the decreases in milk supply, and we identified two sources of milk supply reductions: reductions in the number of cows and the reductions in the amount of milk produced by cows. Do you have any estimates based on your model of the actual number of cows that the national herd would be reduced by and the average marketings per capita it would be decreased?

A. We didn't report that data, but we have it, and I can get it. I don't have it off the top of my head, but we can get that.

Q. If you could find that and produce it for us, that will be appreciated.

A. Okay.

Q. In that data, if you look at just the number of cows that are going to be lost, do you have any breakdown between the number of cows that will removed from farms
that will still be in existence versus the number of whole herds that will be retired by farmers?

A. No, we do not. Strictly the number of cows.

Q. You would agree that, in all likelihood, a number of cows will be reduced by farmers who decide to go out of business as a result of low prices?

A. I think that likely would be the case.

Q. Do you have any way with your model to predict the number of farms that will go out of business as a result of low prices?

A. No, I do not, but I agree that -- that a portion of cows will leave.

Q. Do you have any guess or any estimate as to the impact of these changes region by region or order by order or a geographic basis?

A. Not at this time, but cow responses
are different, and I believe there are certain reasons that they are more responsive to price changes than others. I don't have that information right now before me.

Q. Is that something you can produce?  
A. I can get the response, but I can't make the calculations very quickly.

Q. If you were to produce that kind of information, would you be able to ascribe to the different regions the number of cows that would be culled in those regions?

A. I don't think so. I have got some rough estimates, but I don't have it calibrated to the point right now to be able to do that. That would be the kind of thing that we would expect to do in a full-blown analysis, not a preliminary analysis.

Q. Would you be performing a full-blown analysis at some point before a rule change to take effect?
1  A. Yes.
2  Q. In your position with AMS, do you
3    study any of the impacts of price increases
4    and decreases on the farms of varying sizes?
5  A. No.
6  Q. Do you have any opinion based on
7    your model or other work you have done as to
8    how this change may or may not affect a
9    large farm versus a small farm?
10  A. I am currently not aware of any
11    recent study that has been done that
12    differentiates between supply or among
13    supply responses across -- across sizes.
14    However, I think the -- what I read
15    and sort of hear around is that perhaps the
16    very largest farms are less responsive to
17    smaller price changes, and perhaps there are
18    some very small farms that can absorb price
19    changes, but maybe there are some that are in
20    the middle range that are between management
21    regimes that may have a more difficult time
But that's -- that's reading and hearing and no definitive studies that I'm aware of.

Q. In the hearing notice, it states that the marketings under the federal program account for 61 percent of all milk used for manufacturing, so 39 percent of milk outside the Federal order system.

Do you anticipate that these changes will have an effect on the prices received by producers who ship their milk to those non-Federal order manufacturing prices?

A. Yes, sir, I do. As a matter of fact, in our analysis, we show that one of the impacts is that the manufactured dairy product price, its NASS product prices will increase. And so, therefore, if you are selling milk that's mainly for cheese, for example, it would have a positive effect on it.
Q. I asked about the regional impact of the changes on the production and the changes in production. Does your model forecast the price changes or mailbox prices or all milk prices on an order-by-order basis or geographic basis?

A. No, sir, it does not. But with the changes in the Class III and Class IV prices, the entire price structure is going to be moving up and down pretty much the same across the board. Milk markets are national in scope and the adjustments that take place are regional. But ultimately, it is national, and all these markets are tied together.

The question that you asked would have a different answer if we were dealing with a Class I differential, for example, in one region. But when we are talking about the entire price structure moving up and down, it would be an across-the-board kind
of effect.

Q. It would also be different if, for instance, we decoupled Class I prices from Class III and IV prices and didn't change to make allowances for Class I and II?

A. That would be a different scenario.

Q. If such a scenario were proposed, would your office be able to provide us with an analysis under those scenarios?

A. Yes.

Q. Using numbers in my head and not off of any report, would you agree that there are roughly, give or take 10 billion pounds, about a hundred billion pounds of milk marketed through the federal system?

A. Well, let's see.

Q. It's in there somewhere.

A. I'm not a numbers guy. Let's see.

Q. I heard from Mr. Beshore 120 million.

A. That looks about right to me.
Q. Okay. So if we use Table A-2 and the blend price falls, I want to say 13 cents, and the blend price falls 13 cents a hundredweight, that is 130 million less 26. 

So $156 million, roughly, it would amass, right? Or you are not a numbers guy?

A. Well, it is pretty right, because if you look right there in terms of Federal order cash receipts, the total change that we calculated is $155 million.

Q. And that's real money, right, out of producers' pockets?

A. That would be money that's in the pool.

Q. It is no longer in the pool, and that money that's in the pool gets paid back to producers, correct?

A. That's a portion of what is paid to producers.

Q. Where else would the producer get the income that's not in the pool?
A. Well, there are over-order payments that are made which can be additional funds and -- excuse me just a second.

Q. Sure.

A. I want to check something here for this answer. If you look on Table A-1. The baseline, in this case, 2005 and 2006, the Federal order minimum prices test were estimated to be 14.72. And at the national level, the all milk price at test were 14.75. So they are close, without question.

Q. And actually, I just noticed this last line on Table A-2 is U.S. producer revenue showing loss of $258 million. So that is $158 million that producers are not going to receive under Scenario 1?

A. That is correct.

Q. And under Scenario 2, it is $243 million that they lose?

A. In the first year.

Q. That's just the first year?
A. In the first year.
Q. And $318 million in Scenario 3?
A. That's what we estimate, yes, sir.
Q. And that's just for that year. And your model shows that there are mitigating impacts but still losses every year for all producers throughout, is that correct, and that's -- that takes into account all their income and that takes into account over-order premiums, the all milk price. It takes into account all those items as money producers will never get back?
A. [The witness nodded.]
MR. MILTNER: Can you just state your answer?
THE WITNESS: Sorry. Yes, that is correct.
BY MR. MILTNER:
Q. So even your model, and it is a model that is run one hundred percent accurate, we are talking, over time,
potentially billions of dollars taken away from producers that they cannot recover?

A. Well, tables are showing hundreds of millions.

Q. Each year?

A. Less than that in subsequent years. So I don't come up with billion in what we have got here.

Q. Let's come up with a billion. Then Table A-4, if I look at the very bottom right corner, average impact to revenue of --

A. That would wind up being a billion, yes.

Q. And that continues to apparently 2010 on at $148 million year?

A. No, sir, it would be declining.

Q. By a billion dollars because it is 149 a year, so maybe some very slight --

A. It would be declining.

Q. And just so we are fair and equitable, even under the lower the more
modest cut, under Table A-2, we are still looking at $72 million a year, on average, and $50 million a year in lost revenues and actually increasing, is it not?

A. Say that again.

Q. If you look at Table A-2 and you look at producer revenues, the average for your model period is $72 million in losses per year, and in that scenario, we are actually seeing increased losses every year over the last three years? But the bottom line is, under any of the scenarios, we are looking at hundreds of millions, if not billions, of dollars that's going to be lost --

A. In these particular scenarios, that is correct.

MR. MILTNER: Thank you. I don't have any other questions.

THE WITNESS: I have some clarification that I would like to make. You
were asking me a while ago concerning the
monthly changes that were calculated with
respect to blend prices and classified prices
by the order.

MR. MILTNER: Yes.

THE WITNESS: I want to talk about
that vis-a-vis what we are doing with these
annual numbers. There are two ways to come
up with annual numbers. One is to have
monthly calculations that are made and
monthly models. And if that were the case,
if we had a monthly model, then our first
month would be similar to the kind of
changes that were calculated by the order
offices.

What we have to work with are annual
numbers that are annual averages when we
start off with them. So a lot of the monthly
variation that is taking place all the time
is already taken out of the data. So there
is really no difference in terms of concept
here except that we are starting off with annual average numbers to begin with.

And I might add that when we do policy analysis, we are bound to do it against the USDA baseline, which is constructed with these kinds of annual averages. So that -- I wanted to put a little bit more context on that to make sure that there is no substantive dispute between what we are doing here and those numbers.

Ours just happen to be annual averages to begin with.

BY MR. MILTNER:

Q. In other words, your annual model is -- that is the data you have --

A. That's right.

Q. -- available to you? And you suggest that's actually what you're required to do because the baseline is an annual figure?

A. That is correct.
Q. And so, in using annual figures, you lose a lot of the contours and seasonal changes that would otherwise show up?
A. That is correct. And that's why your question about the cows in terms of the end of September and the next day, it doesn't -- it doesn't compute with what we have to work with. We have to work with annual averages to begin with.
Q. Thank you. I appreciate that clarification. Thank you.
A. Okay.

THE JUDGE: Other questions? Mr. Vetne.

EXAMINATION

BY MR. VETNE:

Q. I believe you were asked the question or maybe simply affirmed a statement to the effect that your model shows losses for all producers every year.

Do you recall --
A. Yes, I do recall that discussion.
Q. To the extent that some producers now are taking their milk to a cooperative manufacturing plant and, when the commodity dairy product is produced, they are not recovering the costs of making that product in the market price but, nevertheless, have to account to the pool at a price that is higher than the value of the milk, that group of producers, if they had to account for the pool, at the value of milk reflecting a make allowance as to that recovery of costs, that group of producers would gain because they would no longer be subsidizing other producers in the pool, correct?
A. Well, I don't -- I don't know that I follow where the subsidy came from.
Q. Well, let's see. If -- on a hundredweight basis, right? If the Class III price is $14 but 50 cents of that $14
represents manufacturing costs that cannot be recovered, not by virtue of the marketplace, but by virtue of regulation -- you have a quizzical look. Let me start being even more basic.

I'm not going to use actual numbers here. I'm just going to use easy numbers for easy repartee. The price of 10 pounds of cheese from a hundred pounds of milk that can be recovered is $15. Okay, 10 pounds of cheese sells $1.50 a pound is $15 recovery gross from the sale of the commodity. The Federal order allows a dollar to be recovered, 10 cents per pound for cheese. So the Class III price, then, is $14. Are you with me so far?

A. [The witness nodded.]

Q. The actual cost to make that cheese is $1.50, not a dollar, a dollar fifty per 10 pounds. Are you still with me?

A. Yes.
1 Q. A cooperative manufacturer operating in the Federal order system must account to the pool for milk going into that cheese at $14. All of the producers in the pool, whether they make that cheese or not, get the benefit of that $14 that the cooperative has accounted to the pool for milk going into that cheese, correct?

A. Well, they -- all the producers in the pool share in the revenue.

Q. Share in the -- that $14 is pooled money, correct?

A. [The witness nodded.]

Q. And all the producers share in that $14 from the revenue of that sale of milk to that cheese. But the cooperative making that cheese, it's costing them a dollar fifty, not a dollar. That cooperative, by 50 cents, is not recovering its costs, and by 50 cents is subsidizing other producers in the market.

That's what I meant by subsidy.
Would not those producers -- and the question, getting back to the original one, would not those producers be a group of producers that would fare better if they were able to recover their costs and were not forced by regulations to subsidize the whole pool?

A. I'm not going to address your statement about the subsidy.

Q. All right. Address it any way you want.

A. The way the order works is that the returns from the order are shared while producers are pool in the order.

Q. The classified prices are shared?

A. That is right.

Q. Right.

A. And this hearing is trying to derive at the appropriate level of what the make allowances are by -- in your hypothetical, if the organization is losing money on the
plant, then it has a decision to make. But it is also the case that the -- the returns to the producers in the organization are not coming from just Class III, they are coming from the entire pool.

So I don't know what else to say, but I'm not going to address the subsidy portion of it.

Q. Okay. I won't ask you to adopt that word.

I agree with you, the system is supposed to share the returns on the sale of milk. In my hypothetical, the cost to produce cheese is 50 cents greater than allowed in the regulated price formula.

Are you able to agree that the return to producers on the sale of milk into cheese is not uniformly shared in that cooperative making of it, is suffering less return for that milk than yield producers?

A. No, I'm not going to agree to that.
The cooperative that's making the cheese could be involved in a variety of cheese-making activities. There was discussion earlier today about the fact that there is different cheeses being manufactured and sold on the market. And based on these kinds of numbers, there is not enough in the story here to know whether the cooperative is making money or not.

Q. As a system-wide basis is really what you are saying, that many organizations, including cooperatives, have a number of business endeavors? They sell milk to bottlers. They make cottage cheese. They age cheese. They put jalapenos in and make it really sharp and good. All those things produce revenue. That's what your answer is. You do not dispute that the NASS survey price for commodity cheese represents an actual sale price for a whole bunch of
cheese, do you?

A. No, I don't dispute that.

Q. And you don't dispute that, when the Federal order fixes a minimum Class III price, that that's the price that has to be paid for milk going into that cheese?

A. For cheese manufacturers that choose to pool that milk.

Q. In the Federal order, yes. I'm talking about Federal order milk.

A. Manufacturers are not bound to be in the Federal order. But if they choose to be in the order, then that is the minimum price that's required to be paid.

Q. Minimum price?

A. That's the accounting to the pool.

Q. That's the accounting to the pool.

Now, in producing your model -- let me see if I remember. The all milk price reported by NASS includes or does not include revenue to producers before the
producer has to pay for transportation?

A. My understanding of the all milk price is that it is an FOB plant price, which means that the milk is delivered to the plant. So that's the price that the plant's paying at the door.

Q. Oh, okay. So it does not include income before transportation. I think the same thing was described as a mailbox price earlier. You are not sure about it?

A. I think the mailbox price, as we spoke earlier, includes monies such as thirteenth checks and cooperative dividends, and I think it's net of hauling. But you would have to check with Mr. Rourke's testimony for sure about that.

Q. We can check the record.

To the extent -- well, let's try this. If manufacturing plants consistently do not recover from the commodity market the cost of producing product, like producers
1 who don't recover the cost of production, 
2 they tend to close, go out of business. Do 
3 you agree with that? 
4 A. [The witness nodded.] 
5 THE JUDGE: That was a yes. 
6 THE WITNESS: Yes. 
7 MR. VETNE: Thank you. 
8 THE WITNESS: I would say yes unless 
9 there is some other purpose for keeping that 
10 plant open. 
11 BY MR. VETNE: 
12 Q. You are aware that plants -- there 
13 is a lot of things that go into business 
14 decisions. 
15 A. That is correct. 
16 Q. But you are aware that, over the 
17 years, the number of plants has dwindled 
18 just as the number of producers has 
19 dwindled? 
20 A. That is correct. 
21 Q. Is there any component of the models
that you -- projections that you produced
that factors in the additional cost to dairy
farmers in future years if, as a result of
nonrecovery of costs, a plant that is there
today is no longer there tomorrow and the
producer has to haul his milk an extra 2 or 3
or 500 miles?
A. I do not account for that in the
models.
Q. Does the model essentially assume
that all the outlets that are there now will
be there in the future?
A. No, there is no assumption
whatever. What we have done with the
model is to statistically estimate the
effect on prices of, in this case, changes
in the make allowance.
Now, the way that affects the lots of
organizations is far beyond my ability to --
to take into account. I wouldn't attempt
it. But there is no question that when you
change something like that, that it will affect organizations differently, and the producers in the organization will be affected.

Q. Or producers who are in a part of an organization?

A. There is no question. There are effects that we don't purport to understand.

Q. So if I understand correctly the all milk price that you captured in your model from NASS, which is an FOB plant price, would not capture increased costs to producers, transportation costs, primarily, from doing nothing?

A. That is correct. It doesn't account for that.

MR. VETNE: Thank you.

THE JUDGE: Mr. Wellington.

EXAMINATION

BY MR. WELLINGTON:

Q. Bob Wellington, Agri-Mark. I
just have a few questions referring to the appendix of the preliminary analysis. I'm not sure what exhibit number that was. But on Table A-1 of that, which is your baseline table, I'm referring to the bottom of baseline table, where you have U.S. marketings?

A. Yes, sir.

Q. If you look at from the 2005-2006, the first year of your analysis, to the last year of your analysis, was showing that milk production is growing about 10 billion pounds per year during that period, total growth of 10 billion pounds. Do you agree with that?

A. Well, I see the growth going across there. It goes from 175.8 billion to 179.1 billion, etc.

Q. Right.

A. Okay.

Q. If we were to then look at your Table A-4, which is the Scenario 3, the
maximum impact scenario that you looked at,
and we were to look at the average impact on
U.S. marketings, over the five-year period,
it shows minus 327 million pounds, correct?
A. Yes.
Q. So if I were to accumulate that over
the five-year period, it would basically be
five times that average?
A. Correct.
Q. Or approximately 1.6 billion pounds.
So if the baseline was up 10 billion
pounds, and then depresses the baseline by
about 1.6 billion pounds during that time
period, milk production is still up even,
with the impact of Scenario 3, by
approximately 8.4 billion pounds. Even under
Scenario 3, the milk supply is growing.
That's what I'm trying to get at.
A. That's what we show there.
Q. That's what the model would show.
And then, in addition, on that table
A-4, you -- the total impact over five years accumulates to over $1 billion. That was the question I was asking you earlier.

A. Say that again.

Q. On Table A-4, the average impact on U.S. producer revenues was $207 million per year?

A. Times the five.

Q. Times the five is roughly about a billion dollars?

A. Correct.

Q. But if you were to calculate that on a per-pound-of-milk basis or a hundredweight-of-milk basis, you really have to divide that by the total amount of milk produced over that five-year period because this is a five-year cumulative impact.

A. I don't know what you want to do with it, but let me explain what we have here.

Q. Sure.
A. Again, we have got annual numbers, and we have changes from the annual baseline. This averages out at the -- in the final column of this column is just simply taking those five numbers in the row and dividing them by five. It's a simple average of those annual numbers.

Q. Right.

A. That's what this is.

Q. But what I'm saying is, the billion dollar number, that was a cumulative number over a five-year period?

A. Yes.

Q. So I was just saying that in order to get the average impact per volume of milk, you have to divide that by the cumulative milk production during that five-year period?

A. One could do that.

Q. One could to do that?

A. One could do that.
1 Q. That's fine. Thank you.
2 THE JUDGE: Other questions? Mr. Beshore.
3
4 EXAMINATION
5
6 BY MR. BESHORE:
7 Q. Marvin Beshore. Just one question, Dr. McDowell. In the hundred-million-dollar
8 litmus test for this type of study that you refer to, is that per year, over five years,
9 Federal order marketings, national impact,
10 or how do you determine that?
11 A. I believe that that executive order -- and perhaps our counsel can help us with
12 the title of it, but I believe it refers to
13 a hundred million dollars per year.
14 Q. And for a rule of this type, would
15 that apply to impact within Federal order
16 marketings or nationally, do you know?
17 A. I believe it is national, but I'm --
18 I'm not the one to interpret the very
19 specifics of that executive order. We
generally think that we were getting close to that number, so we provided the analysis.

Q. In this case, you thought you might be close. That's why you did the analysis?
A. Yes.

Q. Thank you.
THE JUDGE: Other questions?
Dr. McDowell, you were asked to estimate the impact of increasing the make allowance. Your testimony here today was -- it is not in favor or against any of the proposals being considered at this area?
THE WITNESS: That is correct.
THE JUDGE: Your testimony is part of your duties here as an employee of the United States Department of Agriculture?
THE WITNESS: That is correct. I think it may be useful for us to explain how we came up with these scenarios. The proposal refers to changing the make allowances as calculated by Charles Ling. We
1 didn't have that information available to us,
2 so we looked to California. And we thought
3 that a logical thing to do would be to see
4 what the changes in the manufacturing cost
5 reported by California, what that change was
6 from 1994 to 2004.
7
8 So that's how we started out, and I
9 think that's referred to in the hearing
10 proposal. And if you'll look there, the
11 change in cheese was very small. Well, the
12 context of the proposal was perhaps cheese
13 manufacturing costs had gone up
14 significantly. So that's why we did what we
15 did with the cheese make allowance.
16
17 With regard to whey, we didn't have
18 any history like that for whey, so we
19 arbitrarily chose a 10 percent. And it was
20 simply to have a set of scenarios that would
21 illustrate the effects of increase in these
22 make allowances. But we have no idea --
23 when we did this, we had no idea what the
numbers would be, and we have no position at this point.

THE JUDGE: Other questions? Mr. Yale.

EXAMINATION

BY MR. YALE:

Q By the way, I want to thank you for having this study. This gives a context to look at this a lot different than what we have been able to do in the past. Maybe you aren't a numbers guy, but the numbers are informative.

I have a question that I wasn't sure was fully clarified. And that is, in your econometric model, you do have provision for this buyout and milk diversion. It shows up in the model. Can you explain why it is there and what impact that has on this model?

A. Yes. The first thing is that we have to be consistent with USDA baseline.
So we want to take into account programs and policies that affect the number of cows in milk production. And with regard to the past, we have had some equations in there to try to estimate some of it. But it's very difficult, as you know, because of the nature of the program. It has size implications, regional implications and so on.

But the fact is, in the baseline, we have other people that help us in this process, in the USDA process, that are more closely associated with that program. And so, the baseline incorporates that information.

So it is in there, and we account for it. But we don't generate any estimates of that in the past. It just so happens for this particular baseline, it was ending, so it's not in the future.

Now, for the next baseline, we will
have to address it more than we have this time because the MILC program is back, it appears.

Q. So you keep it in the program for a number of years after the program ends. You don't -- holder buyout ended, what, 20 years ago, approximately?

A. Right.

Q. And the conversion program was prior to that?

A. Right. And it is necessary for us to have it in our -- now I think the I understand the question better. We have to account for these kinds of events in our estimating procedures because they are events that have taken place. So when we go back and look at data from, say, 1980 and estimate something, we have to account for the fact that these additional events that take place with regard to the market are properly accounted for.
Q. And because your model doesn't look at anything back to 1980, it really has no impact on the end result of your conclusions that you provide?

A. That is correct. It helps us better fit the equations for the things that we are interested in, namely, price.

Q. Okay. Thank you.

A. You are welcome.

Q. That's all I had.

THE JUDGE: Other questions?

Dr. McDowell, it looks like you may step down. Thank you.

MS. DESKINS: We have no further witnesses at this time. We will, however, recall some people for which requests were made as soon as they are able to fulfill those requests.

THE JUDGE: Very well. It's a little after 4:00. Mr. Vetne, do you want to start or do you want
MR. VETNE: Oh, I think we'll start.

Mr. Wellington is ready to present his statement, and most people have received their copy.

THE JUDGE: While you are passing copies out, I have been asked to remind the people in the audience that the court reporter does need four copies of any statements which are being put into the record.

[Whereupon, the witness was duly sworn by the judge.]

THE JUDGE: Please be seated, tell us your name and spell your last name for the hearing reporter.

Whereupon,

ROBERT D. WELLINGTON,
called on behalf of Agri-Mark, having been first sworn by the judge, was examined and testified under oath as follows.

THE WITNESS: My name Robert D.
January 24, 2006 USDA Volume I

1 Wellington. That's spelled
2 W-E-L-L-I-N-G-T-O-N.

3 THE JUDGE: Very well, Mr.
4 Wellington. Your statement has been marked
5 as Exhibit 29. Do any of the tables need to
6 be separately marked or can I refer to them
7 -- do you want two rather than one exhibit?
8 THE WITNESS: I'll defer to my
9 counsel on that.
10 THE JUDGE: Do you want a cumulative
11 exhibit?
12 MR. VETNE: Your Honor, I think it
13 would be good to have one and then have the
14 tables be A, B, C, D.
15 THE JUDGE: Very well.
16 MR. VETNE: And I would like to --
17 THE JUDGE: Actually, the tables are
18 numbered.
19 MR. VETNE: Oh, they are numbered.
20 Yes, let me say that this document was
21 handed out earlier. Most people received a
1 copy. For some reason, many of the copies
2 did not a page 2. Hopefully, those that did
3 not have a page 2 now received one. If you
4 don't have a page 2, there are a few extra up
5 here.

6 THE JUDGE: And it also appears that
7 Table 9 is --
8 MR. VETNE: There was a Table 9 that
9 should have been attached that wasn't.
10 Let's just pretend it is attached, is that
11 all right --
12 THE WITNESS: That's fine.
13 MR. VETNE: -- as part of the
14 exhibit.

15 EXAMINATION
16 BY MR. VETNE:
17 Q. Mr. Wellington, you provide your
18 curriculum vitae in your prepared testimony,
19 is that right?
20 A. Yes.
21 Q. Who you are and what you have done.
1 And you testified many times at Federal
2 order hearings and state order hearings and
3 regional hearings and so forth?
4 A. Yes, I have.
5 Q. Okay. Proceed with your testimony, please.

STATEMENT FOR THE RECORD OF ROBERT WELLINGTON

My name is Robert D. Wellington. I serve as Senior Vice President of Economics, Communications and Legislative Affairs for Agri-Mark Dairy Cooperative. I have served in that capacity, along with being their economist, since 1989.

Prior to that I worked eleven years as an economist and the chief of research and market information with the former New York - New Jersey Milk Market Administrator's Office. I have a Bachelor's and a Master's degrees in agricultural economics from Rutgers University, where I also taught.

Agri-Mark is a Capper-Volstead
Cooperative with approximately 1300 member-owners whose farms produce milk throughout the six New England States and New York State. Agri-Mark owns and operates a cheese plant in Middlebury, Vermont, another in Chateaugay, New York, a cheese and other dairy products plant in Cabot, Vermont and a butter-powder plant in West Springfield, Massachusetts.

Proposal #1 was submitted by Agri-Mark in order to address a very serious crisis faced by its member-owners and its operations as well as the operations of all dairy product manufacturers who use Class III and IV milk pooled under Federal Milk Marketing Order.

BACKGROUND:

Current Class III and IV Federal order prices are determined using end-product pricing formulas. Such formulas begin with a national survey of the price of the primary
end-products which use Class III and Class IV milk. The survey is conducted weekly by NASS using pricing information from many plants which manufacture commodity cheddar cheese, butter, nonfat dry milk and whey powder. A monthly weighted average price is determined for each of the four products. The ruling commodity prices are then adjusted by fixed manufacturing allowances and yield factors to determine final Class III and IV milk and component prices to be paid under the Federal order. The manufacturing allowance is the amount of milk allowed in each pricing formula in order to manufacture each type of product. The class prices produced after manufacturing allowances are subtracted from dairy commodity prices are the imputed values of raw producer milk for each manufacturing use.

Monthly commodity prices used in the Class III and IV formulas vary each month.
according to the actual selling prices of the cheese, butter, nonfat dry milk and whey powder. When any of these prices change, the prices of milk and milk components paid by manufacturers also change. However, under current Class III and Class IV price formulas, the make allowance is fixed and does not change no matter how manufacturing costs change unless a Federal order hearing, USDA decision and favorable producer referendum occurs.

Manufacturing allowances that are fixed in the class pricing formulas bear no relationship with the selling prices of any of the dairy products mentioned or the prices received by farmers for their milk. If cheese, butter, nonfat dry milk, NFDM, and whey powder prices were to double tomorrow, Class III and IV prices and farm prices would more than double, but manufacturing plants would receive the exactly same allowance. In
fact, manufacturing costs for energy, insurance, labor, capital and/or any other input could double; yet the manufacturer would not get one penny more to cover those costs under the existing order provisions.

THE SITUATION:

The costs of manufacturing dairy products have risen dramatically since the time period when the order manufacturing allowances were last surveyed. Current order provisions use costs from cooperative plants from primarily 1998 as well as California plant survey costs from 1999 as reported in February 2000. Energy costs in particular have more than doubled, but other costs such as employee medical programs, insurance premiums and packaging have increased dramatically as well.

The manufacturing costs have risen to such a degree that dairy commodity manufacturing plants that purchase Federal
order Class III and IV milk are losing substantial amounts of money. A number of manufacturing plants in the Northeast milk marketing area where Agri-Mark members farm have ceased production recently and class pricing problems have played a role in these closings.

During the past two years, a number of Class III manufacturing plants have closed or substantially reduced their cheese production. These plants include a Kraft cheddar cheese plant in Canton, New York, a Sorrento Italian cheese plant in Goshen, New York and a Saputo cheese plant in Allentown, Pennsylvania. Each of those three plants formerly received upwards of 30 million pounds of producer milk per month. Just last fall, the Lucille Farms Italian cheese plant in Swanton, Vermont closed its doors, citing the distorted Federal order Class III prices as a major reason for their recent financial
That plant regularly received about 15 to 20 million pounds of milk per month.

A fifth cheese plant operated by Suprema Cheese in Ogdensburg, New York that received about 20 million pounds of milk per month closed in 2004. The plant was recently reopened by a kosher cheese maker. That plant now receives only one million pounds of kosher producer milk per month. A Losurdo Italian cheese plant in Heuvelton, New York recently down-sized from 20 million pounds per month to 10 million pounds per month.

These six plants combined no longer use almost 140 million pounds of producer milk per month or about 1.7 billion pounds of producer milk per year. That is the equivalent of the milk production of more than 1000 Northeast dairy farms.

Table 1 shows the monthly Class III, Class IV and total producer receipt milk
volumes for the Northeast Federal order in 2005. Also shown are the monthly milk volumes as a percentage on the average annual monthly volume. Class III usage ranges from a high of 107 percent of the average volume in May to a low of 92 percent of the average in October. Class IV usage ranged from a high of 145 percent in May to a low of 48 percent in September. Clearly, both Class III and Class IV prices seasonally balance producer milk supplies. Class IV plants do this to the greatest degree.

Table 2 shows the Class III, Class IV and total producer receipt milk volumes for the Northeast Federal order on an annual basis from 2001 through 2005. Class III and IV usage as a percentage of total producer receipts are also calculated. Current Class III usage of milk has fallen 2.3 billion pounds from the 2001/2002 period. While much of this lost manufacturing milk volume
originated from the Northeast plants which closed or down-sized, it also shows that remaining Class III plants are using less producer milk. Class III utilization has fallen from 31.4 in 2001 to 22.9 in 2005.

Milk production and total Northeast order producer receipts fell in 2003 and 2004. Class IV butter and nonfat dry milk plants again performed a balancing role and used less milk in both years. However, when milk production rose in 2005, the remaining cheese plants in the region absorbed relatively little of the extra milk, while butter/powder plants absorbed most of it. Class IV utilization rose from 8.8 percent in 2003 to 9.7 percent in 2003 and then to 12.7 percent in 2005. These Class IV plants took in the extra milk to clear the markets of surplus milk, not because it was profitable to do so. It is not surprising that that all the remaining large Class IV plants in
the Northeast are operated by cooperatives. Federal order Class III and IV plants perform important roles in Federal orders. They balance Class I and II needs seasonally and on weekends and holidays, as well as provide nearly regular orderly markets for producers in the Federal order marketing areas. Proprietary plants that purchase Federal order milk must pay the Federal order minimum prices. Competitive pressures as well as fairness issues necessitate that cooperative plants do likewise or else risk losing members and milk supplies.

In industries not subject to government price regulations, increased costs may be passed on and recovered by buyers. Even in the regulated dairy industry, Class I and Class II processors may pass on costs without limits imposed by USDA. However, this is not possible for dairy commodity manufacturers operating under Federal milk
order pricing. Any attempts to raise commodity prices and apply that additional sales revenue to cover the higher manufacturing costs have been disallowed by USDA. In 2005 international demand for nonfat dry milk powder was rising as were the costs of energy to make the product. Dairy America, a federation of cooperatives, including Agri-Mark, that jointly market about 80 percent of the U.S. nonfat dry milk production, was able to adjust its selling price and accounted for the increase as an energy surcharge. Their hope was to exclude this energy surcharge from the NASS price survey. NASS did not allow a separate surcharge and instead raised the NASS survey price. That higher price was subsequently used in the Class IV price calculation and raised the milk price paid by Federal order nonfat dry milk manufacturers accordingly. Despite higher energy costs, manufacturers
received no additional money to cover those costs.

Manufacturing allowances used under the Federal order are intended to cover the cost of making the products. Cheese, butter, nonfat dry milk and whey powder prices used in the formulas are updated monthly, resulting in new class prices. Agri-Mark believes that manufacturing allowances must also be updated to reflect current reality.

The impact of current Federal Milk Market order manufacturing allowances on Agri-Mark plant operations for our fiscal year 2004, which goes from December 1, 2003 to November 30, 2004, are shown in Table 3. This table uses the product volumes and costs that are reported in the 2004 RBCS report as well as our actual return on investment, administrative costs and marketing costs which will be discussed in greater detail further in my testimony. Agri-Mark operates
whey condensing equipment at its Cabot plant and whey separation and condensing equipment as is Chateaugay plant. Whey in various forms is shipped from those plants to our full whey processing facility that is part of our Middlebury cheese operation. The Agri-Mark Middlebury plant does not produce commodity whey powder but instead produces whey protein concentrate and permeate, lactose powder. I have estimated the pounds of whey powder equivalent from the pounds of cheese produced at each plant based upon a ratio of 0.6 pounds of whey powder for each pound of cheese produced. Our costs of making whey protein concentrate and permeate are much higher than that for whey powder and the final prices are different, so it would not be appropriate to use our actual costs. Instead, I used the costs being proposed based upon the RBCS and CDFA surveys and combined in the same fashion USDA used in
their last decision.

The total impact of Agri-Mark incurring its manufacturing costs while only receiving the equivalent of the current order manufacturing allowances is a negative $15.4 million in 2004. This represents a cost difference of 65 cents per hundredweight on all of the milk produced by our member-owners. Agri-Mark members have, in fact and effect, subsidized the Northeast blend price by accounting to the pool for much more than the value of milk used to make Class III and Class IV commodity products. The amount of this unfair subsidy has grown steadily as manufacturing costs have risen for seven years, but the manufacturing allowance has not changed. The inequity is now of crisis proportions.

Due to this cost crisis facing Agri-Mark and all Federal order dairy manufacturers, Agri-Mark and others in
notification industry are seeking the fastest and simplest manufacturing allowance update that can be done in a fair and reasonable manner. We believe that the fairest way, and hopefully the quickest, is to update the order manufacturing allowances by duplicating the surveys and methods already accepted by USDA that have already been used in the past to determine make allowances. We all have various concerns relative to several other Class III and Class IV pricing provisions, but we have laid aside those concerns temporarily in order to address this crisis. Once this crisis has been addressed, Agri-Mark is very supportive of having a hearing conducted - having a second hearing conducted and more comprehensive Class III and Class IV pricing hearings as soon as the Dairy Division of USDA deems appropriate in order to deal with those.

OTHER ISSUES.
We also believe that a full, nationwide manufacturing cost survey methodology should be developed and then conducted annually to regularly update make allowances and prices. Cornell University is developing such a methodology and survey. Agri-Mark operations and financial staff are assisting Cornell in this endeavor. When the survey is complete and reviewed by the industry, we believe that is when a more comprehensive hearing should be held.

PROPOSAL #1.

In order to provide the necessary information for an emergency cost update hearing, Agri-Mark asked the Rural Business Cooperative Service, RBCS, now known as the Cooperative Service, to update the survey that they have conducted in the past. Dr. Charles Ling has done so and we appreciate his efforts. The California Department of Food and Agriculture also conducts an annual
survey of plant costs which is usually released in the fall. We also appreciate their willingness to testify about their survey at this hearing.

Table 4 shows the calculations of the new make allowances being proposed by Agri-Mark under Proposal #1. It uses the weighted average of the largest RBCS and California manufacturing cost surveys for 40-pound block cheddar cheese and butter.

CHEESE:

In order to determine the cheese manufacturing allowance, we are proposing using the weighted average costs of the RBCS 40-pound block cheddar plants and all the California cheddar cheese plants. Relative to the California survey, this is the same group as used by USDA in the last decision setting current allowances. The RBCS survey had sufficient plants this time to report costs separately for plants which produced
40-pound blocks of cheddar cheese. Although cheese costs from additional plants were also available in the RBCS survey results, that larger group also included plants that produced cheddar cheese in 640- and 500-pound containers and some other types of cheese, as well as the 40-pound block plants. The weighted average costs of the larger group, inclusive of the 40-pound block group, was $0.18 cents below that of the 40-pound block only group. We believe that the price difference was caused by the lower costs of producing barrel cheese. In fact, when the 40-pound block group is removed from the larger group, the remaining plants in that larger group are shown to have a cost of production of $0.1211. This is 3.0 cents below the 40-pound block group. In the current order pricing provisions, USDA already adds exactly 3.0 cents to the NASS barrel cheese price to bring that price to a
40-pound block level. This makes it clear that USDA already accounts for the lower costs of producing barrel cheese in this formula and therefore only the 40-pound block cheddar cheese manufacturing costs should be included when setting manufacturing allowances for cheese.

In addition, the CDFA cheese cost manufacturing survey has adjusted plant costs since 1996 to standardize their reported costs to a 40-pound block plant basis. Please see footnote 1 of the CDFA summary table entitled "Weighted Average Manufacturing Costs for Butter, Nonfat Powder, Skim Whey Power and Cheddar Cheese, the 1989-2005 amended January 2006." This is exhibit -- I don't know the number offhand -- already discussed by the CDFA representative.

THE JUDGE: It's 23 as supplemented by 24 and 25.

MR. WELLINGTON: Thank you. Exhibit
In the decision establishing the current make allowance for butter, USDA combined the RBCS weighted averages for all plants in that survey with the weighted average of only the high cost butter plants in the CDFA survey. The Department's reasoning for using only the high cost subgroup for California was to reflect similar plant sizes as those in the RBCS survey, along with reflecting the balancing role that such plants perform in the Federal order system.

As we reviewed the RBCS and California plant size data for 2004 shown in Table 5, we saw that the low costs butter group averaged 72 million pounds of production annually and the high cost group averaged 234 million pounds. The simple average of both groups was 48 million pounds.
The RBCS plants produced 36 million pounds of butter per year but had a capacity to produce more if not for their balancing role. Had there been sufficient plants to report a California medium cost group, we likely would have preferred that option, but it was not available. Under the circumstances, we felt it was fairer and more appropriate to use the entire weighted average of all CDFA butter plants in calculating a proposed make allowance, even though that method results in a smaller make allowance than the method used by the USDA in the last decision.

NONFAT DRY MILK:

The make allowance for nonfat dry milk determined in the last decision also used the entire RBCS weighted average for all plants but then only used the weighted average of the two lower cost subgroups, of three total groups, from the CDFA survey. As shown in Table 5, the RBCS nonfat dry milk
plants produced an average of 31 million pounds of product annually, although like with butter, they performed a balancing role. This compares with 156 million pounds for the low cost California group, 60 million pounds for the medium cost group and 13 million for the high cost group. If you combined the low and medium cost group, the average production would still be 101 million pounds per plant. We propose that USDA use only the medium cost group from California. We believe that this is the most appropriate cost group when considering comparable plant sizes. We do not believe it is appropriate to use the weighted average of all three subgroups because the three low cost plants produce so much powder that they dramatically distort the average costs of the seven other plans. In addition, the shear volume of the nonfat dry milk production indicated that it is unlikely that they perform a balancing role
similar to the RBCS Federal order plans.

It is important that USDA understands the limitations of weighted averages when determining a cost. An average cost weighted by the product volume implies that half the product volumes in the group will have higher costs and half lower costs. Those with higher costs than a fixed manufacturing allowance will not be able to cover their costs and will lose money on that part of their operation. However, when there is a wide range of plant sizes involved in a cost survey and those much larger plants tend to have lower than average costs, using a weighted average leads to not just half the product volumes not being able to cover their costs it also leads to the majority of plants not being able to cover their costs. When the huge plants more often happen to be in California and the smaller ones are in the Federal orders, a weighted average cost can
lead to the majority of plants in the Federal orders not being able to cover their costs. I do not believe that would be the intention of the Department, particularly relative to nonfat dry milk plants which balance Class I markets.

It is also important to recognize that the recent building of extremely large dairy product manufacturing plants out west will likely result in lowering the weighted average manufacturing costs. However, all else being equal, when such a large low cost plant opens its doors and the national weighted average cost appear to fall as a result, the actual cost incurred by the remaining plants in the country have, indeed, not changed. For USDA to reflect such a change in manufacturing cost allowances would likely hurt most other plants in the country.

WHEY POWDER:

We propose that the whey make
allowance be determined by adding a
differential cost per pound to the NFDM
manufacturing allowance as discussed above.
This is the same method USDA used in the last
decision when a cost factor of $.019 per
pound was added to the nonfat dry milk make
allowance. I understand that others will be
providing testimony to show that the updated
cost factor is $.025 due to higher energy
costs and perhaps other factors. For my
analysis purposes, I will show the price
impacts of using either a $.019 or a $.025
additional cost. Based on the evidence and
testimony at this hearing, we believe that
USDA should use the appropriate fixed cost,
whether it be $.019 or $.025 and add it to
the nonfat dry milk make allowance to set the
whey power manufacturing costs.
In that last decision, whey powder
plant cost data was not available. For this
decision, we had hoped that approximately
1 plant cost data would assist the Department
2 in setting the appropriate make allowance.
3 However, we are concerned about the
4 widespread difference between the RBCS and
5 CDFA survey costs and some of the cost
6 components in the RBCS survey. In addition,
7 whey is handled in many different ways at
8 cheese plants, depending upon the size of the
9 operation, its proximity to alternative
10 outlets for its whey and even the age of the
11 plant. Some cheese plants even dispose of
12 their whey by land spreading or feeding to
13 cows or pigs. Agri-Mark's plant in
14 Chateaugay, New York currently land spreads
15 some of its whey component products because
16 our whey-processing facility in Middlebury,
17 Vermont cannot handle all the whey from our
18 three facilities. On occasion, we and others
19 in the Northeast sell condensed whey to
20 Canada and other areas. Our concern with
21 whey is that if the Federal order pricing
formulas continue to assign a high value to
the Class III price based upon the
manufacturing of whey at very large, new
plants that costs tens of millions of dollars
to build, smaller and older plants like many
in the Northwest will be at a large
competitive disadvantage under minimum
Federal order pricing. If whey pricing
issues force a company to build a whey drying
facility that often costs far more than its
cheese plant, that company may just close its
doors or relocate entirely to the milk
surplus western states. That just happened
this fall with a cheese plant in Swanton,
Vermont.

California has been collecting whey
cost data for two years now, but even their
price setting authority did not recognize
their own survey data and methodology as
appropriate to set the state's actual make
allowances. During both of those years, the
survey has reported a cost of $.267 per pound, but their rate setting authority used only $.20 per pound for the past year as the appropriate make allowance. The RBCS data generates similar concerns. It reports dramatically lower costs than in California, a full ten cents per pound lower when all comparable costs are added. In addition, the RBCS survey reported energy costs for whey powder which are 35 percent lower per product pound than for nonfat dry milk. This makes little sense since whey begins with a higher moisture content than nonfat dry milk and requires an additional processing step. I am not an expert in this area, but Mr. Richard Langworthy, who is in charge of all of our manufacturing operations, including our whey processing facility attached to our Middlebury, Vermont plant can speak further to this issue during his testimony. In addition, I believe that other knowledgeable
witnesses will also be giving testimony later
in the hearing.

Dr. Ling has conducted his cost
survey many, many times for cheese, butter
and nonfat dry milk. This has allowed him
and survey participants to thoroughly review
the methodology for these products. This is
only the second time that Dr. Ling has
attempted to calculate whey powder production
costs. Problems in the allocation of costs
as well as the reporting of all costs may
have played a role. In addition, I
understand that the economies of scale
achieved by the RBCS survey plants at near,
or surprisingly above 100 percent capacity,
are only achieved through the transportation
of condensed whey from other facilities.
These transportation costs need to be
accounted for if the Department wishes to
make use of the RBCS and DCFA data. In
addition, any plant operating so close, or
above, full capacity on an annual basis in markets that do have not have production seasonality -- I'm sorry, that do have production seasonality must have times of the year when their whey cannot be processed in their full plants. The Department must also somehow account for those costs.

Indeed, most plants producing American cheese, such as cheddar, do not process whey into powder or other dry whey products as disclosed in USDA's publication "Dairy Plants Accepted and Approved for Grading." Of the 83 American cheese plants listed for 2005, 46 plants do not dry whey or whey products. Neither do the hundreds of smaller plants who must find ways to dispose of their whey by-product. This situation should counsel caution as the Department looks to assign manufacturing allowances that will likely overstate the Class III price for most cheese makers.
The industry needs a quick decision on updating manufacturing allowances, as quick as possible to update manufacturing allowances as possible. Clearly, the methodology of whey cost accounting needs more work. In fact, this is an area where the Cornell manufacturing cost study can address more thoroughly at the next hearing hopefully held within a year or so. In the meantime, we support updating the nonfat dry milk manufacturing allowance and adding the appropriate cost differential of either $.019 or $.025 to it in order to set the whey make allowance by the same approach as in USDA's last decision.

RETURN OF INVESTMENT, ADMINISTRATIVE AND MARKETING COSTS:

Agri-Mark's proposal includes updating the return on investment as well as administrative and marketing costs in the same manner used in the last decision.
regarding manufacturing allowances. That
decision made use of the California costs for
the appropriate group categories reported in
the CDFA survey. Table 6 shows the 2004
California costs along with the Agri-Mark
costs at our Middlebury, Vermont and West
Springfield, Massachusetts plant facilities.
Agri-Mark costs are above the
California costs for every category except
administrative costs for our Middlebury
cheese plant. Our Middlebury plant is
relatively new and very labor efficient which
may be the reason why our allocated
administrative costs are lower. In addition,
we believe that the California costs are
sufficiently representative at this point to
be used again.

IMPACT OF 2004 SURVEY ALLOWANCES ON
CLASS AND COMPONENT:

Table 7 shows a summary of the 2004
survey manufacturing allowances that are part
of our proposal. The cheese manufacturing allowance increases from $.65 to $.179 per pound. The butter manufacturing allowance increases from $.115 per pound to $.151 per pound. The nonfat dry milk make allowance rises from $.14 to $.187 per pound. The whey powder manufacturing allowance rises from $.159 to $.206 when a $.019 factor is added to the nonfat dry milk price and to $.212 when a $.025 is added.

The price of butterfat falls $0.044 -- should be cents per pound. The price of protein remains unchanged and the price of nonfat solids fall $.0.46 cents per pound. The price of other solids falls from $.048 to $0.54 per pound depending upon the additional nonfat dry milk factor.

Class III prices fall from $.43 solids to $.46 solids per hundredweight, once again, depending upon the nonfat dry milk factor used. The Class IV price falls $.55
The impact of Proposal #1 upon Agri-Mark operations can be seen in Table 8. This table is the same as Table 3 from the beginning of my testimony. However, in this table the manufacturing cost allowances have been changed from the current ones to the 2004 survey allowances. These reviewed make allowance reduce our cost shortfalls by $7.2 million or approximately $600,000 per month. This represents $0.30 per hundredweight on our annual member milk volume.

Keep in mind that these 2004 make allowances do not make our operations break even. The allowances were designed to be conservative and used weighted averages that tend to disadvantage smaller plants like ours. In addition, as noted earlier, the impacts shown in Table 8 make it appear that
our whey operations would now break even.
That is likely not the case, but my use of the 2004 whey powder make allowances as a proxy for actual costs resulted in the break even status of whey powder.

ADJUSTING MANUFACTURING ALLOWANCES TO INCLUDE 2005 ENERGY COSTS:

It is a lengthy process to gather and organize cost data. The costs shown in the two surveys use primarily 2004 information since 2005 data is not yet available this early in 2006. In the case of Agri-Mark, the cost time period we used was our fiscal year, which was December 2003 to November 2004. General costs during 2005 have only gone up slightly in most areas with the notable exception of energy and energy-related costs. Energy costs, particularly for fuel oil, natural gas and propane have jumped substantially.

Richard Langworthy, Agri-Mark's
Senior Vice President of Manufacturing Operations will be testifying on Agri-Mark specific energy and other costs later in this hearing. His information will show the huge increases in energy costs that have occurred just in the past few years. These high rates are also reflected in our anticipated energy costs for 2006.

On January 10, 2006, the U.S. Department of Energy released its short-term energy outlook and discussed its energy cost price projections for West Texas Intermediate Crude Oil, Gasoline and Crude Oil prices and Natural Gas Henry Hub Spot Prices. The crude oil price averaged $41.44 per barrel in 2004, which was a 33 percent increase from 2003. In 2005, that price jumped another 36 percent to $56.47 on average. According to the U.S. Department of Energy, that price is expected to average $63 in 2006 and $60 in 2007. In 2006 and 2007 oil prices are expected to be
52 percent and 45 percent respectively above 2004 price levels.

Natural gas prices, Henry Hub Spot, averaged $6.20 per thousand cubic feet in 2004 and rose 45 percent in 2005 to $9.00 per thousand cubic feet. 2006 and 2007 prices are expected to be $9.80 and $8.84 respectively or increases of 58 percent and 43 respectively above 2004 prices.

Clearly, energy prices are increased substantially in 2005 and expected to remain significantly above 2004 levels through 2007. It is crucial that the Federal order manufacturing allowances incorporate at least 2005 energy price changes.

We have worked with others in the industry to find a very simple set of energy indices that can fairly and reasonably update 2004 energy costs to reflect 2005 levels. We propose that the energy adjustments for 2005 be calculated using the Producer Price...
Indexes for Industrial Natural Gas, BLS series WPU0553, and the Industrial Electric Power Distribution, BLS Series WPU0543, Base equals 1982, weighted by the costs per pound of product in the RBCS survey as well as the CDFA survey, if those individual prices are entered into the hearing record.

These Producer Price indices show a 6 percent annual average increase in electric power costs and a 23.8 percent increase in Industrial Natural Gas costs from 2004 to 2005. I have applied those percentage changes toward the appropriate costs per pound for each product under the RBCS costs only since California energy costs are not available yet.

The bottom rows of Table 4 shows that as a result of this energy adjuster, the cheese manufacturing allowances would be increased by $.0021 per pound, the butter allowance would increase by $.0028 per pound.
and the nonfat dry milk allowance would rise by $.0098 per pound.

We understand that the National Milk Producers Federation will be proposing an ongoing energy index to adjust the manufacturing allowances on a continuing basis. Their proposal uses the same Producer price indices as we used in our 2005 adjustment. While we support the National Milk Producers Federation proposal, we, as well as National Milk Producers Federation, all recognize the ongoing energy adjustor is a new concept for settling manufacturing allowances. There is concern that the National Milk Producers Federation proposal may take more time and review for the Department to consider than Agri-Mark's relatively simply and straightforward update of current manufacturing allowances. We believe that the Department should therefore issue an interim emergency decision relative
to Agri-Mark's proposal using 2004 RBCS and
CDFA survey data adjusted for 2005 energy
costs and then provide a more thorough
comment and review period before issuing a
decision for the ongoing adjustor proposed by
National Milk Producers Federation.

IMPACT OF PROPOSED MANUFACTURING ALLOWANCES
ON CLASS AND COMPONENT PRICES:

The manufacturing allowances proposed
by Agri-Mark include a moderate 2005 energy
adjustor. Those allowances are also shown in
Table 7. The impact of the energy adjustor
is approximately a quarter of a cent per
pound for cheese and butter and one cent per
pound for nonfat dry milk and whey powder.

The proposed manufacturing allowances
are $0.181 for cheese, $0.154 for butter,
$0.197 for nonfat dry milk and either $0.216
or $0.222 for whey powder. The butter fat
price falls $0.047 per pound, the protein
price falls $0.003 per pound and the nonfat
dry milk price falls $0.056 per pound. The other solids price falls either $0.058 per pound or $0.064 per pound. The Class III price falls either $0.51 or $0.54 per hundredweight while the Class IV price falls $0.65 per hundredweight.

IMPACT OF PROPOSED MANUFACTURING ALLOWANCES ON DAIRY FARMER PRICES:

There is no way to avoid Proposal #1 having a negative impact on producer blend prices announced under the Federal orders. This has been a great concern to Agri-Mark as our cooperative is owned and controlled by its dairy farmer members. In the past, Agri-Mark has played significant roles in successful efforts to increase dairy farmer income. These efforts included the Northeast Regional Cooperative Marketing Agency, RCMA, many individual state price setting programs such as in Maine, Federal order pricing in 2000, the Northeast Dairy Company, the Milk
Income Loss Contract, MILC program, and the Cooperatives Working Together program. Any proposal that lowers regulated producer milk prices is not done lightly.

However, it is our belief that if this manufacturing allowance distortion from reality is not corrected, the income of Agri-Mark members and all dairy farmers will fall even more than the amount resulting from our proposal. If not corrected, not only will dairy farmer net earnings continue to fall, severely disorderly marketing conditions will result and jeopardize the existence of local outlets for producer milk in many areas of the country.

The impact of Agri-Mark members of not correcting this problem has already been discussed. Our members cannot keep bearing millions of dollars in losses indefinitely. The only reasonable alternative if nothing is done is to consider closing or severely down-
sizing all our plants. Three times in the
past Agri-Mark members have stepped forward
and kept cheese plants open that were about
to close. Our members have invested tens of
millions of dollars of their own money in
these plants, as well as in our Massachusetts
butter/powder market balancing plant. They
have done this so they have local, orderly
markets for their own milk and that of their
neighbors. Agri-Mark is the only
organization in the Northwest that has
actually increased its plant ownership in the
past decade.

As already discussed, many dairy
farmer plants in the Northeast have already
shut their doors and others are taking less
milk. This has affected the local demand for
milk in the region. Whereas national supply
and demand conditions drive national dairy
product and national basic milk prices, local
supply and demand conditions drive over-order
premiums. The recent closings of so many plants have placed great pressure on premiums paid by all handlers. With fewer plants buying milk, producers have lost bargaining power in dealing with the handlers that remain. Class I premiums have fallen by $0.20 per hundredweight in the past year and will likely fall further if this situation is not corrected.

In addition, as dairy manufacturing plants close and eliminate local outlets for producer milk, producer paid hauling costs to more distant plants rise and disorderly marketing conditions appear as more milk is displaced and must find an immediate home. Allied Cooperative Federation based in northern New York expressed similar concerns in their original letter to USDA supporting Agri-Mark's' hearing request. As a result of additional hauling costs and plant operation losses from many large cooperative -- I'm
sorry. As a result of additional hauling costs and/or plant operation losses, many large cooperatives in the Northeast reduced their member producer price differentials, ppd, by $0.10 to $0.25 beginning in the summer of 2005. Agri-Mark reduced our member ppds by $0.15 in July 2005.

In its notice on January 5th, 2006 announcing this hearing, USDA included an economic analysis of the impacts of changing Federal order make allowances. The analysis concluded that producer blend prices would likely fall from $0.05 to $0.13 per hundredweight, on average, over the next five years. As markets adjust and dairy product prices rise, this impact will fall to the $0.03 to $0.09 range. The impact on average all-milk prices is likely to be even more modest because, as I noted, producers' bargaining power will be improved if losses are reduced for management plants and if
cooperative manufacturers are able to recover costs for the benefits of producer-owners of plants.

The Agri-Mark proposal incorporates manufacturing allowances changes for cheese and butter that are very near the lower end of the three scenarios discussed. However, due to energy and other cost increases during the past six or seven years, our proposal has a greater change than USDA assumed for nonfat dry milk and whey powder.

I believe that the impact of our proposal will likely fall in the range between scenarios 2 and 3. This implies a $0.09 to $0.13 impact over five years and a $0.03 to $0.06 longer term impact. However, if these manufacturing costs issue is not resolved quickly, the impact on dairy farmers will be far greater than those amounts. Once a company decides to close a plant, that producer milk demand is usually gone forever.
We would ask the Department to provide a similar economic analysis in the final decision to document the likely impact if our proposal is enacted.

EMERGENCY DECISION NEEDED THIS WINTER:

An emergency decision is needed this winter so that order provisions can be amended by early spring. All Class III and IV manufacturers that operate plants using Federal order milk are losing large sums of money each and every day that goes by. USDA has implemented amendments within sixty days after the hearing in the past. Similar expedition is justified in this case.

Agri-Mark members take on the risk and responsibility of balancing the Class I market and providing local outlets for their milk and the milk of their neighbors.

Enactment of Proposal #1 means that approximately $700,000 per month in plant margin losses can be avoided. Each day that
goes by without a decision means more than $22,000 to Agri-Mark members.

It is particularly important that the amended manufacturing allowances be in place in early spring. As already noted in Table 1, April, May and June are usually the peak months when Class III and IV plants do the most balancing for the Northeast Federal order. Of those three months, May is the most important from a balancing perspective. As losses to the Class II and Class IV plants keep mounting, those plants will likely be willing to take less and less, which will likely result in disorderly marketing conditions and lower prices to dairy farmers.

Agri-Mark is one of the key balancers of milk in the Northeast. Table 9 shows the seasonality of component usage the our four plants. It is also important to consider milk component usage instead of just milk usage since the growth in sales of lower fat
Class I products and high fat Class II products create their own seasonality. For example, the average butterfat test for producer milk falls as summer heat begins in late June. At the same time, butterfat demand rises to meet Class II frozen dessert needs. Table 9 shows that July Class IV butterfat usage at our West Springfield plant was only 77 percent of the annual monthly average. As summer heat continued to take its toll on butterfat tests and ice cream sales increased at the same time, butterfat usage at our plant was only 28 percent of the annual monthly average in August 2005.

Nonfat solids supply and demand also show large seasonality fluctuations that need substantial balancing. Nonfat solids usage remains strong in June and July as schools go out of session and Class I sales decline. July 2005 nonfat solids usage at our nonfat dry milk plant was 138 percent of the annual
monthly average in July; however, that rate fell to 90 percent in August and then 50 percent in September 2005 as schools came back into session.

Class III component usage at our cheese plants also balance seasonal changes in producer milk production that Class I and II plants cannot or will not balance due to the perishable nature of their sales. Generally, our cheese plants use about 105 percent of the annual monthly average in the spring flush months of March through May compared to about 92 in September and October. Although less than Class IV volume swings, our Class III plants do handle milk swings in excess of 12 million pounds per month. This is the equivalent of the monthly milk production of about 80 dairy farmers.

If Class III and IV manufacturing plants under Federal orders are to continue to perform their crucial roles in balancing...
1 Class I milk and milk component needs as well
2 as providing orderly local markets for dairy
3 farmers, those plants must have Class prices
4 that truly reflect the value of the milk to
5 their operations. The Agri-Mark proposal
6 aligns Federal order manufacturing allowances
7 with the average costs of manufacturing and
8 will allow such plants to continue as outlets
9 for producer milk and providers of key market
10 balancing services.

11 We urge the Department to quickly
12 review this hearing record and issue a final
13 interim decision as soon as possible so this
14 severe problem can be corrected no later than
15 this spring. Thank you for this opportunity
16 to present our concerns and proposed solution
17 for your consideration.

18 Thank you, Mr. Wellington.
19
20 You referred in the course of your
21 testimony to nine tables attached and there
22 are nine numbered tables attached following
1 Table 9 which was inadvertently omitted and
2 inserted. There is a document which has
3 Exhibit blank, USDA approved dairy plants to
4 which you refer on page 8 of your testimony.
5 I think it will be helpful for Your
6 Honor just to pencil in Table 10. It is the
7 next consecutive table in the exhibit.
8 THE JUDGE: Following table 11.
9 MR. VETNE: Following -- we have 9
10 printed tables, 8 and then 9, and that table
11 and then an energy outlook document.
12 THE JUDGE: Which would be table 11.
13 MR. VETNE: Table 11.
14 BY MR. VETNE:
15 Q. Mr. Wellington, is the four pages
16 that consist of your penciled in as table 10,
17 are those the excerpts of American cheese
18 plans to which you refer on page 8 of your
19 testimony, some of which produce whey and
20 milks?
21 A. Yes, that's true.
Q. And that is simply data taken from the publication by Dairy Programs, dairy plants surveyed, approved for USDA grading service?

A. Yes, it is.

Q. Okay. And there is one more attachment, which we can pencil in as table 11, even though part of it is not a table. Short-term energy outlook, you refer on page 10 of your testimony to Department of Energy projections of energy prices for 2006 and 2007. And at the top of this page, it says, This is an excerpt consisting of page 1 and figures 1 through 3 of a 52-page document. And that is the data to which you referred on page 10 of your testimony.

A. Yes, it is.

MR. VETNE: And, Your Honor, although I will have other requests for official notice all at one time, tomorrow morning this is probably a good place to do it. I'd like
to request official notice of the published USDA dairy plants surveyed and approved for grading service, publications for 1998 to date. 1998 was the last year in which we had a cost survey, so the plants and changes in plants since that time, I think it would be helpful for reference.

THE JUDGE: Very well.

MR. VETNE: And the other document is the full document of the Department of Energy's short term energy outlook. This one was released in January of 2006. It's a 52-page document which gives information on projected prices and supplies for various energy sources. I would like to request official notice on that, as well, Your Honor, within the briefing period of the next edition of the short term energy outlook which is scheduled to be released on February 7.

THE JUDGE: Subject to its being
1 released.

2         MR. VETNE: Subject to its being
3 available at the time of briefing, but
4 February 7th, I think you said. I know that
5 we may have a couple more --
6 BY MR. VETNE:
7      Q. Bob, look at page 5 of your
8 testimony.
9      A. Yes.
10      Q. Near the bottom of the page, about 10
11 lines up, there's a 40-pound block with $.018
12 cents.
13      A. That should be $.018 without the
14 cents.
15      Q. Without the cents.
16      A. Right.
17      Q. And on -- let's see.
18      A. There are a couple of others there.
19      Q. There are several of those there.
20 Wherever there appears to be a dollar sign --
MR. VETNE: Page 9, there are two of
them near the bottom of the page.

THE JUDGE: One at the top, first
paragraph?

MR. VETNE: As well as at the top,
about seven lines down from the top of the
page, $0.19 or --

A. Those really default to the dollar
sign.

Q. Okay. And the bottom of the page
about two-thirds of the way down, the price
of butter --

A. Butterfat false, .044, that cents
should be removed also.

Q. And the next line, same thing?

A. Yes

Q. And the next line, same thing. And
the bottom of page 11, three places, same
thing?

A. Absolutely.

Q. Those are all --
A. Cents, yes.

Q. Those are all dollars, actually, point-something dollars.

A. Remove the cents from those.

THE JUDGE: Also on page 12, his this, additional hauling costs, I suppose additionally?

BY MR. VETNE:

Q. Yes, on page 12, next to the last line. You read "additional" hauling cots rather than --

A. I corrected that, hopefully, for the record.

MR. VETNE: And there may be one or two others. We're going to have a chance to see you again tomorrow morning, I think.

So, Your Honor, with those clarifications and references, I ask that the exhibit with attachments be received.

THE JUDGE: So admitted.

[Whereupon, Exhibit No. 29]
was received in evidence.]

THE JUDGE: Ms. Deskins, do I hear a motion to adjourn?

MS. DESKINS: Yes, Your Honor, we move to adjourn the hearing until tomorrow morning.

THE JUDGE: And what time would you all like to start? 8:30 again? 8:30 it is.

I look forward to seeing all of you tomorrow morning.

[Whereupon, the hearing adjourned at 4:58 o'clock p.m.]