VOLUME VII

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

In the Matter of Proposed Docket Numbers
Amendments to Tentative AO-14-A77, et al.
Marketing Agreements and DA-07-02
Orders

National Public Hearing
Tuesday, April 10, 2007
9:08 o'clock a.m.
Radisson Hotel Circle Centre
31 West Ohio Street
Indianapolis, IN 46204

BEFORE:

JUDGE VICTOR W. PALMER
U.S. ADMINISTRATIVE LAW JUDGE
UNITED STATES DEPARTMENT OF AGRICULTURE

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JOHN ROETLIN,

having been first duly sworn in by the Judge, was examined and testified under oath as follows:

STATEMENT OF JOHN ROETLIN

JUDGE PALMER: All right. Let's get started. Sir, would you give your -- we're on the record. Would you give your full name, sir. Your name.

MR. ROETLIN: John Roetlin.

JUDGE PALMER: Spell it for the reporter.

Spell your name.

MR. ROETLIN: R-O-E-T-L-I-N.

JUDGE PALMER: All right. And you own a cheese plant?

MR. ROETLIN: Yes, sir. I own Twin County Dairy at Kalona, Iowa.

JUDGE PALMER: You want to bring that microphone a little closer to you. They're having a little trouble hearing.

MR. ROETLIN: Can you hear me?

JUDGE PALMER: Now we can.


JUDGE PALMER: All right. Sir, and you've
looked at the proposals that are here, I gather, and you want to give some -- your thoughts on some of these proposals.

MR. ROETLIN: Yes, sir. I just -- my testimony is not going to take very long. Can everyone still hear me?

JUDGE PALMER: Go ahead and tell us what you wish to say, sir.

MR. ROETLIN: I've never been to one of these proceedings. I don't have a clue what goes on.

JUDGE PALMER: They don't either. They don't either.

MR. ROETLIN: I think that's probably right.

JUDGE PALMER: All right.

MR. ROETLIN: I know that there's probably not too many cheese plant operators here, I can tell you that, because if there were, if they had something to do with it, they wouldn't be doing the way the present formula is set up.

Our company is a private company. It's owned by the family. My father started it with a bunch of Amish and Mennonite farmers in our area; as a matter of fact, 32 of them. And it
was a cooperative type of an operation, but my father, he had the cheese equipment, and the farmers' cooperative had the building. It's one of those old Wisconsin type of cheese operations where they had a cheese maker and he worked on a percentage. That was in 1947.

In 1967, myself, my father and my brother bought the co-op out. In 1970 my brother and myself bought my father out. In 1985, I'm the only standing survivor here.

I'm not going to go over the 1 through 19 proposals because I think everybody in this room knows what they are, and we've been -- they've probably been across it a million times.

Shall I just continue here?

JUDGE PALMER: Go ahead, sir. If you want me to ask you some questions, I will, but I thought it'd be easier for you to just give a statement.

MR. ROETLIN: And everyone can hear me, right?

JUDGE PALMER: Yes.

MR. ROETLIN: I think for us -- I believe Dave Stutenburg, is that correct, I did talk to him and I wanted to make sure that when the whey
allowance or the whey was put into the order was the year 2000.

Since 2000 to present, our company has only made money two years. And we're a pretty efficient company. We have myself, and my wife is the secretary, we have 55 employees. That goes with semi drivers, so we think we're pretty efficient. And we feel that we have this cut to the bone. And it just isn't there.

We have a lot of people in this room that are paid to put that formula together, I believe. We have a lot of suggestions I think. We have a lot of operators, probably farm groups, farmers, maybe some cheese plant operators of different types, co-op, private, large corporations, whatever.

Where I sit, I don't know what to do about what we have going on, but, like I said, we've only made money two years since 19-- -- or since 2000.

I think I agree with maybe some of the proposals where they're talking about we need to have faster or quicker changes in the Order. Maybe what was good in 2000, 2001, isn't good today. Everybody knows what the whey price is.
And it's almost impossible, when you look at those other solids prices, to make money.

And I think one of the other things I want to say is the plants that invested in whey operations, the plants spent that money. When I say plants, I'm talking about myself, and I don't know, I assume the farmers' cooperatives or large corporations would be the same thing, but a large share of that money that's coming in is going right back to the farmer or however they -- whatever that formula is, and I think somebody needs to look at that.

I really don't have any more. I don't know if this is the way I'm supposed to do it, but this is the way I feel.

**JUDGE PALMER:** Well, what we're going to do, we're going to let some of these folks ask you some questions.

**MR. ROETLIN:** I might want to add, I'm a little hard of hearing. My wife says I'm very, very hard of hearing, so.

**JUDGE PALMER:** The first man who wants to ask you some questions is John Vetne I think. John is going to speak loudly because John sometimes speaks softly.
MR. VETNE: My wife says I'm hard of hearing.

JUDGE PALMER: Yeah, I know.

EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q  Good morning, Mr. Roetlin. My name is John Vetne. I'm an attorney for Agri-Mark and other cooperatives who are proponents of several proposals for make allowance and other parts of the formula.

What kind of cheese does your plant make?

A  My plant makes 500-pound barrels, cheddar, for Kraft.

Q  Cheddar?

A  Cheddar.

Q  Okay. And all of your production is contracted to Kraft?

A  Yes, sir.

Q  Are the sales of -- are the sales of cheese to Kraft and the prices for those sales surveyed by NASS, do you know?

A  NASS.

Q  You report to NASS --

A  Yes.

Q  -- the sale prices?
A Yes.
Q What is the production volume of your plant annually?
A From a million to a million and a half pounds. If we fortify our production equipment, would be 1.5 million. If we use just straight milk, it's about a million pounds.
Q Million pounds of --
A Milk.
Q Of milk per?
A Day.
Q Per day?
A Right.
Q You indicated that your plant has invested in -- in whey processing equipment; is that correct?
A That's correct.
Q What kind of whey processing equipment?
A We do UF, make WPC and also concentrated permeate.
Q Can everybody hear me okay? Okay.
Q Do you process all of the whey by-product that is produced by your plant?
A Yes, sir, we do.
Q Do you process whey from other plants?
A No, we do not. I can go into that just a little
bit more. There's only about -- in the state of Iowa, there's only -- I believe there's four cheese plants, and so geographically it's -- you know, doesn't work too well.

Q You indicated that you've -- your plant has made money only in two years since 2000. What was your profitability during the decade before 2000?

A You mean in dollars?

Q No, how many of those ten years --

A We always made money.

Q Okay.

A Some years -- excuse me.

Q Go ahead.

A Some years we didn't make what we liked, but we always were able to pay the bills and had some profit.

We had a profit in 1999, of course, and in 2000 it started to go down, and from 2000 to 2006 we have had two plus years. One of them was 2000 in the beginning of the other solids pricing, and the other profit year was 2003. And when I say profit, it depends on whose bank account you're looking at, but it wasn't very large. It was several hundred thousand dollars,
well under half a million. So for all practical purposes, you could say that from the beginning of the other solids pricing to today, we probably had one year that we made money, a good amount of money.

Q Okay. And when did you make this investment in whey processing equipment?

A We actually started -- in 1985 we put in a RO system and ran that for a number of years, and last year, 2005, we put up a facility to further process whey. It's not that we had the money. We went to a friendly banker and got it and put it together. And when we first built the building in '05, the pricing of WPC and everything else was very high, somewhere around, I believe it was 78 cents. And as we got it going, the price went down all the years to 2000, and then toward I think about the middle of the year of 2000 the pricing of WPC and permeate started to go up. At first when we started making permeate, we were practically giving it away. But today it's a little bit better story than that. But the other solids pricing has taken -- taken all of it. I mean we're processing the product and we're just
taking the money from that just to pay -- pay
for the milk and pay for the -- it's no profit.
Q  Okay. You say you built a building in 2005?
A  Correct.
Q  What building was that?
A  It was a whey processing plant. It was
 ultrafiltration, RO, and then of course we
 polish our water and use that for cleanup and
 whatever. And we also have an evaporator where
 we evaporate the permeate.
Q  So you made a substantial investment in plant
 equipment to process whey?
A  Yeah.
Q  And that investment was made in 2005?
A  That's correct.
Q  When was it complete?
A  It was -- our first day of operation with it was
 February 27th, I believe, of 2006.
Q  So it's been in operation for over one year?
A  Yes, sir.
Q  And during -- during that year, have you been
 able from your sale of products to make payments
 on the cost of that investment?
A  No.
Q  And is the reason for that the difference
between -- there's an inadequate margin between what you receive for your product and what you have to pay for milk?

A That's correct.

Q The milk that you receive comes from what source? Who sells you milk?

A The -- most of the milk that we receive we receive from -- we buy from Swiss Valley Farms, we buy from Dairy Farmers of America, we buy from Prairie Farms, we buy some from NFO, so we pretty much buy most of the milk around our geographic area, it's produced in that area. But those are the major suppliers.

Q Do you -- are you filing reports to the market administrator for your use of the milk or do your sellers, your suppliers file those reports?

A I don't understand the question for sure.

Q Are you regulated by USDA, your plant?

A We're a USDA plant. We're inspected USDA. I don't know if that's what you mean.

Q Okay. You're inspected for your plant facilities, but your plant is not price regulated?

A Yes, we are. We buy the milk from DFA, Swiss Valley, those people. We are regulated, so
we -- our pricing is priced through the Class III price plus.

Q Okay. So your -- DFA or Swiss Valley, they have to pay the Class III price and that's what they charge you?

A Correct.

Q Do you know how many producers supply your plant on average?

A How many producers would be involved in that?

Q Uh-huh.

A Probably 350, maybe 400. That's a guess. I'm not real sure, but that's -- that's close.

Q Okay. Does your plant regularly receive milk from the same producers day after day?

A Yes, we do.

Q Do your contracts provide for a regular, committed supply from --

A Yes, it does.

Q -- from DFA or Swiss Valley?

A Yeah.

Q Do you receive additionally milk that is not committed to you? You get a call saying are you willing to take an extra load today?

A From those particular people or somebody else?

Q From those people or anybody else.
Both. We sometimes call, we're short, don't have enough or would like to have more and then call, but --

Q So sometimes you look for milk?

A Sometimes I look for milk, and I don't know why.

Q And sometimes other people look to you to buy milk?

A The question is what?

Q Sometimes you call others?

A I call others, they call me.

Q It goes both ways?

A They know that we have -- that we help a lot of these co-ops with milk supply and holidays and if there are -- if they're long, we help them. Sometimes it's a little bit harder to rake them over a tree stump to get milk when it's short, you know what I mean, but, like I said, I don't know why we do that. I would be better off just leaving the milk where it's at and forget about this for --

Q All right. You currently make milk into cheddar cheese in 500-pound barrels?

A Yes, sir.

Q Have you made cheese in any other form in recent years --
A: Well --
Q: -- blocks or smaller barrels?
A: Yes, we have. We've done that, I've made -- we've made six or seven different kinds of cheese. I made Swiss cheese, I made about everything there is out there.
Q: Say since 1990, have you made a variety of cheeses?
Q: It's all been cheddar. And since 1990 has it all been in 500-pound barrels?
A: Pretty much, yeah.
Q: And has it -- does it all go to Kraft?
A: Yes, sir.
Q: Do you deliver your product to Kraft?
A: We have trucks, so we charge -- we deliver, but we charge. There's a haul rate that you -- that is assigned to us.
Q: Where is it delivered? Where is the product delivered?
A: Allentown, PA; New Ulm, Minnesota; Springfield, Missouri; and Champaign, Illinois.
Q: Do you know how Kraft uses your product?
A: Some of it goes into a -- into a cave down in Springfield. I don't know what they do with it.
Sometimes they've aged it. I think primarily it goes to American slices. We kind of have a niche market with them because of our body, it has a certain body, our cheese; therefore, it works well for them to blend it with -- with some of the other products that they have.

Q When you make cheese, your by-products are -- you get whey skim and whey cream; correct?
A Correct.

Q What do you do with your whey cream?
A We sell our whey cream to a creamery. The name of the company is Alcam Creamery out of --

Q How do you spell Alcam?
A Alcam, A-L-C-A-M, I believe it is, out of Wisconsin somewhere, I'm not sure where, what the -- what the city is that they're from, but.

Q Do you truck it to Alcam?
A No. They pick it up.

Q How frequently do they pick it up?
A They pick up three times a week.

Q And when they pick it up from you, do they pick up milk from any others that you're aware of?
A Any other creamery or --

Q Any other cheese --
A Yeah, Wapsie Valley in Independence, Iowa. They
pick up that cream also.

JUDGE PALMER: John, I think we're getting more detail than we really need. The basic testimony is that the whey price is too high. We've got a pretty good understanding of his operations at this point, so maybe you just want to move on to something else.

MR. YALE: Your Honor, could I speak? I think I know where John's going, and it's not a position that we take. By the way, Benjamin F. Yale, Select.

But one of the things that's really important is having this information of what goes on in the plants so that we do know where the whey cream comes from and how it's sold and stuff. I think it's valuable. I mean I'm not -- I wish that he'd said another answer, but I think it's valuable information.

JUDGE PALMER: Well, then, I'll let him continue. Go ahead, John.

MR. VETNE: I'm adopting him. This is no longer Cross, Your Honor. This is Direct. I'm adopting this witness as my own and I'm asking him Direct questions.

JUDGE PALMER: Go ahead.
MR. YALE: No leading questions then, John.

JUDGE PALMER: You've been adopted. You've been adopted.

MR. ROETLIN: Well, if they keep going, I'm not always politically correct. I think that's --

JUDGE PALMER: All right.

MR. VETNE: And I would encourage you to be politically incorrect.

BY MR. VETNE:

Q    When you sell whey cream, how is that priced?
A    I believe it's 1.15 over -- I stand to be corrected, but I think that's the price that we get.
Q    Well, there's no way to correct you.
A    Yeah.
Q    Whatever -- your belief is that it's 1.15 over --
A    I believe it -- it's either 1.12 or 1.15. I'm not sure.
Q    Is that 1.15 or 1.12?
A    I think it's 1.12 or 1.15.
Q    Over what?
A    Over Chicago, I believe, is that -- is that the -- that's the multiplier over -- over the
butter market, I believe. Somebody in here help me out on this?

JUDGE PALMER: They're not going to do that.

MR. ROETLIN: Is that Bob Wellington back there?

Q Is that somebody else's responsibility in your operation, the sale of --

A It's mine and someone else's, but I mean that was set up a couple years ago, and that's about all we can get.

Q Okay. And to whom do you sell your whey products?

A We sell our whey product to Land O'Lakes. We sell it to Bongard's. We sell it to Litchfield.

Q Litchfield is?

A Litchfield, Minnesota. Bongard's is in Minnesota. Land O'Lakes is in Minnesota.

We sell it to Protient. Protient, P-R-O-T-I-E-N-T.

I think based on the fact that we're selling to Bongard's and to Land O'Lakes, it tells you that our product is pretty good.

Q All right. When you make cheese, when you make cheddar cheese, do you recycle whey cream into
your vat?

A We do not. The people that we sell cheese to don't really -- they don't really like that. Some buyers, some cheese buyers don't care or -- but Kraft does.

Q When you make -- when you make cheese, do you fortify with milk solids from any source?

A We had till the price got where it's at right now. I think it's -- as some people in here probably know, I think it's about a buck sixty-five, something like that, and, you know, I --

Q A buck sixty-five for what, sir?

A A pound of powder or solids, however you want to -- on powder.

Q On powder?

A On skim, nonfat dry milk.

Q Okay. And would you fortify with powder or condensed or both?

A We've done both. We've bought -- we've bought some UF out of New Mexico and -- but now, you know, I think the way the whey price is now, you can't -- you can't afford to do that either because when they UF that milk, some of your lactose goes and now it's something that we want
to sell, so we don't -- we just don't buy it.

Now, we do buy -- also buy cream. We fortify back into the cheese vats with the cream, and the price currently, we can do that, but.

Q  Do you buy cream throughout the year or are you more likely --
A  Pretty much throughout the year. And that, by the way, is not 1.12 or 1.15. That's 1.28. That's the multiple on that. And I think that's kind of a standard price for cream, I think, 1.28 over Chicago I think, so that -- that we do do. But then we turn around and sell it for 1.12 or 1.15, so.

Q  You buy it for 1.28 --
A  The only thing we would be selling would be what would be left over in the whey, so. It's kind of okay, I guess.

Q  Do you know what the composition, the average composition of milk that you get from dairy farmers is at your plant, butterfat content, protein content?
A  Pretty much, yeah.

Q  What is that?
A  3 point -- I believe it's 3.6 something on the
fat or 3.7. 3.2, I believe, on protein, and I'm not sure what the other solids is.

Q Okay. Do you -- because you sometimes -- you sometimes add cream and add --

A We add cream all the time.

Q You add cream all the time?

A Yeah.

Q What is the composition of the milk in your vat including added cream, added solids, do you know?

A About -- I believe it's about 3.8 or 3.9, something like that.

Q Fat?

A Yeah, fat.

Q So the protein portion would be a bit lower, then, if you're just adding fat?

A Since we're adding the fat?

Q Yeah.

A That'd probably be right.

Q So something less than 3.2?

A Yeah.

Q What is -- how many pounds of cheese do you get from your vat per hundred pounds of milk in your vat at 3.8 percent fat?

A That, of course, is seasonal, you know what I
mean, in our area. It's from about, I believe it's October to January or so, it's -- maybe we yield about 10 pounds, something like that, and then after January the yields start to go down, and we get into July or something like that, we would probably have about 9.0 yield; in other words, nine pounds of cheese for hundred pounds of milk.

Q Is that from a hundred pounds of milk from producers or a hundred pounds in the vat?
A Hundred pounds in the vat.
Q In the vat. So the yield -- since you're adding cream, the yield from producers would be somewhat less?
A That's correct. I believe that before we started to fortify it, we'd probably get something like 8.7 or 8.8 pounds of cheese.
Q Before you started to fortify?
A Before we started to put cream in, yeah, and then sometimes fortify with dry milk and whatever.
Q When you use the term fortify, you're talking about added fat as well as added nonfat solids?
A Correct, yeah.

MR. VETNE: I think I'll let some other
people ask some questions. I might have some
more. Thank you very much.

THE WITNESS: Thank you.

JUDGE PALMER: You're now in his will, I
understand.

Other questions? Mr. Yale.

EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q Good morning. My name is Ben Yale, and I
represent Select Milk Producers, Dairy Producers
of New Mexico, Continental Dairy Products, Lone
Star Milk Producers and Zia Milk Producers.

You indicate that you both fortify and
bring in cream. Is that all at the same time
that you'll add additional cream and then also
bring in other solids for your vat?

A Well, like I indicated earlier, we -- when the
price of dry milk was less or UF milk, some of
the people you represent, we would do both. We
would bring the dry milk or the condensed or the
UF milk, and also if -- see, we're going into
skim, so we have to add fat back, otherwise our
FDBs would be way too low on the cheese.

Q Right. And part of the thing of it is you got a
fairly high level of protein coming in in your
producer milk. I mean you have a fat-to-protein ratio that's relatively narrow compared to some milk, isn't that true, or you don't know? Your 3.2 percent protein is somewhat high, is it not?

A  But that wouldn't be year around. That would be -- I'm talking about months like October to maybe January, but here oftentimes when we go past February or March, we would end up 3.0 or 2.9, you know what I'm saying.

Q  Right. And at those times, that's when you would need to bring in some additional solids so you could use all the fat that you have in the vat; is that correct?

A  That's true.

Q  And then maybe in that period when you're at the 3.2 percent protein, you may need fat in order to use up all of the solids; right?

A  I don't understand the question.

Q  I mean if your fat-to-protein ratio is low because the protein test is high, then you would need to buy additional cream in order to get your fat ratio up?

A  Correct. And, of course, we're limited by the cheese buyer what -- how much fat you're going to have in there, because you put too much fat
in, then your body goes to hell, whatever, so
you're kind of playing a game of running
between, so.

Q Just hearing you talk, I get the impression you
try to produce, what, a full fat cheddar, is
that how one would describe it?

A That's correct.

Q You have about as high a percentage of butterfat
as you can get into your cheddar, is that -- I
mean to the point -- I mean obviously there is a
limit, the casein can only hold so much, but.
You don't -- you don't know the answer to that?

A No.

Q By the way, when you said you sold the whey
cream FOB, is that FOB your plant or is that FOB
the -- the price that you sell your whey cream,
is that FOB the plant, your plant?

A That's correct, yeah.

Q Now, you, because you sell to Kraft, do not
recycle your whey cream?

A That is correct.

Q But that is a process that is used by other
cheese makers?

A I think it is.

Q Now, I want to talk -- this issue with the whey
solids, I think you bring up an interesting point. I think it is a -- it's a problem that the Secretary needs more information on. And although I represent producers and we like to see the higher whey value, I think we also understand some of these situations and what's going on.

You do not make any sweet whey powder; right? You concentrate all of it?

A We do not.

Q All right. Now, you said you do whey protein concentrates. Do you do any WPIs as well or you just --

A No, we do not. You mean like 90s, 80s and 90s?

Q Right.

A Yeah. No.

Q You don't do that?

A No.

Q So you're like WPC 50 or 40?

A 55.

Q 55?

A Yes.

Q Okay. And the -- when you sell -- I don't need to know the price you sell it at, but do you have a reference price, like you were talking
about that your whey butter is the Chicago price
times some multiplier; right?
A Yes.
Q Okay. When you sell your WPC, is there some
reference price that you use and we say we'll
sell it at this plus or this times the number or
something like that?
A Yes.
Q What do you use for that?
A We use the 34 market.
Q Oh, the WPC 34?
A Yes.
Q And then just adjust it for the amount of
protein?
A Correct.
Q So that WPC 34 to 35, so that's --
A Yeah, this is a -- we take 34 market, we take
the mostlies of the 34, subtract a -- I guess
you would say a make allowance type of thing or
minus, some people sell it 13 cent, minus 13,
minus 15 or whatever, so you end up with a --
just say, for example, it's 80 cents, say the
mostly market is 80 cents for 34, say you minus
15, so that ends up in your formula, your mostly
price would be 65 cents.
Q Right.
A Did I do that right?
Q Yeah.
A Okay. And then you divide that by 34.
Q Okay.
A And then you come up with a price of three
dollars and something per pound of protein and
then you multiply that by the amount of solids
in the tanker, so you're coming out with --
current pricing, you're probably coming out with
$18,000 a load maybe, something like that, on
WPC.

And then your permeate formulas is the
same. We go off of the lactose market, and
there'd be a minus in that also because it's
liquid.
Q Right. Let's talk just so that we have that
clear in the record. The permeate is -- prior
to -- as I understand your process -- well, as
part of fortifying, you UF, ultrafilter, the --
the whey?
A We do.
Q Yes.
A Yes.
Q All right. And what that does is that
concentrates the proteins?

A Takes the protein in one stream and takes the permeate into another one.

Q Which is mostly the lactose?

A Which runs through -- right, which is the lactose is -- it's just mostly lactose.

Q Right.

A Goes through an RO, we condense it up to maybe -- whatever percentage, 27, 28 percent. Then we run it through an evaporator, get it up to 45 percent, something like that.

Q And that's pretty much a wash in terms of what the lactose is worth? Are you able to make -- lactose market I guess is better today, but in the past it's just finding a way to get rid of the lactose; right?

A Lactose is better. WPC is better. The whey price is too much to justify in the other two, but.

Q All right. I want to ask this question, and maybe you know the answer, maybe you don't. But you indicated that you got at some times of the year 3.7 percent butterfat and 3.2 percent protein from your producer milk that comes in, and you produce the cheese and there's a whey
stream that comes off. And then that -- out of that whey stream you remove the whey butter, right, and you sell the whey butter, and then what's left of that whey skim you then run through this RO, evaporator and the drier to come up with both a WPC powder or maybe -- and then a permeate that you come up with; right?

A Correct.

Q Now, have you ever determined that out of a hundred pounds of milk that comes into your plant, how many pounds of solids of the whey proteins and the lactose and the other show up in that whey skim? Do you know what that ratio is?

A The -- yes. We figure that all the time. We figure what the other solids price is, and we end up with what our whey would bring us, which is WPC for us and permeate, so there's a combination of those two. I believe it's adding three dollars and some cents to the other solids price, and we use that number, and without assessing any costs to the operation, we would make a profit on that whey operation, but once you assess your cleaning and your CIPing and -- it's a wash. Is that your question?
Q  Well, you answered the next question, so that's fine, but --
A  I don't know if I can or not.
Q  Well, here's the thing. Are you familiar with the Class III formula for setting prices in terms of how you pay for the components?
A  I'm sort of familiar with it. You mean how it's generated, how you end up with the price?
Q  Right.
A  Yeah, you get -- yeah, I think I am.
Q  Okay. Now, in the -- you end up paying per pound so much for the other solids that come in from the producer of milk; right? There's that --
A  Yeah, right.
Q  Okay. How does the pounds of other solids that you pay for that comes in the plant compare to the pounds of other solids that actually show up in the whey skim that you're able to turn into WPC or lactose?
A  I think I answered that. It turns --
Q  I'm talking in pounds or percentages. Can you say that? You get like about 5.8 pounds of other solids in your milk coming in or 5.7, 5.8?
A  Do you know what that number is?
A: Yeah.
Q: Somewhere in that range?
A: Yeah, something like that.
Q: All right. So you go through -- so let's say for the moment you just had a hundred pounds of milk come through, okay, and you process that into cheese, okay, and some of those other solids stay in the cheese, right, a small amount?
A: I suppose some would, yeah.
Q: Okay. My question is at that point how many of those show up in the whey stream or the permeate?
A: Well, I'd have to look at the formula pricing. They say 5.69; is that correct?
Q: Yeah, something like that. I mean it comes out --
A: I don't think -- you know, you're not going to get that.
Q: That's my question. I'm trying to figure out what that --
A: And I can't -- I'm not prepared to give you that because I don't have that.
Q: That's okay. Well, you're given a lot of information. I appreciate that very much.
A And, like I say, it's not 5.69, I can tell you that, so.

Q Now I want to go back to just two other issues that you addressed. I want to just give you three statements you've made, then I want to try to tie them together.

You indicate that it's not been profitable the last seven or eight years, which you attribute probably to the whey, the other solids price, and you also made a statement that you pay a premium for your milk over and above the Class III price from your suppliers.

A Yeah.

Q All right. And I guess the question is that have you looked to see if the elimination of the premium would be sufficient to create the profitability or do you also need to have an adjustment in the other solids over and above that to establish that profitability? I don't need an exact number.

A Well, anytime you can cut a cost, you're going to cut a premium or cut it -- whatever it is that you want to call it, but it's definitely -- other solids is definitely probably one of our biggest problems.
Q
Right.

A
At least currently. I mean we're putting the money in, but it looks like you're taking this money and giving it to somebody else because you're not getting it, you know what I mean.

Q
Right. So let me just rephrase the question and see if this is the answer, is that if your premiums that you paid for your milk disappeared, you would still need to have some relief on the other solids for profitability?

A
The premium we've paid for years.

Q
I understand.

A
We paid the premium prior to the other solids ever going into the -- to the formula, and it's always worked, okay.

Now, our philosophy is, you know, in our part of the country there are premiums. In your part of the country there aren't. I would say that if I could buy the milk and I buy it at what your people are buying it for, that would be huge. I mean that's one way of answering your question.

Q
Right.

A
If you have your own producers, there is a certain cost assigned to that, you know. You
might have to pay bonuses. I'm talking about now if you're on the farm direct buying. You buy -- you've got volume bonuses, premiums, you've got quality premiums, on and on and on and on. And that's just come on in recent years too.

But we feel that if you -- we buy the milk from the people that we do, it just more or less replaces the cost that it would cost us to procure the milk, to service the producer, to -- to have the competitive edge that you have to have to get that milk. And being an independent, I can't bring it back into the thing and reblend or do any of those things, you know. We can't do that.

Q I understand that. You've been very helpful. Thank you very much.

MR. YALE: I have no further questions.

JUDGE PALMER: All right. Mr. Beshore.

EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q Good morning, Mr. Roetlin.

A Good morning. How are you.

Q My name is Marvin Beshore, and I represent DFA and also Dairylea Cooperative, which is in the
northeast, in Syracuse.

Is some portion of your -- of your milk
supply Grade B or Grade C milk, manufacturing
grade milk, some portion of the milk that you
process?
A Yes.
Q At your plant, is it what's termed Grade B or
Grade C?
A Well, there's -- some portion of it is
manufacturing grade, but it's still priced off
of the Class III.
Q Okay. That was -- that was going to be my
question.
A Is that your question?
Q Okay. So all of the milk supply that you
purchase -- by the way, your -- I think this was
clarified with maybe Mr. Vetne. Your plant is
not a pool plant --
A Correct.
Q -- under the Order? But all of the milk you
purchase, whether it's pool milk or nonpool
milk, the price that's negotiated with your
suppliers is based on the Federal Order prices?
A Correct.
Q Okay. Now, I think you also indicated to
Mr. Vetne that you report your -- your
production to NASS --
A Correct.
Q -- in barrels. Can you tell us, what's the
average moisture content of the barrels you
produce?
A For us, it's -- I can't give you a specific
because I'm not sure Kraft would want me to do
that, but it would be -- it would be from 3.2 to
3.4 -- or, I'm sorry, 32 to 34 moisture.
Q Percent moisture?
A Yeah.
Q And then the moisture is a specification of your
buyer; correct?
A That's correct.
Q Okay. Now, do you look at the weekly NASS price
publications?
A Correct.
Q Okay. Do you notice -- I mean there's a
Minnesota-Wisconsin price that's quoted in those
NASS prices, you've noted that?
A That's where we go. That's where we get our
pricing.
Q Okay. Your pricing is based -- although you're
in Iowa, it's based off of the Minnesota and
Wisconsin prices?

A Correct. And we have a new price every Tuesday, I believe it is, something like that, and we're on a weekly cycle. They may have changed that. Maybe that's daily now, but, anyway, it got off of that, and then there is moisture allowance; in other words, the pricing you get -- that you're talking about would be 38 percent moisture; is that correct?

Q The prices are standardized I think in the NASS report to some point.

A But it's at 38 percent I think.

Q It's at 38 percent.

A Right. We have a scale that we go by that -- they call it moisture allowance, so as we go down on that scale, we get -- we get more per price -- or more per pound.

Q And those prices are the prices that Kraft pays you --

A Correct.

Q -- for your barrels? Okay. Now, you've indicated you have moisture specifications, and you also have other production specifications such as you are not allowed to use whey cream, reprocess the whey cream.
A Correct.
Q Okay. Now, when you -- your barrels are more expensive to produce because you have to buy your butterfat off the market rather than reuse some of your own cream; wouldn't you agree?
A Run that question by me again.
Q Okay. If you could use -- if you were permitted by your buyer to utilize whey cream in your vat, you would have a lower -- that whey cream is -- you've already paid for it.
A Correct.
Q Okay. And you would be able to obtain more value for that cream in cheese.
A That's true.
Q Okay. So that when your buyer specifies that you are not authorized to use the whey cream in that way because of product quality, are you paying a premium for giving up -- for giving up that opportunity?
A I don't believe so, no.
Q Let me just ask you just one general question. Since I represent dairy farmers here and the issues are in part, you know, how much the plants are going to pay farmers for their milk and how that's going to be calculated, and
you've -- you've indicated you think that the
whey -- because of whey pricing, at least, the
formula presently requires you to pay more for
your milk than you should have to pay to be
profitable; is that fair?

A That's sort of fair, yeah.

Q Okay. Why isn't the problem that your buyers
are paying you too little for your end product
rather than you're paying too much to your
suppliers? What isn't your profitability
problem that you're not being paid enough by,
you know, Protient or Bongard's or Kraft or, you
know, anyone, rather than you're paying too much
for your milk?

A Well, the price -- the other solids price, as I
indicated to you, is -- when they started
putting that into the formula, it definitely
showed what that was going to do. In order
to -- to process the whey at a more profitable
way, obviously we have to spend money for whey
operations and upgrade it and, you know, invest
moneys and, you know, I don't know -- I don't
know what type of formula we need or is
required. That's beyond my pay scale, but the
pricing they got going into that is -- I mean,
you know, it just -- it's unreal as far as our pricing.

Now, you know, I don't know where you're going to assess who's the problem or what the problem is, but there's definitely a problem. And I'm not asking for anybody to fix the problem for me, and I don't know if anybody -- I mean I'm not the only one that has the problem, okay. As I talk to my colleagues around the country, they've all got the problem, and their situations are different than mine, but they all have the problem, and they all pretty much indicate the other solids price is definitely one of the things that needs to be looked at.

MR. BESHORE: Thank you very much.

JUDGE PALMER: Mr. Rosenbaum.

EXAMINATION,

QUESTIONS BY MR. STEVEN J. ROSENBAUM:

Q Good morning. I'm Steve Rosenbaum. I represent the International Dairy Foods Association.

A You're from where, sir?

Q I represent the International Dairy Foods Association, which includes the National Cheese Institute, so we're representing a cheese manufacturer like yourself.
On the -- with respect to the -- to the formula, as I'm sure you know, there really are three things built into it on the other solids. One is the question of how much other solids you can produce out of a hundred pounds of milk, you know, what will come off of it. And then the second is what's it going to cost you to make, for example, the whey product. And the third is what price do you get for the product.

Do you understand all of those -- those three things are all built into the formula in one way or the other?

A Yeah, I understand that.

Q Okay. And you talked about -- and my -- I just want to clarify if I understood correctly your testimony. Is it your experience that you are obtaining less than the 5.69 pounds of other solids that the formula assumes that you're producing from 3.5 percent milk? Is that one of your issues?

A The question is whether we obtain less than that amount of other solids?

It's like one of the attorneys asked me, I mean some of that stays in the cheese, so it's sort of hard -- it would be sort of hard to say
where it goes. I mean it's -- some of it stays in the cheese, so therefore -- obviously if you've got -- the Order says what, 5.69 or whatever.

Q Right.

A If some is staying in the cheese, you're not going to get it on the other side, right. I don't know if I'm answering that correctly or not, but that's --

Q All right.

A Is that your question?

Q All right. Let me move on to the next part, the price part of it. Is one of your issues that you feel like you're obtaining in the marketplace less for your other solids, your whey, for example, than the formula is assuming you're gaining?

A I still -- I still don't understand that question. You have to speak a little bit louder.

Q All right. I'm sorry. The -- you said one of the problems is the other solids pricing --

A Yes.

Q -- as assumed in the formula; correct? You're paying a price for milk, the Class III price for
milk, is based in part on certain assumptions as to what the value is that a manufacturer can obtain for other solids that are produced; correct?

A Yeah.

Q And has your experience been that you're not actually able to obtain that price in the marketplace and that's one of the reasons why it's not profitable?

A I don't know how I want to answer that. If the other solids price continues to go up, right, that means we have to pay more for that portion of the milk.

Q Okay.

A And by -- basically I guess the answer to that would be yes. I mean yeah, we have to pay more than we can get out of it.

Q All right.

A Is that the question?

Q Yes, that's the -- I'm trying to see where you see the formula is not currently working.

A I see. Yeah.

Q I think you've answered that question now. What kind of -- do you have open vats or closed vats?

A We have Double OOs. They're closed.
Q  Okay. Are they horizontal or vertical?
A  Horizontal.

MR. ROSENBAUM: I think that's all I have.

Thank you very much.

MR. ROETLIN: Thank you.

JUDGE PALMER: Mr. -- well, let me get Mr. Smith up. He hasn't had an opportunity yet. You didn't think you were going to be this popular, did you? You didn't know you were going to be this popular.

EXAMINATION,

QUESTIONS BY MR. DANIEL SMITH:

Q  Good morning. My name is Dan Smith. I represent the Maine Dairy Industry Association, which is --
A  Pardon me?
Q  The Maine Dairy Industry Association, which represents all the dairy farmers in the state of Maine.

I just wanted to ask you a few questions about your premium structure. You've said there were different types of premiums that you pay. Can you just explain that a little bit more between what those types of premiums are?
A  I don't know the specific amounts, how much --
No, that's okay.

It's like type, quality premiums, you pay -- you
might help me out, see what else there is and I
can say yes or no.

Quantity premiums, do you pay quantity premiums?
Volume, volume premium.

I don't believe so. I'm not sure. I'm not sure
about that.

Is there an additional, just an amount above
what might be --

Yeah, there is a premium so much per -- per
hundred, plus components.

Plus the components?

Yes.

And how are the premiums negotiated? Is there a
process -- is it every year, do you sit down
with farmers every year?

Pretty much. I mean, you know, it's -- yeah,
it's -- every year you talk about it, and over
the last couple of years we have gotten some
relief from our milk suppliers. They all know
the problem. When you call them, they know.
They understand. They see that number out there
too. They see the other solids price out there,
and they know.
So --

So we've gotten some -- some relief on that, yes.

So in addition to looking to the solids price, do you look to the Class I premiums that are available in the market in -- in calculating that number?

Do we?

Yeah.

No, we do not.

So it's just straight up --

Strictly in Class III.

Class III. Have you had any discussions with suppliers about hauling costs? Have you had to make any adjustments on hauling costs when fuel prices have been going up recently? Has that come up in your --

There are -- some of the suppliers charge surcharges on fuel.

And have those been adjusted in the last six months or a year?

They're adjusted weekly.

Weekly. And --

We go through a federal -- a sheet that's published by the DOT.
Q Yeah. Any additional discussions beyond that with your suppliers, beyond those weekly discussions, adjustment discussions?
A Pretty much -- no.
Q That's the adjustment, okay. I just want to ask you one more question, a follow-up to a question Mr. Beshore asked about recovering the cost in the marketplace.

If you -- you indicated that your discussions with other processors around the country indicate the problem is -- that you've described is a common problem. Why do you think the market is not responding by increasing your price to you rather than having to recover it in the formula for the price? Why isn't your price able to go up? Why can't you charge more to the market?
A The price -- the pricing is -- we go off of the weekly markets on the whey. I'm specifically talking about whey, okay. Cheese would be a daily, the market goes up and somehow the NASS -- I'm not sure how they -- we're on NASS, but it still follows -- follows the CME, and it's just a couple weeks later, I believe, or whatever.
But, anyway, on the whey, that price is published weekly, I think it's every Thursday, and there is nothing I can do about that price that's published from the buyers and sellers and mostlies, and I'm not sure where that information comes from. Maybe it's -- maybe some of you can help me out. I don't really know where that --

Q You're working off the published price?

A Correct.

Q And that sets the price.

A Yeah.

MR. SMITH: Thank you.

MR. ROETLIN: Yes, you're welcome.

JUDGE PALMER: Are there any other questions? Mr. Beshore, you have another question?

EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q Just one question, Mr. Roetlin. Do you know what percentage of the butterfat that goes into the vat is incorporated in your barrel cheese product, is retained?

A That is part of our -- do you know what FDB is?

Q No, I don't. Sorry.
Fat on dry basis. That's calculated on a fat on dry basis, so we have -- our butterfat has to be a certain butterfat in cheese, but I'm going to say -- I'm going to come off the top of my head again, 36 1/2 percent fat.

In your cheese?

Cheese on a dry basis.

Okay. Now -- but let's say -- so I think you told Mr. Yale, and -- in the vat, your -- it's about 3.8 or 3.9 percent butterfat?

You know, it depends on the time of the year. You know, that's sort of a number you got to chase because it depends on the time of the year. It changes. In our part of the country, we're -- a lot of the -- you get in the spring and they pasture and they whatever, the butterfat is much lower, so.

Let me ask it another way. For every hundred pounds of butterfat that goes into a vat, do you know how many of those pounds are incorporated in your barrel of cheese?

Well, our -- our fat test on our -- on our milk is about 3.5, 3.6 or whatever, and then we add cream to that and we base how much we put in there based on the butterfat or FDB of the
cheese, so we regulate that. If the FDB, say they -- let's say we're allowed to have a 50, 56 FDB; well, if you got too much fat in there, that goes too high, and if you got not enough fat, it goes too low, so for us it's something like 200 or 250 pounds of fat we might put into that cheese vat.

Q What I'm trying to -- trying to learn, if possible, is do you know -- let me try the other end. Do you know how many pounds of whey cream you have for every vat of cheese you make?

A I don't know. I guess we never figure it per whey cream per vat, but I mean it would be very easy to find out. My girls probably do it, divide it out and see what you sell at the end of the day -- or the end of the -- every pickup or per week, per month, whatever. I --

Q You don't know that number?

A I don't know it here now today.

Q Okay.

A But we have a number like that, but I don't have it.

MR. BESHORE: Okay, thank you.

MR. ROETLIN: But --

JUDGE PALMER: That's all right. Sir, you
don't need to volunteer. He's gotten his answer.

How about over there, yes.

MR. ROETLIN: I'm going to add something to the --

JUDGE PALMER: Oh, if you wish to, go ahead, sir. Add whatever you want to.

MR. ROETLIN: I don't necessarily think the fat's the problem. I think the problem is the other solids price. I don't think the protein is the problem. I don't think the fat's the problem. It's the other solids price that's the problem. Until somebody decides to change it or --

JUDGE PALMER: Well, now you're going to get some questions from folks from the Government, the people over at that table. Go ahead.

EXAMINATION,

QUESTIONS BY MS. HEATHER M. PICHELMAN:

Q  Good morning. My name is Heather Pichelma. I'm with the USDA's Office of the General Counsel.

A  Yes, ma'am.

Q  First of all, on behalf of the Secretary, I just
want to thank you for being here today, traveling from Iowa and coming here and testifying. The Secretary really appreciates your willingness to come here, and it was a great benefit that you are here today, so thank you.

A I hope it helps.

Q Absolutely it helps.

Actions under the Federal Milk Order Program are subject to the Regulatory Flexibility Act. The Act seeks to ensure that the regulatory and information collection requirements are tailored to the size and nature of small businesses. The Act defines a dairy products manufacturer as a small business if it has fewer than 500 employees.

And I believe from your testimony before, you said, there are --

A I have 55, and they probably do as much work as a hundred would do. I mean we're -- we are really, you know -- okay.

Q Absolutely. So I guess my question to you is as a small business owner, do you have anything else you would like to tell the Secretary about how the Milk Order Program and specifically
these proposals, how they are affecting you, advantages, disadvantages, how is it on a small -- on a small business owner in your opinion, anything else you would like the Secretary to know?

A I don't know. I think I've pretty well covered it. I -- I tried to, and what I've told you is from my heart and it's honest. I don't have an attorney to do this. I guess I could have brought one along, but my bottom line doesn't permit it.

JUDGE PALMER: You picked up a few along the way when you got here.

A All I can say, ma'am, is something has to change or people like me are not going to be here, and we're not going to be able to handle the milk. We're going to have dairy farmers who are going to have milk out there, if we don't have plants to put this stuff into, I think that will be an economic problem for the dairy farmers also. I mean we're not all Southwest Cheese or Southwest United States. We're not all California. I'm in the Midwest. Here's where I live, here's where I have my family. It's a small business, we're just trying to survive.
And having said that, I'm sure they're
great people, I don't have any animosity toward
them or anything else, toward the positions
they're taking, but it's got to change.

That's all I have, ma'am.

MS. PICHelman: Thank you.

JUDGE PALMER: Any other questions over
there? No. Any other questions? Mr. Vetne.

MR. VETNE: I have some Redirect, might as
well have --

MR. YALE: Redirect?

MR. VETNE: More Cross.

MR. ROTTELIN: Could I say something to the
lady for the USDA?

JUDGE PALMER: Yes, go ahead, you can do
that.

MR. ROTTELIN: I think that if they need to
make changes, I don't think that -- let's put it
this way. I don't think there's a single person
in this room that doesn't know what the problem
is, but I'm not sure how many people in this
room want to change it.

But we need to have a more timely -- you
know, for that make allowance, let's go back,
the make allowance that we got in March 1st, is
that correct, they had a make allowance on cheese and dried whey March 1st? That thing has been in the make for what, a year and a half or something like that.

And then when they did do it, it was very small and it wasn't really what was required, but we thank everybody for that, but it's not nearly enough. But they need to do it quicker. They need to be able to -- if they're going to be the boss over this milk, whatever you want -- the Federal Orders, they have to be able to change quicker, to be able to make that change that needs to be made. Maybe we go down the road two years from now and the -- and the whey solids -- say they made a change on that, just for an example. Maybe they, with their infinite wisdom, think it needs to be up a little bit. Well, they need to be able to change that. It doesn't -- it can't be just set in stone. It needs to be maybe more flexible and quicker.

That's all I have.

**MS. PICHELMAN:** Thank you. And thank you again for being here today.

**MR. ROETLIN:** Thank you.

**JUDGE PALMER:** Mr. Yale, you have a
question or so?

EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q Yeah, kind of a follow-up on that. Was the --
you've indicated the profitability earlier.
Were these changes in make allowances enough
that came out in March, will that be enough for
2007? The changes in the make allowances that
came out in March, will that be enough to make
it more profitable for you in 2007?

A No, I think that the -- I'm just going off the
top of my head. I don't have those numbers with
me, but --

Q Right.

A The numbers that I heard that were indicated
earlier would have been much more in line with
what should have happened than what did happen,
and in the time period in between, we have -- I
get a publication, what the hell's the name of
it, Milkweed, and -- and I read that and I
have -- I don't know if Mr., whoever he is, if
he's even in here, but it's good entertainment
once a month. And there's certain people he
definitely doesn't like, but that's okay. He
sees it maybe as -- only as a dairy farmer, and,
you know what, we're in this together. The dairy farmers, the cheese plant operators, the co-ops, the independents, the large corporations, we're all together. And I don't really see why it can't -- I was a former Marine, you know, I can be pretty -- pretty aggressive and whatever, but, you know, as I've got older, I've gotten a little bit more mellow and maybe try to see the other person's point of view, but.

Q I think that comes back to that question that Mr. Beshore asked, that since the dairy farmers have the same financial problems as the plants, the plants have financial problems, maybe the answer is not that you pay less for the milk, which the farmers can't afford, but we find some way to get more money out of the market so that you benefit and the producers.

A But in my view, he's already done that. They've done it when they put the whey allowance into the -- into the formula, that's when they done it and that's when they got it, so if you take this thing out of there -- well, let's back that up. The only way that you can get this money back out of this is by spending a huge amount of
money for whey operations. And if this price --
I'm not real sure about this, we got a lot of
smart people in here, maybe they can throw a
pencil and a calculator to this real quick, but
if you were drying whey, sweet whey, a hundred
percent of it, how would that come out?
I guess I'm asking you the question instead
of you asking me. I don't know how that would
come out. Would that come out?
That was why I was asking some of your questions
earlier, we were trying to find that answer. I
mean there may be a problem both in getting more
money out of the market and there may be a
problem in the whey formula.
Well, I don't know.
And that's a question that we're trying to find
out.
I can't change the market. There's a published
paper that I go by, and that's what everybody
goes by. I mean you even have a hard time
trying to contract milk. If I go to my friendly
coop and try to contract milk, he's gotta go
down there and sign up X number of producers in
order to get that contract in so I can buy it at
a certain price, and some of those friendly
co-ops don't like to do that. They don't want to do that. Okay.

Q Okay. Change subjects.

A Yes.

Q You've been extremely helpful, and eye-opening for us, and, by the way, we may be different sizes and have different issues, but I think a lot of respect for people like yourself and producers in the upper Midwest as well, so.

And I think that's part of the challenge, frankly. I mean you talk about the Southwest. There is such a diversity in size and stuff that it's starting to put a strain on how we deal with the system, but that's -- I mean if you have a comment on that --

A I've bought a lot of milk out of the Southwest, out of Select, one of the groups you represent; is that right?

Q Right, yes. Their UF milk.

A Right. But today I couldn't buy that milk because it's not possible to buy that --

Q Because of whey?

A -- and have them take the other solids or lactose, you might -- not other solids, the lactose and dump it out in a field somewhere.
Q I understand that. That's --
A It's not possible to do anymore, so I had to spend seven and a half million dollars to put this plant in.
Q Right.
A And then I got to spend another six or seven million putting in a drier to dry sweet whey.
Q Okay. So -- and I appreciate that. I think it's a point well taken.

Let me change subjects a second, kind of come at what Marv Beshore, Mr. Beshore asked a little bit ago. Both from producer and the cream you buy, you have a hundred pounds of fat come into the plant. How many pounds of that fat go out in the whey cream, do you know, approximately?
A Just let me think a little bit here, okay. The cream is usually about 45 percent when we sell it.

Something like maybe -- maybe something like 20,000 pounds a week, maybe, so that would represent maybe $20,000.
Q Okay. But 20,000 pounds of whey goes out, then you receive seven million pounds --
A I think I'm doing that right, okay.
Q So out of the seven million pounds of milk you receive and the cream, about 20 million pounds go out as whey cream -- or 20,000 pounds go out as whey cream?
A Twenty thousand a week, so it'd be -- I'm not sure. I'm not sure I did that right.

JUDGE PALMER: That's all right. This is not a math exam. Let's --

MR. YALE: I appreciate that. And I don't have any other questions. Thank you.

A But --
Q Yes.
A I want to reiterate here --
Q The fat's not the problem.
A -- butterfat's not the problem.
Q I understand that, but that's another issue --
A Protein's not the problem.
Q The other solids.
A Cost of milk; you know, it's the other solids driving up the cost of milk.
Q Right. Very good.
A I think we all know that.

MR. YALE: Okay. Thank you.

JUDGE PALMER: You are now excused -- oh, you want to ask some more questions. I have to
take a break, but. Are you okay up there? Are you okay?

MR. ROETLIN: Oh, I'm fine.

JUDGE PALMER: And the reporter's okay.

All right. Come on up, Mr. Vetne.

EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q Sir --

A Yes, sir.

Q -- you indicated that protein is not the problem, butterfat is not the problem. Some of the proposals here would increase prices, regulated prices, costs for fat and protein.

A Did you say some of the proposals would increase or decrease?

Q They would increase.

A The price of?

Q The price of milk that you -- the price of protein you use in cheese and the price of fat that you use in cheese.

A Correct. From what I saw, somebody's proposal was like -- just see if we're on the same page here. You're saying like 1 -- I think Select or this gentleman has 1.20 or 1.21; is that what you're saying, it would go -- they would --
JUDGE PALMER: Stay with Mr. Vetne.

A -- they would go with that 1.12.

Q Let me ask it this way. Some of the proposals here, when it ends up in the final formula, whether it's other solids or protein or anything else, would increase the price, the Class III price, by 20, 25 cents.

A Yes, which would take away the make allowance we just got.

Q It would put you back to where you were before.

A Exactly.

Q But it doesn't really matter to you whether it's in the other solids or the protein. If you're paying more for milk and not getting more for the cheese that you sell, it squeezes your margins.

A It's -- I mean -- and maybe I didn't -- maybe I was not clear on what I said, that it doesn't matter. Of course it matters. Everything matters.

Q So when you say that protein is not the problem, would you agree that it would be a problem if your protein price were increased?

A Yeah, I -- absolutely, but I mean I guess I was thinking in the -- in the mind that what we
currently have right now as far as protein and
butterfat, but if it was increased, of course it
would impact, yeah. That's not what I meant
when I said that.

Q  Okay. You indicated to Mr. Yale that you sell
about 20,000 pounds of whey cream per week?
A  I said that, but I'm not sure.

Q  You're not sure. But you receive about a
million pounds of milk per day?
A  Correct.

Q  So that's 20,000 pounds of whey cream from
receipt of seven million pounds of milk?
A  Roughly.

Q  Plus the cream that you buy.
A  Correct. Somebody put a pencil to that and then
call me up and tell me how bad I'm doing here.
Okay.

MR. BESHORE: I already did.

Q  When you buy milk, you indicated that you buy
Grade A milk and Grade B milk, you pay the same
price for that milk.
A  Correct.

Q  Do you know what portion is Grade A and Grade B?
A  It's primarily Grade A.

Q  It's primarily Grade A?
There's not much Grade B left, yeah.

But the Grade B portion is not designated separately?

No, it's all the same, classed off of Class III.

And it's all commingled, you don't know what portion is which?

Exactly.

And when you sell cheese, you indicated that you have been selling at a new price every week, and it might be every day. Is your cheese based off the CME?

Okay, I thought about that after I said that. We have -- we have a price given to us every Tuesday -- we have a price given to us every Friday that will involve all the cheese from Tuesday to the previous Friday for that whole seven days, and it is averaged out on a per CME pricing every day and is averaged out for a whole week.

So it's --

You understand what I'm saying?

So it's a CME weekly average?

CME weekly average, correct.

Applied retroactively by week.

Correct.
Q Do you know whether that same price formula is applied to other suppliers of barrel cheese to Kraft or is that only for you?

A I would assume so.

Q So if you wanted more for your cheese and Kraft didn't want to pay more, it would just go someplace else?

A Well, basically that would be it, but, yeah.

Q When you make cheese, do you sometimes produce a barrel that doesn't meet Kraft's specifications, that is off grade?

A I can remember one time, seriously, one time in -- since I've completely owned it myself in '85 that we had a cheese that we had to sell to C -- MCT, I don't know who they are, from out East somewhere, and he wasn't very happy because it wasn't quite as good as he thought it was, but, anyway, I told him it wasn't good, but, anyway, only one time.

Q Okay.

A So our quality control is excellent. We sell to Kraft. I don't know what anybody's affiliation is here with cheese or whatever, but these people are pretty meticulous. They want it a certain way and that's the way they get it, and
we give it to them that way.

One of my employees one day, we made a change and he got really upset. He said well, why do we have to do this. I said don't even ask me why we have to do it. I said if they want it green, that's the way we'll give it to them. That's all. I mean, and, like I said, the list of people we sell whey to, and we got -- if we had the whey, we could sell a lot more of it. But I -- it's priced off of that market that comes out every Thursday.

Q Where do you sell your dry lactose? Where do you sell your dry lactose? To the same buyers?

A We don't have any dry lactose. I make -- I make whey protein concentrate 55 and I make -- and out of -- the end product out of that is permeate, which is based off the lactose market. It's about 45 percent solids. It's liquid.

Q What do you do with that permeate?

A We sell it to Protient is one of the people; Land O'Lakes is another one.

Q You sell it in liquid form?

A In liquid form, correct. If we got a little extra money, we would put a drier up and dry it. In about a year from now we can do that.
Q  All right. Having made -- having been -- you've been in the black two years in the past six full years.
A  I said since --
Q  Since 2000?
Q  So that's six accounting years for you?
A  Correct -- seven.
Q  Seven accounting years for you. Okay. If that is your projection for the future, will you stay in business long term?
A  I hope so.
Q  How would you stay in business if you're --
A  Well, that's one of the reasons I'm here, number one. Number two, we have a very good banker. We're not late with any of our payments ever. We intend to be -- and some of my personal assets have went into this, to finance this, to pay for what we have to pay for.
Q  If your price goes up --
A  It's not coming out of the cheese plant, that's what I'm telling you.
Q  Okay.
A  And it's not a hobby, either.
Q  If your cost -- the price went up by 25 cents
back to where you were before and you told your banker that, would that affect your ability to borrow money to make improvements?

A He probably wouldn't be very happy.

Q Would that affect your ability to borrow money to make improvements?

A I would think it would. Eventually it's going to. You know, anybody can see if you continue to do this, eventually -- it eventually would cause you a problem borrowing money.

Q And the farms that ship to you you say come from your area.

A Yes.

Q If they weren't shipping to you, how far would they have to take their milk to find a manufacturing home, or any kind of home for the milk? How much further?

A I would say quite a ways. I don't have -- I don't have the ability to answer that, but it would cost somebody. It would be -- DFA or Swiss Valley or somebody, it would cost them additional money to get it to other locations. Well, that would just come off the producer. I mean it's like they would be -- it would cost them more, but I don't know what that would be.
Q  Paid by the farmer?
A  I just --
Q  Be paid by the farmer, the producer?
A  Well, sure, it would be.
Q  Finally, you indicated that some of your raw ingredient is subject to a fuel surcharge.
A  Yes.
Q  And that's a fuel surcharge that's indexed off of some government --
A  Yes.
Q  -- publication of fuel costs?
A  Yes, the DOT listing that comes out weekly, I think, if anybody's familiar with that.
Q  Department of Transportation?
A  Yes. We get it -- we get it -- we subscribe to whatever it is, it comes in the --
Q  Do you know what product is being indexed, diesel fuel or --
A  Diesel fuel.

MR. VETNE:  Okay. Thank you.

MR. ROETLIN:  You're welcome.

EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q Just a follow-up to that question on energy
indexes. You've talked about make allowances
and the slowness for updating make allowances.

One of the proposals in this hearing would
put an energy index in your make allowance so
that when your cost of natural gas or diesel
fuel or fuel oil in your operations went up,
your make allowance would go up with the
publication by government sources of those
changes. Would you favor that?

A If I understand the question correctly, I think
I would. If I understand your question
correctly, if the price of energy, utilities, is
that what you're saying?

Q Yes.

A I don't know how they would pick those numbers
out.

Q Natural gas and electricity.

A If that goes up and our make allowance goes up?

Q Yes. Just as your fuel adjuster works
presently, the fuel surcharge works on products
you're purchasing, your make allowance would be
adjusted with those indexes in the same manner.
A: I think so.
Q: It would help the lag issue, wouldn't it?
A: Yeah.

MR. BESHORE: Okay. Thank you.

JUDGE PALMER: Thank you very much, sir. Thank you for coming down, and we're going to let you go now. We appreciate your testimony.

MR. ROETLIN: Thank you.

JUDGE PALMER: Thank you. We're going to take a short recess now for five minutes, and we'll go off the record.

(At this time a recess was taken.)

ROBERT D. WELLINGTON,
having been first duly sworn in by the Judge, was examined and testified under oath as follows:

JUDGE PALMER: All right, Mr. Vetne, Mr. Wellington is sworn.

MR. VETNE: John Vetne representing Agri-Mark and others.

Bob Wellington's statement in virtually complete form, there may have been an edit or two, was posted on the Internet so you could have it in advance, and this version with the complete tables was distributed yesterday.
Is there anybody that needs a copy that didn't get one? Okay.

**JUDGE PALMER:** Meanwhile, we're marking it as Exhibit No. 35.

*Thereupon, Exhibit No. 35 was marked for purposes of identification.*

**MR. VETNE:** Okay, Mr. Wellington, you have previously addressed other issues, and you now wish to provide affirmative proponent testimony on Proposal No. 14?

**MR. WELLINGTON:** Yes.

**MR. VETNE:** You may proceed.

**TESTIMONY OF ROBERT D. WELLINGTON**

**MR. WELLINGTON:** Okay. My name is Robert D. Wellington. I testified during the first week of this hearing on Proposals 1, 2, 10 and 11, and now wish to do so regarding Agri-Mark Proposal 14.

Proposal 14.

This proposal seeks to amend the Class III and Class I product pricing formulas by using a combination of the weekly NASS (National Agricultural Statistical Service) and CME (Chicago Mercantile Exchange) cheese price series to determine the cheese price to be used.
in the Class III and Class I product price formulas.

CME versus NASS Cheese Prices.

U.S. cheese manufacturers use the CME market prices as a basis to set the cheese prices they charge in the marketplace. In addition, California uses the CME price series to set its state mandated milk price for milk used to make cheese (Class 4b). However, USDA uses a different price series in its price determination.

USDA uses the NASS cheese price survey to determine the cheese prices that, in turn, are used to determine the Class III prices each month. While the NASS and CME are closely linked, that relationship usually involves a two-week lag.

The two-week lag between NASS and CME prices became a serious problem in 2004 when CME cheese prices changed so quickly from week to week that the monthly average between the two price series fluctuated dramatically. In fact, the two prices varied by more than ten cents per pound in seven of the twelve months of 2004.

Figure 1, which is at the back of my
statement -- in fact, I would add, offer my
testimony, there's two figures at the back of
the testimony I handed out, I put them at the
back because they're both in color, I think it's
easier to understand them. One is labeled
Figure 1 and the other one is labeled Figure 2A,
as well as Figure 2B.

Returning back to my prepared statement.

Figure 1 provides a graphic representation
of the differences in CME versus NASS weighted
average cheese prices shown in red and the
differences in CME versus Proposal 14 weighted
average cheese prices, and I'm inserting in
black, on a monthly basis from 2003 through
2006. The intent of Proposal 14 is to reduce
those differences while still using the NASS
price series as the primary indicator of cheese
price changes. The data shown in Figure 1 is
also given in Appendix Table 1.

Relationship Between the NASS and CME
Cheese Price Series.

The following table shows the simple
regression results estimating the relationship
between the NASS and the CME for block and
barrel cheese price series. The table shows the
relationships based on having no lag, as well as one-week, two-week and three-week lags. The time period considered is from January 2000, when the Orders were amended to use NASS pricing, to February 2007. Specifically, there are 372 weeks going from January 22, 2000, through February 24, 2007. The initial weeks of January 2000 were not included in the direct regression analysis due to the assumption of a three-week lag as one of the scenarios.

As seen in Table 1, a two-week lag in the CME relative to NASS prices shows the best relationship. In fact, during the last seven years, the CME price series accounted for between 97 percent and 98 percent of the variation in the NASS price series.

And that Table 1 is as written.

How Proposal 14 Works.

Figures 2A and 2B show the weekly timeline for the monthly cheese price used in the Class III and Class I price calculations of Proposal 14. Using the month of April as an example, Figure 2A shows the NASS cheese prices for the four weeks of April that are used to calculate the Class III price -- Class III price for the
month. While the April NASS prices are correlated with the CME price for the last two weeks of March and the first two weeks of April, there is no adjustment in the price formulas currently done to relate the two.

Underneath the current April Class III pricing line -- timeline in Figure 2A is an alternative timeline showing the weeks to be used in Proposal 14 that links the cheese price used to calculate the Class III price (referred to as "the Class III cheese price") with the CME market prices. The proposal uses the actual CME weekly prices for the four weeks of April adjusted by the difference between the NASS cheese prices (for the last two weeks of March and the first two weeks of April) and the previous month's CME cheese prices (the four weeks of March in this example).

The Class III cheese price setting mechanism of Proposal 14 uses all the weekly observations of all NASS and CME prices. Over a number of months, the CME current month price series and the previous month CME price series cancel one another out, leaving only the NASS price series as the average price indicator over
time. This proposal allows the USDA to use up-to-date CME prices needed by the industry while making the appropriate adjustments in those prices to assure that the NASS price is the primary determinant of cheese prices over time. If the CME price is manipulated in such a way as to diverge from the true NASS prices, this proposal adjusts those CME prices to the actual NASS prices to correct the situation.

The timeline chart in Figure 2B shows how the cheese prices for the Class I price determination can also be adjusted in order to use the more current CME price series, while also maintaining a relationship to NASS prices. This part of the proposal allows the use of actual CME prices for the second and third weeks of March to determine the Class I price -- Class I cheese price instead of the current first two weeks of NASS pricing. This part of the proposal does use a different set of weeks than currently used, so it may not come back entirely to the NASS pricing on a historical basis. However, it does relate back to the NASS price series.

Impact On Federal Order Prices.
Appendix Tables 2 through 5 show the detailed monthly changes in the cheese prices used in the Class I and III formulas, the changes in the Class I and III prices, the changes in the Northeast Order producer price differentials and the Northeast uniform prices, and changes in the protein price.

Table 2 contains a summary of those appendix tables showing the average of the annual and four-year cumulative time periods (2003 to 2006). While the annual averages under Proposal 14 can differ from year to year, the four-year cumulative average for all prices were less than a half a cent per pound of cheese -- I'm sorry, the four-year cumulative average difference was less than a half a pound of cheese or less than two cents per hundredweight of milk for all prices.

The Proposal 14 is not intended to increase or decrease any prices used or determined by Federal Orders. The intent is to reduce the monthly differences between the prices that most cheese manufacturers sell their product for and the cheese prices used to determine their cost of milk. In this process, the proposal also
reduces the number of weeks it takes to transmit marketplace cheese prices into changes in farm milk prices.

Next in the statement is Table 2.

And then at the end of the statement, the last paragraph is: Originally I had hoped that this proposal would also lessen the occurrence of negative producer price differences, which are mostly a by-product of the time lag between Class III and Class I price changes. This was indeed the case when the Class I cheese pricing changes (shown in Figure 2B) were considered independently of the Class III price changes. However, when both changes were considered at the same time, as is being proposed, the lags are reduced for both the Class I and III prices, but the lag relative to each price series is not reduced. This is why Appendix Table 4 does not show any reduction in the negative PPDs for 2004.

Thank you for this opportunity to present Proposal 14.

JUDGE PALMER: Mr. Vetne.
DIRECT EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q Mr. Wellington, with respect to Proposal 14, do you have any additional comments that you did not include in your prepared statement?

A In regard to just this proposal?

Q Just that proposal.

A Not in -- not in regard to Proposal 14.

MR. VETNE: Your Honor, Mr. Wellington, his cooperative is having their annual meeting this week; in fact, it's going on right now in his absence and he's going back today. I have some additional Direct testimony, a few comments on some other things, but in order to keep things clean in the record, Testimony on Proposal 14, Cross on Proposal 14, I will ask that when -- those questions when the Cross on 14 is over.

JUDGE PALMER: Okay. I understand. So this is on Proposal 14 only, although he's going to testify on some other matters after that's complete.

Do we have questions for him on 14?

Mr. Yale.
CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q Good morning.

A Good morning.

Q I'm going to ask you a question about the

pricing of cheese. What is the reference price

at which most cheese in the United States is

sold?

A The Chicago Mercantile Exchange, to the best of

my knowledge.

Q And the cheese -- even if it's not cheddar

cheese?

A My understanding is it's for all the basic

cheese varieties. It is for our cheese

varieties and it also is for all our types of

cheese varieties, although mostly what we do is

cheddar.

Q And that is the CME price plus or minus some

basis?

A That's correct.

Q All right. Now, when you -- there's no future

cheese market, right, futures cheese market?

A No, not -- there's a Class III, but not on

cheese.

Q Right. So when you contract to sell cheese,
say -- let's say that you and I entered -- I'm
going to buy some cheese and we're going to
price it for when it -- it's going to be made
and I'm going to take it in September. How do
we reference, how do we price that?
A Usually in our case, it's the price -- the CME
price when the cheese is made, plus or minus
ascribed for difference.
Q So that's what's called the vat price sometimes,
right, or priced at the vat?
A We don't use that term, so I -- but it sounds
like it would be appropriate.
Q All right. So the concept is is that you and I
have agreed that whatever the market price for
cheese is in September, whatever that is, we've
agreed to have the transaction and all we're
going to do is adjust whatever the value for
your variety and your quality and location and
other factors will add or subtract the basis off
that?
A That's generally the case. I mean if there was
some other circumstances, we would try to
negotiate the plus or minus, we would try to do
that, although that's always difficult to do.
Q Right. I'm not arguing whether you'd get more
or less. The point of it is -- and that's
commonly done throughout the cheese industry, to
your understanding?

A Well, it is, and, in fact, that's the -- the
purpose of my testimony here shows that the NASS
prices are very closely correlated to the CME
also.

Q Right. So what we have, then, is without the
futures market is that the price risk between
the buyer and seller of the cheese has been
offset because they've all agreed that it's
going to be the market price at the time the
cheese is made; right?

A On the cheese side.

Q The futures side. I mean selling the cheese,
the buyer and the seller of the cheese don't
have any price risk in terms of whether they're
going to be under or below the market because
they've agreed they're going to tie themselves
to the market at the time the cheese is made.

A Basically, yes. Yes.

Q All right.

A I mean there is risk in terms of the make
allowance and --

Q Right, right. No, I understand that.
A: We're just saying that --
Q: Now let's talk about from the cheese plant's standpoint is is that there's a market risk to them that their raw product costs may be more or less than what it would be to make the cheese, sell it at the CME price plus or minus the agreed basis; right?
A: Yes, plus it's not -- when you make cheese, you don't just make cheese, as you know, we make whey products, and that creates another set of problems.
Q: Another set of problems. But in a volatile market, one in which prices move up and down rapidly, the two-week lag between the NASS reporting and the CME creates a risk to the plant that although they've agreed to sell the cheese at that reference price, their raw product price is going to be based upon something several weeks old?
A: Right. Plus, if you look at the average price that they pay for the milk, it's the average over the month, and hence if you look at Figure 1, you'll see that there's a tremendous difference between the CME and NASS prices, even though they average closely over time, you know,
I believe I said seven out of ten months -- or out of twelve months had price differences in excess -- what'd I say, I think it's ten cents at least, and so that does create some accounting problems and sales problems, and that's really why we presented this proposal.

Q Now -- but that's a -- the assumption is -- with the NASS is you're producing the same volume of cheese throughout the month and buying the same volume of milk, that's the only way that that average can really work to your costs; right?

A Well, when they calculate the NASS, they do put the weekly --

Q They weight it.

A They weight it and they put the weekly volumes or whatever, but when we're looking at what our costs are, we're looking at the monthly costs.

Q Right, but now -- and you would agree, then, would you not, that there is a risk in the selling of cheese at the vat price or at the making the price, that the cheese plant has the risk that they don't know what their raw product supply is going to be for that milk, plus the other risk you talk about, the whey, but I don't want to talk about that, I just want to talk
about the --

A That's correct.

Q All right. When you negotiate prices for the sale of cheese, do you consider that risk in establishing your basis?

A Well, we would like to, but it depends on if --- if we go to our customer and say well, we need this much more for our cheese, if the customer says no, I can get the cheese elsewhere, then -- then we can't get it. If we can't get it, we can't get it. We would like to cover all our risk.

Q Well, do you have a situation, though, where you may have the possibility -- I know as a co-op it's a little more difficult, or may be easier. Do you see a tendency in some cases maybe where you sell milk to people who make cheese where they try to -- the plants try to offset that risk by reducing what they pay their producers so that they've got themselves a kind of a hedge?

A Well, I mean we did have quite a bit of push-back from the cheese manufacturers who we sell milk to to make cheese because of all these factors on the Class III price, and so our
premiums did have to go down because we have all -- when they came to us and said you understand our problem, we of course understood their problem, we were having the same problem, so we tried to react.

I mean, you know, which piece of the equation of the value of cheese versus the value of the raw product creates the problem is almost irrelevant when there's a problem, and they just want -- they just want to correct the problem. And, of course, we couldn't -- we couldn't correct the problem for them even with premiums and the like. We could, you know, address them to some degree, but it still wasn't enough to solve the problem for us or them.

Q But the more of the risk that we remove from the system, that does improve the efficiency and hopefully the value of both the cheese and the raw milk; right?

A Usually costs -- risk is associated with increased costs.

Q Now, in your Direct -- or not -- yeah, I mean in the testimony you've had over both this hearing and hearings -- particularly when we had the make allowance hearings last year, there was a
lot of talk about the fact that the use of the
NASS also created a degree of circularity in the
pricing in the sense that if you raised the
price of cheese, you were able to negotiate, for
example, with your plants and obtain another
half a cent a pound on your basis per pound,
that that would then be reported to the NASS;
okay?

A Right.

Q And then if the whole market was able to do
that, the NASS would come back and force you to
take that money that you got in the extra price
for the cheese and pay it back to the producers
and in the end the plant didn't gain from that
extra sales price.

A That's true. For example, the previous witness
said that his numbers are reported to the NASS,
and so the question was asked could you go back
to, I guess his customer was Kraft, and get a
higher price, and he explained the difficulty in
doing that, but if he did do that, he would then
be reporting that higher number to the NASS
again.

Q So your proposal I think responds to a
legitimate concern about the price risk and
being able to line up what the plants pay for
the milk for the day they sell the cheese
because of the industry that we're in, but it
doesn't address the issue of the circularity,
does it?

A No.

Q Now, why -- if we're going to try to adjust to
the CME, why not just use the CME, or do like
California where CME -- it's CME minus and they
adjust this number from time to time based upon
what sales are actually at and use that as the
basis rather than going through the mechanism
that you have?

A Well, we considered that, and many of our
manufacturing people asked that same question.
And I had initially had discussions with the
Department on this several years ago. Before we
were into the hearing process, we were talking
about how do we address this problem informally
and what kind of proposal might be appropriate.
And based upon what they wrote in the decision
back in the late 1990s when they determined to
use the NASS pricing, I got the impression they
felt very strongly about using the NASS, and in
subsequent conversations two years ago, I
continued to get that feeling, that NASS is very important to them.

Also when I talk to producer groups, they are very concerned about the CME being manipulated because it's much smaller volume market than the NASS, and so there's some comfort level of having so many millions of pounds on a weekly basis with the NASS, so I felt at that time that it wasn't going to be a successful proposal to use the CME, and so therefore I was going to have to keep the NASS as part of the equation, but also try to return the price to the CME, hence this sort of hybrid price that we came to, but I believe there is some value to the NASS in that the CME is a relatively small volume market, and when you're -- under the NASS you're selling a lot more products, and usually when you're selling products in marketing products, you're giving some kind of volume discount, and NASS might reflect a volume discount, for example, that CME doesn't. That's why usually the NASS prices are slightly below the CME. Now, that's my hypothesis.

We don't -- we do sell some product at the
CME price, or I think we even sell at a slightly bit under, that's very generic product. We don't report it to the NASS because we don't have a large amount, we don't have it on a regular basis, but we do relate to it somewhat, but the volumes are such that there's not really a volume discount, but perhaps if Mary Ledman was here, she might be able to explain some of that further.

Q So one of the issues I think you point out is that there's a perception by producers and others that the CME, I think the expression is that it's too thin or something like that; right?

A That's what I've heard.

Q But what we have found by your own statement and exhibits there is that the NASS basically proves that the CME is what the market is; right?

A Essentially, yes.

Q So the -- the alternative to deal with that, then, would be is not so much to abandon NASS in terms of the collection and the reporting of the data, but to not use it fully into the formula and as a result you begin to have the benefits of using the CME as your pricing mechanism, but
you can use the NASS to provide the sense of
security and confidence to the rest of the
industry that in fact that does reflect what the
market is doing.

A That's true, but if you're getting to the point
of will it reduce the circularity, I'm not
convinced it will do that either, but your
statement I believe is true.

Q Well, the -- if you use the CME and you're not
incorporating the basis and people change their
basis to increase their margins at the plants,
the NASS captures the basis where the CME does
not; right?

A Yeah, but everybody -- you're seeing this
incredibly close link between the CME and the
NASS, and if -- if, for example, we try to
increase our price relative to the CME to maybe
get beyond some of these circularities, okay,
that's the most difficult negotiation we have
because they'll say well, no, I want -- this is
what our price is, it's the CME. I'd give you
more for your cheese if the CME goes up, okay,
but everything is relative to the CME, so it
builds -- that circularity tie is built right
back in. That's one of our problems, so I don't
think -- I don't think we get away with it just by -- away from it just by going to the CME versus the -- from the NASS.

Q Does Agri-Mark participate in the CME market, cash market?

A No, not that I'm -- I don't believe we -- on cheese, no, not that I'm aware of. On butter, we might have on a very, very rare occasion in the past, but not generally, no.

MR. YALE: Very good. I have nothing further.

JUDGE PALMER: Questions? Mr. Beshore.

CROSS-EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q Bob, can you tell me in -- I hope I didn't just miss this in your testimony, but can you tell me how you -- in your tables how you weighted the CME to make it comparable to the NASS?

A I was afraid someone was going to ask that question.

Q So it's not in your testimony, I didn't miss it?

A Well, no, you didn't miss it. It's not in my testimony. In fact, I was thinking about that too because when I -- when I did all these calculations and all -- you know, all the
appendix tables, this looks like a lot of information, but it's really straightforward just calculation; you plug in new cheese prices and you generate all the formulas that generate these prices, okay.

But when I used the last CME -- or, actually, when I'm using the current CME, I need a volume to do it, and so what I ended up doing was I used that current week's NASS volume for that weight, okay, but in reality -- and I thought the question would probably come from the Department, would be well, you don't have that information, okay, and that's true, we don't have that information, so in retrospect I looked at it and said well, you can use the NASS price from one month ago -- I'm sorry, the NASS volume from one month ago as the volumes, but in my -- in my analysis I did weight by the weekly volumes, but what I did was whatever week I had a price for, I used the NASS volumes for both the CME and the NASS because that's the only volumes I had.

Q Okay. Now --

A Did that answer your question, Marvin?

Q I think so. They're weighted by volume the same
way?
A Yes, they're all weighted by volume, although
there was an issue with the timing.
Q And how did you make your CME prices and NASS
prices comparable in the sense of NASS reports
for barrels two prices. There's only one CME
price.
A I used the NASS price that's per barrel that's
used in the Federal Order pricing.
Q Which is the -- the moisture adjusted price?
A Yes. Yes. I just used that same NASS price.
Q And is it your understanding that the NASS
barrel price is a moisture adjusted price?
A The NASS barrel price is --
Q I'm sorry, the CME barrel.
A CME. Well, actually that's a good point. We
don't deal with barrels, so I did jump to that
assumption.
Q Okay. So you were comparing the published CME
barrel price with the moisture adjusted 38
percent barrel price at NASS?
A Yes.
Q Okay. So you don't deal with barrels. Is there
any barrel production in the Northeast or
New England, very much?
Most of the -- the cheddar plants I'm aware of make block, but there could be, but I'm not aware of it. I couldn't say no because I don't know.

It's limited, if any --

I would believe so.

-- in your part of the country. Are there any new barrel plants under construction?

In the Northeast?

In the Northeast.

No.

Are you familiar with the term block/barrel spread?

Yes.

What does it mean?

The difference between the block and the barrel pricing. Is that what you're referring to?

I'm just asking for the -- you know, your understanding of that terminology. I mean it's something that people use in the industry, right, just the -- that terminology, block/barrel spread, is something that's discussed from time to time or mentioned.

Sure. Well, particularly under the current formulas where you add three cents to the barrel
price, and if that spread is less than three
cents, it ends up enhancing the overall price
level.

Q And has there historically been a difference in
those prices that's referred to as the
block/barrel spread?

A Yes. In fact, I had a proposal that I withdrew
that asked the Department to change that from
the three cents add-on to the one and a half
because I believe it averaged one and a half
over the most recent time period.

Q What time period was that?

A Oh, gosh, I -- I think it was back to 2003 -- no, I think I went back to -- I think I went
back through the whole time period, like a
six-year time period, and it went down to about
a penny and a half. It's been shrinking over
time and it's reversed itself, actually, where
for many weeks in the last several months the
barrel prices have actually been above the
block, but I believe over that lengthy time
period, it was a one and a half cent difference
where the block prices were above the barrel by
a penny and a half.

Q Okay. Over a six-year period?
A I believe -- whatever I had in my testimony, I believe it was during that time period.

MR. BESHORE: Thank you.

JUDGE PALMER: Yes, any hands? Ready for Redirect from Mr. Vetne?

MR. ROWER: We have a question over here.

JUDGE PALMER: Oh, question over there, I'm sorry.

CROSS-EXAMINATION,

QUESTIONS BY MR. HENRY H. SCHAEFER:

Q Good morning, Bob.

A Good morning.

Q In the beginning of your discussion of your proposal, you mention the change to both the Class III and the Class I formulas.

A Correct.

Q And I assume in this case you were really looking at when the Class III would be the mover of Class I?

A That's correct.

Q Your proposal also includes incorporating the NASS and CME for cheese, and you do not mention doing that for butter.

Q Is there a particular reason you've not also included that for butter?
A Well, I thought about doing it for butter too, but I realized that what I was proposing here was adding another level of complexity, okay, and it didn't appear that people in the industry for the butter side had the same concerns, I talked to my own butter people about it, and that two-week lag was an issue but it was not nearly as much an issue as cheese, and so we decided that we would just pursue that area where we felt we had the most problems.

Q Along the lines of complexity by adding the CME and using the two price series, do you view that complexity as really being able to improve the price, I guess I'll say price discovery for the protein price calculation in that obviously you mentioned with the CME that you would be more timely, the price series basically in aggregate reflect each other?

A Yes, that's what I was trying to do was to really move the two price series closer together. I had hoped, as I mentioned, for example, to also help reduce some of the huge fluctuations in the producer price differential. Unfortunately it ended up not doing that that I hoped to when I finally did the final analysis,
but that was the intent.

Q Again along the lines of the -- you talked about how you weighted these.

A Yes.

Q You weighted the CME based on the NASS. Do you view that as an appropriate weighting or would you just use the CME as a straight, unweighted average as currently as published by Dairy Market News and other sources?

A Well, the weight is only a factor if there's a significant change in the volumes from week to week or within barrel and block. Within barrel and block there's not a whole lot of shifting, I mean occasionally there can be, but not a whole lot. Week to week could matter, particularly when you have holiday weeks and you have more cheese being made because Class I bottlers or others aren't using it or schools are out or whatever, so I think weighting is still important, and so the -- and the only way I believe you could do that is to have some measure of the production of both those commodities. NASS will give you that, whereas the CME will not give you that.

Q When you're looking at your calculation and you
have in Figure 2A and 2B there the weeks that you would use and you've got the example here of April, did you do any calculations when you were doing your computations then of your prices the months in which there's a five-week month and then you would have a four-week on each side of it or something like that, whether you'll have overlapping weeks in some cases and, if so, will you go ahead and use those overlaps?

A Okay. That's a really good question, because that added a lot of complexity when I was going through this thing week by week, as you can imagine.

I used every week that was in that time period involved, and the way I did it was that if -- you would first approach the current month, and if it had five weeks, you use the five weeks, but if the previous month only had four weeks, then you use four weeks for that comparison, but then when you went to the next subsequent month, the previous month would have those five weeks, you see what I'm saying, so whatever month had five weeks, you used the five weeks either in the current or the previous, and the same thing with the NASS, so it can add some
little bit of difference.

It's why at the end of the day when I
looked at the numbers they all didn't come back,
but they came back very, very closely, and I
think part of it was the weight, part of it was
five versus four and some of the comparisons
when you try to get the average, you couldn't
quite come back to the zero impact.

Q On your regressions, you used a simple linear
regression --

A Yes.

Q -- for your comparisons. Did you do any looking
to see whether autocorrelation was a factor in
the time series data?

A No, I didn't.

Q If, generally speaking, time series data does
have some autocorrelation in it, would that have
had an impact on your results, do you believe?

A It could have, but I haven't -- it's been such a
long time since I've dealt with regression, I
hadn't even considered autocorrelation on it,
but I've got to remember exactly what the impact
of autocorrelation is, but I know that one
number -- it's a current number -- a previous
number affecting the current number, and I guess
it could have had an impact, but I didn't consider that.

Q And also when you made your comparisons, you went back in this case back to 2000. Did you make an adjustment to the barrel price for moisture at that time, because during -- of course, during the time period of which we've used these price series, we did make a moisture adjustment from 39 to 38, I believe in 2001.

A I used the reported NASS prices, so I did not.

Q Do you believe that that would have any impact on your results?

A It certainly could, although keep -- well, it could between the difference between the NASS and the CME, yes. I was about to say the CMEs will cancel each other -- if they cancel each other out, you're basically using the NASS's that USDA used during those periods, so keep in mind that I'm comparing the actual prices generated using the NASS reported by USDA used in the Federal formulas, I'm using those in both cases, so actually I think it might have distorted it if I would have gone and changed the NASS numbers and tried to say that it should be now at 38 percent moisture where in the
beginning of -- in 2000 it was 39 percent
moisture, you see what I'm saying. I just -- I
didn't want to bring anything more into this
than just the time lag difference, so I tried to
use the current week bottle prices as reported.
I think I'll go back a little bit to the
complexity of adding these two series together,
and rephrase the question just a little bit in
that by doing so, what do you see the main
accomplishment that you're going to get from
this since the price differences are really
negligible?
Well, over time they are, but they're not from
month to month, and what I was really trying to
do was -- going to Figure 1, was address those
huge differences that you see in the red bars
that occur primarily in 2004, really in like the
first half of the chart, that's the issue I was
trying to get at. And keep in mind that this
proposal was first discussed with the Department
in March of 2005, and that's about halfway into
that chart, and so the industry was looking at
that first half of the chart and saying there's
a serious problem we have to address.

Now, if you look at the second half of the
chart, it doesn't look as serious, because you didn't have that huge volatility. That doesn't mean that this year or next year we can't have that huge volatility. We may be setting up a situation of a repeat of that volatility, but that was the intent of trying to address it, and that was really the -- almost the sole intent, although initially I did feel if we could do something with those negative producer price differentials, they just created a very serious issue on the farm because, as you recall, in 2004, in one of the months, March or April, I mean we had a producer price differential of negative over two dollars a hundredweight. It was probably three dollars a hundredweight in a lot of orders, so if we could find a way to reduce that, that would be a positive thing. Unfortunately, when I ended up looking at what happened, it didn't reduce it.

**MR. SCHAEFER:** Thank you, Bob.

**JUDGE PALMER:** Other questions over at that table at all? Anyone over there? Any other questions here?

Mr. Vetne.
DIRECT EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q Mr. Wellington, just a couple of questions on
some formula-related issues.

Yesterday Mr. Yale presented some testimony
and it addressed, among other things, product
yields and noted that there has been no survey
of cheese yields similar to a survey on cheese
plant costs.

Do you have any comments on making a
regulation, regulated prices, based on
hypothetical or idealized yields without such a
survey?

A Well, I think using those formulas, the
Van Slyke formula, to try to get at the yields
at a minimum price is probably the best way to
approach it. I mean the alternative is to go
sample plants for yields, and the problem is
there's just so much that go into the yields at
the plant, and, you know, it's not just a
question of saying how much cheese came out of a
vat. You have to look at how much -- how much
additional cream you may be adding and
additional milk solids, you have to look at a
number of those things, and then if you say
well, the benefits of adding those should all be accrued, for example, to the Class III price to benefit farmers, then what is the advantage to the plant operator necessarily doing that, if it all goes back to the farmers in general.

It's not that I'm against having farmers get additional money, but our farmers own our plants, and so if there's some benefits that we can accrue because they take the risk and put up the money, the capital for these plants, that should go back to the owner of the plants, the farmers, and not necessarily to all the farmers in general, so we have some concerns about -- about doing a yield survey or something like that.

We think that a lot of it should be a negotiation process, that these are the basic yields that pretty much most plants can get, and if you can do better than that and you're competing for milk, as we compete in our area, well, then you have some additional money to attract that milk to your plant.

Q: I believe Mr. Yale's testimony suggested that if -- if a particular cheese maker has a yield that is lower than the hypotheticals he
advocated, that's something that should be addressed in the marketplace.

Can you comment on the ability of a manufacturer to respond to lower yields in the marketplace when there's a minimum regulated price?

A Well, that's it. In our area—at least, in the Northeast, we really try to have some level of integrity on the minimum pricing. They truly are the minimums. And I know that's often hard to do, and we've had to get around that at times, too, when there's a big surplus of milk and we got to do something with it, but our members, for example, are very cognizant of what the blend prices are at and what they're announced at, and if we pay something below that blend price, they're going to know right away. And we had to do that this past year because we had that reblend because we had losses and couldn't cover our manufacturing costs, so in our neck of the woods, a minimum means minimum. It means you don't pay less unless everybody knows you're paying less, and then it's extreme circumstances when that happens.

Q You indicate that in the past year or so you
haven't been able to recover your manufacturing costs. Does that mean that you're also not able to pay for the additional investments that you have made recently or might make in the future?

A Yes, I mean we're not -- we have not spent our depreciation, I don't think we spent 50 percent of our depreciation in the last couple years because we couldn't afford to do that, and the banks basically said we couldn't afford to do that, so we're not putting any new investments at this point.

We did put new investments back in the -- in -- well, basically 1999 to about 2003, and we put quite a bit of investment, $7 million in our cheese plants, we put $20 million into a whey processing facility, but today we could not do any of those things.

Q Okay. If -- if the Department simply looked at yields or revenue shrinkage available from the most current technology available today or available tomorrow or yesterday, I mean literally yesterday, and created a formula that assumed everybody constructed that, is there a way in that formula that the people that made those investments could pay for them?
A  Well, there would have to be something in the
make allowance that would give them an
additional make allowance to cover those, as
well as give something to those plants that
don't have that new technology and allow them to
purchase that new technology.

    It's just not a question of saying we're
going to go out and buy that technology because,
boy, we can be much more efficient. You've got
to have the money to go do that, you have to
have a bank willing in most cases to loan you
that money, and at the profitability rates of
cheese makers these days, those are very
difficult things to come by, particularly the
banks.

Q  Now, in your testimony at the last session with
respect to the basic manufacturing costs and
make allowance, you relied on manufacturing cost
surveys and studies by CDEA, Dr. Ling at USDA
and Mark Stephenson; correct?

A  Correct.

Q  And you were here yesterday for the testimony of
Ben Yale.

A  Yes.

Q  And Ben Yale included reference to -- and
reproduced Dr. Ling's surveys and indicated in
support of Proposal 3 that the allowances that
Dr. Stephenson came up with for butter, powder
and cheese should be the ones that are
eventually adopted. Do you recall that?
A  Yes.

MR. VETNE: Your Honor, I'd like to have
marked for this record the -- the Stephenson
survey material as the next consecutive exhibit.

JUDGE PALMER: Any problem with this?
Offhand I don't remember it. No problem? Oh,
you've already put a number on it, have you not?

MR. VETNE: No, that's the number from --
this was copied. It needs a new number.

JUDGE PALMER: Needs a new number, so make
it 36. I'm going to scratch out the number
that's on here.

MR. VETNE: 36 and 37?

JUDGE PALMER: 36 for the top one, and the
next one will be 37. 36 will be "Testimony on
Cost of Processing," and the other one is -- I'm
sorry, they both say "Cost of Processing."

MR. VETNE: One starts with the word
"Testimony." The other starts with the word
"Cost."
JUDGE PALMER: All right. "Testimony" is 36, "Cost" is 37.

MR. VETNE: Of course, this has been available on the Web for about six months now.

(Thereupon, Exhibit Nos. 36 and 37 were marked for purposes of identification.)

MR. VETNE: I made a few limited copies. If you can share with your groups, that'd be fine.

Q Mr. Wellington, with respect to Dr. Stephenson's survey, Dr. Stephenson has indicated in his testimony he set out to get a representative sample of participating plants producing butter and nonfat dry milk and cheese and whey.

A That was his intent.

Q But with respect to butter, he had lower than expected participation, so he expressed lack of confidence in his butter numbers.

A Yes.

Q And, similarly, with nonfat dry milk, there was a lower participation than the -- than the study designed.

A Well, actually, I think nonfat dry milk plants, I think there were a similar number.

Our concern was the fact that butter is
usually the companion product, but I actually do believe on nonfat dry milk, he did obtain the number. On cheese plants, he did not.

Q: On cheese plants -- now, cheese plants, rather than -- rather than a survey, random survey of plants producing cheese on that one -- one product, he actually split the survey into two components, so he had a sample of plants from the population of large cheese plants and then a sample of plants from nonlarge cheese plants.

A: That's correct, he stratified his sample, and he -- the sample size, if I recall properly, I believe it's 20 plants he sought, and he had five large plants and -- that he geared out of the stratified sample of the 10 percent of the largest plants, I'd have to refer back to his study, but of those plants, and then 15 plants that were in the remainder of the plants. At the end of his survey he had results -- indeed, he had results from those five large plants, but I believe he only had results from 11 of the 15 smaller plants.

Q: Okay. So the less -- the lower participation than desired and intended from the small plants with respect to the total --
Yes.

-- produced a somewhat skewed to large plant
result?

We believe that was the case, yes.

And, similarly, by design, unlike the other
three commodities, by design by isolating large
plants in a stratified sample, the design of the
survey combined was intended to --

MR. YALE: Your Honor --

JUDGE PALMER: For leading is that the
objection, Mr. Yale?

MR. YALE: Well, yeah, he's testifying, but
I guess I can't say much about that, but my
concern here is that we're now starting to have,
without Dr. Stephenson, starting this
characterization of this testimony rather than
letting it be what it is.

JUDGE PALMER: I agree with you.

MR. VETNE: Okay, we'll let it be what it
is. It's been received; correct?

JUDGE PALMER: Well, it's been identified.

MR. VETNE: Okay. I ask it be received.

JUDGE PALMER: Is there any objection to it
being received? Mr. Beshore.

MR. BESHORE: If this is being proffered as
testimony without the witness, apparently it is, it's in essence testimony --

JUDGE PALMER: I think that's a good objection. I would receive it to the extent that this witness refers to it in his testimony as a source, but not as the doctor's testimony.

Q Mr. Wellington --

MR. VETNE: And I'd like to get back to that, but let me lay some more foundation.

Q Mr. Wellington, did you talk to Mark Stephenson about his availability to be here for this segment of the hearing?

A Yes, I did. In fact, I originally wanted -- because of my -- because of my proposals, particularly the second one, which was going to use his methodology to update on a regular basis, I felt that it was very important that Dr. Stephenson be at the hearing, and so I originally asked him to come to the first hearing.

Unfortunately the first hearing, the date of the first hearing wasn't known till a few weeks before that hearing, and Dr. Stephenson had a hip replaced during that week, so he obviously could not make it.
And, in fact, I spoke to him to see if he could make this one, and this was his first week back to school, he's a professor, and so he felt that he really couldn't miss doing that this week. And so I did try to get him here.

And, in fact, in our discussion of that, Dr. Stephenson offered that if the hearing were to go on for a third week, and if that third week was going to be held sometime after the end of May, that he would be willing to update his costs with another year if he could get the industry to agree, and so he said the end of May, I would probably say more like June. No offense to Dr. Stephenson, but it always takes longer to do these things.

And so one of the things I was going to ask, and I want to do it on the stand, was ask for consideration from the Department that if you should go to a third week, that it be held at a time -- if it could be held in June or sometime no earlier than June, there might be an opportunity to get that additional information, more current information from Dr. Stephenson. And I know that's important to the Department on the make allowance hearing; in fact, the
Department reopened the hearing to have
Dr. Stephenson's information, so I would ask for
collection of the Department if they -- if
they could go to a third week and if such a week
could be held in a time period that would allow
Dr. Stephenson to both be here to talk about
these testimonies and to provide updated
information.

Q And that would address, in addition to Proposal
No. 2, the methodology that you suggest be
applied by the Department in a continuing
survey, it would also address the Proposal No.
1, which proposes to use the most current data
available, that would provide, hopefully, 2006
information or a report similar to the
comparable most recent information available
from CDFA.

A I think what it was was his original data that
he put together a little over a year ago had
2004 and 2005 mixed data, so I would envision
that this data would be 2005, 2006 mixed data,
but hopefully it would be clearly a year more
current.

Q Right. And it would provide testimony
responsive also to Proposal No. 3, which -- by
New Mexico producers which proposes to adopt
some of Stephenson's results?

A  Yes.

JUDGE PALMER: Well, just for clarity's
sake, all of that I give over to the Government
table and they can let me know what, if
anything, they want to do when it comes to
Friday of this week.

Meanwhile, though, the exhibit is being
received, but only as a source of material to be
used by the witness, not as a substitute for
Dr. Stephenson's testimony, regardless of what
his problems are.

MR. VETNE: Your Honor, there were two
exhibits. One was entitled "Testimony" and one
was entitled "Cost of Processing," which was --

JUDGE PALMER: Well, we'll let them both
in. This witness is competent to work with
them.

MR. VETNE: Okay. My question is whether
Your Honor's limitation applied equally to both?

JUDGE PALMER: Yes.

MR. VETNE: The limitation, as I understood
it, applied to testimony, but you're saying it
applies to both?
JUDGE PALMER: It applies to both. You really need him to explain the exhibit that he prepared. We'll do it that way, something that you can use, but it's not his testimony.

MR. VETNE: Okay. Your Honor, of course, to the extent necessary, I take exception to that limitation, and --

JUDGE PALMER: You can argue it on brief.

MR. VETNE: And I will address it on brief and perhaps later in the hearing. Thank you.

JUDGE PALMER: Great.

(Thereupon, Exhibit Nos. 36 and 37 were received into evidence.)

JUDGE PALMER: Any other questions? Yes, Mr. Yale.

CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q In the "Cost of Processing in Cheese, Whey, Butter and Nonfat," I'm not sure, is this 3- --

A 7.

Q 7. In the back of that is an Appendix A. It starts at page 12.

A I have a copy, but I'm missing page 12.

Q Well, do you have page --

A I have 13.
Q: Well, I'm looking at the wrong exhibit. I'm looking at the one that has the study. I'm looking at his -- I think it's the one that has been posted on the Web site, but he had the -- how the program worked. I may have given you the wrong exhibit number.

A: No, I think you gave me the right one, Ben, I just don't have -- I'm missing that page 12.

MR. ROWER: There is no page 12.

Q: Okay. Do you have the Cornell Cost of Processing Program?

A: Cost of Processing in Cheese, Whey and Butter, September 1, 2006.

Q: Yeah, but then he has an appendix attached.

A: Okay, let me -- the page that has 12 says -- that says "Appendix A -- Directions." Is that what we're referring to?

Q: Yes.

A: Okay. I'm sorry. I have that page.

Q: That uses a different label on the thing. Okay. Have you read that Cornell Cost of Processing Program?

A: Back quite a while ago when he first -- when the report came out last September, I -- to the extent I remember what I remember.
Q    And you were here when he testified?
A    Yes.
Q    And I'm not sure whether you asked any
questions, but you were aware of the line of
questions and his testimony.
Did he at any time indicate that as part of
the collection of the data, he requested the
plants to exclude the costs associated with
improving plant yields or efficiency?
A    I don't recall that, Ben. He may have; I just
don't recall it.

JUDGE PALMER: You see, that's the whole
problem with taking an exhibit in, you don't
have the person who prepared it.

MR. YALE: Well, I'm not trying to get -- I
want his recollection because it's a setup for a
follow-up question of Dr. -- or Mr. Wellington.

JUDGE PALMER: I'm sure you have a good
reason and you'll -- go ahead, Mr. Yale.

Q    The question really comes down to this, is that
when they collected this cost of these plants,
there was no adjustment made for what kind of
yields or types of operations or anything else
that were made.
A    I don't believe there was.
Okay. Now, in the NASS survey, I know you testified you don't participate in it, but you're aware of --

Well, Ben, if I can just correct that. To the extent that yields would affect the number of pounds of product produced, okay, yields were incorporated for the total cost by the pounds produced, but there was no intent to look at yields specifically as a separate category.

So to -- right, there's nothing as a separate category, right. Now -- but there is a function between the yield and the average cost to make per pound, though; right?

Certainly, because it affects the number of pounds made.

Now, the -- you indicated that you don't participate in the NASS survey, but you've seen the NASS cheese product prices form that you fill out to report that; right? Are you aware of the standards for that?

On cheese?

Yes, or nonfat dry milk.

Nonfat dry milk, we do participate on nonfat dry milk, and back at the very beginning I met with our plant staff on that, but, boy, we've been
reporting that for many years, so that'd be a stretch for me to try to remember the details.

Q So would you be able to tell me whether or not there's any statement on there in terms of choosing what products and what prices based upon the yields that they received on the -- in making those products?

A Not that I recall. I think it's a very straightforward -- I can tell that I would have faced a lot more resistance from our plant staff about reporting it if it was any more complex than it was, which was basically the pounds and the price.

Q Now, but in the reporting -- you participated in the RCBS study; right?

A Yes.

Q And you also participated, I believe, in the Cornell study, or not? Were you one of the lucky drawees?

A Yeah, we were. Actually we were the first plant on the cheese side that Dr. Stephenson visited. He spent a lot of time in our operations trying to perfect the form and whatever, working with our accounting people and what have you, because we obviously had an interest in getting it done
as quickly as possible, so our Middlebury plant was included, and our West Springfield plant was included on butter and powder.

Q Okay. And in those discussions with Dr. Stephenson, you took him through the plant, did you suggest to him to ignore any processes or equipment that might improve the yields of the operation, or was that all included in what you showed him?

A Oh, we didn't suggest he ignore anything. We just gave him a complete tour of the plant, answered all his questions that he had relative to the operations of the plant. To the extent that our plant was atypical, which it's not really atypical, but if there was anything, we made sure we pointed that out to him.

Q So you reported all of the costs associated with that plant and showed him all the equipment and so that he had a sense of what the capital investment is for that total plant; right?

A That's true.

Q And you have no reason to believe he did anything else with the other plants that were part of the survey?

A No, I don't, and, in fact, I believe he probably
did likewise because I know he -- well, at least
he testified that he visited all the plants.

Q  Right. Right.

JUDGE PALMER: We're really getting into
what Dr. Stephenson did and now we're sort of
trying to get into his mind and --

MR. YALE: I'm not getting into
Dr. Stephenson's mind.

JUDGE PALMER: Yes, you are. Yes, you are.
You said did he do the same for the other
plants, and he wasn't at the other plants.

MR. YALE: Well, let me just ask the
question.

Q  There is nothing in his -- in that cost -- that
cost study includes all of the costs associated
with that plant, including whatever it took them
in terms of personnel and equipment and
investment to produce product at -- at the yield
that that plant generated; right?

A  As far as I know, yes.

JUDGE PALMER: That's what you're assuming?

MR. WELLINGTON: Yes.

JUDGE PALMER: All right. We'll allow it
that way. He's assuming that those were the
conditions of the study and what Dr. Stephenson
did, and when he then used this exhibit for whatever purposes he's using it for, that was his assumption.

MR. WELLINGTON: Yes, thank you.

Q And then one final thing. By the way, we would support having Dr. Stephenson's information. I mean we're not looking at the numbers, we're looking at the process, and we think that's a valuable process.

One of the things, though, that -- do you have an opinion as to whether this study should undergo some independent review or audit just to ensure that the -- you know, there's no mathematical errors made or, you know, something else? I mean we're all -- Dr. Stephenson is very smart but, you know, sometimes we make a mistake.

A Ben, I think that would be an excellent idea. In fact, it's one of the reasons why we're proposing that the market administrator auditor staff review this on a regular basis because we think that can be the case. I mean we have no problem with that because we know the numbers of what were reported at our facilities, and so that'd be great, we'd be happy to open our books
to an auditor on that, and we'd like to know
that other plants also have complete costs, so
we would have no problem.

    MR. YALE: I have nothing further.

    JUDGE PALMER: Any other questions?
    
    All right. We're going to complete with
you on that, and I guess you're going to go on
to your testimony after lunch on the next
section. What's your situation?

    MR. WELLINGTON: I think we're done.

    JUDGE PALMER: You said you had other
things for him.

    MR. VETNE: That's what I just did,
Your Honor.

    JUDGE PALMER: You just did it?

    MR. VETNE: Yes.

    JUDGE PALMER: When I wasn't looking.

    MR. VETNE: I just did that. We just
completed him.

    JUDGE PALMER: You're complete. Have a
good trip.

    We'll see you at a little after one.

    MS. FICHELMAN: Your Honor, I just wanted
to make sure that Mr. Wellington's testimony was
received into the record. Was it received?
MR. VETNE: Oh, yeah, 35.

MS. PICHelman: Exhibit 35, his actual testimony.

JUDGE PALMER: Oh, yes, yes. We're receiving 35.

MS. PICHelman: Thank you.

JUDGE PALMER: Very good. Thank you.

(Thereupon, Exhibit No. 35 was received into evidence.)

(A luncheon recess was taken.)
AFTERNON SESSION

TIMOTHY P. GREENWAY,

having been first duly sworn in by the Judge,
was examined and testified under oath as
follows:

JUDGE PALMER: We're on the record. Okay,
Mr. Greenway has been called as a witness and
has been sworn.

MR. VETNE: Your Honor, Mr. Greenway has a
statement called a Declaration which he prepared
in the course of the session starting in
February, which I distributed in February, again
posted on the Internet about a week ago, and I'd
like that marked as the next consecutive
exhibit.

JUDGE PALMER: That would be 38.

(Thereupon, Exhibit No. 38 was marked for
purposes of identification.)

MR. VETNE: That's been around a long time.
Mr. Greenway would like to waive the reading of
that, but I have some additional Direct or exam
questions of it.

JUDGE PALMER: Well, that's your statement,
Mr. Greenway?

MR. GREENWAY: Yes, it is.
JUDGE PALMER: That's been marked as Exhibit 38. Why don't you go on to your questions, additional questions.

DIRECT EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q Mr. Greenway, your statement is focused primarily on fat recovery in the Foremost facilities; correct?

A That is correct, sir.

Q And just to summarize, what is -- what is the fat recovery you obtain?

A In our Marshfield location, which is a cheddar producing 40-pound blocks, we've historically and currently get about 90.25 percent butterfat retention.

Q Okay. That's produced in 40-pound blocks?

A That's 40-pound blocks.

Q What type of vat do you use?

A We're using a Damrow Double OO vat.

Q What kind of vat is that, vertical, horizontal, lateral? I don't know what they are.

A Well, how do I phrase it in relationship to that. Let's just say instead of being a vertical vat, it's a horizontal vat, and it's kind of like when you look through binoculars
and merge them together, that's kind of what you would have there.

Q Okay. There are vats available to cheddar cheese makers and to other cheese makers that are newer and have some improved technology. Are you aware of that?

A Yes. Yes, sir.

Q Horizontal cheese vats, the Scherping kind that Mr. Yale referred to earlier.

A Uh-huh.

Q Are you familiar with those kinds of vats?

A Yes, I am.

Q And have you looked into procurement of that kind of vat?

A Yes, we've looked at the technology several times at Foremost, and, you know, do believe they are a very capable vat indeed.

Q Okay. Do you believe that that kind of vat would somewhat improve your fat retention in cheese?

A Yes. Yes, there's no doubt. The vats we're dealing with, the Double OO's that we have from Damrow, which has been a very reliable and good vat, you know, with 90.25 percent, I'm sure that our retention values can get up much higher.
They have improved technology in the Scherpings that you mentioned. They have less depth, okay, which gives you a consistency in relationship to the -- when you do the cut, the tension of the curve from top to bottom, you have less stratification. You also -- you know, the radius that they have on those vats is consistent, it's a little bit more narrow, so when you're doing a cut or a stir with them, you basically have about the same speed or have closer speed from the tip of the radius to the center, and so that allows you to be a little bit more gentle.

Q So there are vats out there that will produce somewhat better butterfat retention?

A Yes, sir.

Q Why haven't you put them in your plants if they're out there?

A We've analyzed it several times, and usually the constraining factor tends to be the investment dollars relative to the payback.

Q What do you mean by that?

A Well, for an example, in the Marshfield facility we have eight vats in there, and in looking at replacing those with the type of vats you're
talking about, that's probably going to cost us about $5 million to make that investment just to replace the vats alone.

Q Five million dollars in one plant?
A Yes.

Q To replace eight vats?
A Yes. That would be installing -- taking out the old vats, installing the new ones, process piping, controls, etc., yes. That's probably a minimum number that it would take to do that.

Q That's equipment and labor costs?
A Yes.

Q And whatever salvage you get from the --
A The old vats, yeah.

Q The old vats. In addition to the cost for new equipment and new labor and new fitting and so forth, would you have costs because of reduced capacity or closing of the plant?
A Oh, sure. Anytime you take down a facility within our multi network of ten plants that we have, you're going to have to end up moving that milk into some other product, so, first of all, physically you're going to have to move it from the location, so you're going to have transportation costs associated with that. And
then obviously whatever the other product is it goes into on a temporary basis, we would have to see what the markets were, but that also may be a loss -- or a cost, I should say, in relationship to that installation.

Q So for ten days -- of course, that depends on the season too?

A Yes, absolutely.

Q You have more milk in the spring, less milk in the fall, some days you would have weather problems that might interrupt installation, that kind of thing.

A Uh-huh. Uh-huh.

Q You have to say yes.

A Yes.

Q Okay. Have you looked into how long it would take to recover your investment with that somewhat added fat retention?

A Yes, we've done that actually several times. And this last -- in preparation in relationship to testimony here, we looked at it again in regards to the economic value that was put forth by the USDA in their February 2007 economic forecast that said that the retention would be something like -- increased retention would be
$13 per hundredweight, was the value that was offered in that, at least for Scenario C, which was a multitude of butterfat, protein and other recoveries, and using that with 2006 numbers, basically on a straight payback, that would be -- which it's not including the time value of money, etc., that'd be something like 7.2 years for that particular facility.

If you include such things as the depreciation and tax impacts, the way that a true accountant would look at it or a lender would look at it, that's going to actually lengthen out. If you're using like 6 1/2 percent interest rate, which is a conservative number, would be something like about a 13 year payback.

Q All right. And how much would it cost, did you say, for the downtime or alternate --

A The downtime, you know, we use -- from the pounds that hit that facility that would have to be moved, you know, it's going to be something like 8.1 -- it's going to be 1.8 million pounds at, you know, 50 cents per hundredweight transportation cost is going to get you someplace around 90,000 for that ten days.
Q: How many plants does Foremost operate?
A: We currently operate ten cheese facilities.
Q: And have you estimated your total cost to put that kind of equipment in all of your plants?
A: Well, on a very rough basis, if we were putting that in all ten plants, you have more or less complexity in relationship to egress and entrance to the -- getting in the plants, you know, actually physically getting the vats in, but if you just do a quick, simple extension on that five million per plant, we're talking about $15 million, which in 2006 we had about $138 million worth of plant, property and equipment, and so that's about, you know, 36 percent of our value to replace into that type technology.
Q: And if you were going to consider that, how would you finance it?
A: We'd have to take it to our bank. We do our financing currently through CoBank, which is the bank that does cooperatives, and so in doing that, we'd have to take this to them, our proposal, we'd have to show our payback similar to what I've just stated here today.
Unfortunately, in relationship to that
particular statement is that if we end up paying that out in the minimum Order price and paying that amount, we would not have that return of 13 or 7.2 years because we'd end up paying it in milk price.

Q Okay. So if the -- if the hypothetical additional revenue or the additional revenue from this type of new equipment from greater fat retention were included in a minimum Order price payable to producers, you would not have a return on that investment to show your bankers, you would not be able to recover it even in 13 years?

A That would be correct.

MR. VETNE: Your Honor, I ask that Mr. Greenway's declaration be received, and offer him for Cross-Examination.

JUDGE PALMER: All right. We'll do that, it'll be received.

(Thereupon, Exhibit No. 38 was received into evidence.)

JUDGE PALMER: Do we have questions?

Mr. Yale.
CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q  Good afternoon. I'm Ben Yale with Select Milk Producers, Dairy Producers of New Mexico, Continental Dairy Products from Michigan, Ohio and Indiana, and then Zia Milk Producers from New Mexico and Lone Star of Texas and other states.

A  Good afternoon.

Q  Mr. Greenway, I want to follow up on that last comment. I kind of got around that there will be a cost, and I think that's always assumed, there's a cost to invest into the more modern vats; right?

A  Yes, sir.

Q  Okay. You've testified to that. And then you've said that by just looking at straight -- I assume by straight cash flow, it'd take seven and a half years, and if you include depreciation and tax and everything else, it's a 13 1/2 year payback; right?

A  Yes, sir.

Q  How long have you had the vats that you currently have?

A  They have been in place, I would say -- of
course, we have numerous plants and stuff, but
that's basically '70s and early '80 technology.
Q Okay. These are fairly permanent fixtures that
are purchased; right?
A Yes. That's how come the ten days to, you know,
replace them. In fact, in a place like
Marshfield, we don't have easy access to it
because it's been built around that, and so it
takes considerable time to get into that. It's
the main part, it's the hub of the cheese plant,
so it takes quite a lot to replace these.
Q Now, would you go over again with me what you
just told Mr. Vetne, that you would invest --
that you're not going to be able to get the
money back because you end up reporting that to
NASS and then -- am I missing this, and then
NASS raises the price and therefore you can't
pay -- you aren't going to have any cash flow.
   How is it that you don't get any recovery
back?
A Well, the argument put forth there is
essentially that if we change the minimum Order
portion and take it to 94 percent recovery,
which has been proposed, we essentially -- that
benefit which I stated from the USDA number,
that 13 cents, would essentially be paid out, so if that's the economic value of basically going from where we are right now, which is 90, we're at 90.25, they talked about going to 94, being the 13 cents per hundredweight, if we change that, we then will pay that out in relationship to producers, so -- if the Order is changed and that factor goes to a 94 percent retention, and so at that point I don't -- as a manufacturer, I don't have the recoup of that basically 13 cents to apply against my investment because I'm paying out to producers, which we're happy to do, but we're always looking to try to optimize that as a cooperative.

Q So you've made a business decision that you can, without increasing your -- or changing your plant, that you can deliver to your producers the most money that you can at this point in time; is that right?

A We're always looking to optimize that, of course, and so we're looking for investments that have shorter paybacks. If we retrofit a plant and change it, we're going to assess technology replacement of those parts, of course, that's the time that it makes sense to
do that, and there's no doubt in my mind that we probably would replace those vats to take advantage of the new technology that's out there, but it's kind of difficult to do that once you have that investment in the ten plants, it's the heart of your facility. Unless you're retrofitting to do, you know, a new type of line or new type of product, working with our customer base, we're generally -- just have not been able to show that we can get the return by simply replacing the vats.

Q You've mentioned your product line. Of all of your plants, what percentage of the cheese is reported to NASS?

A It's going to be -- it's going to be a smaller percentage there. I'd have to say I don't know that number exactly.

I know that in regards to Marshfield, which does produce the 40-pound block, that about 85 -- like I have in the statement, about 85 percent of it is cheddar. About 21 percent of that volume in that same time, which is 2006, was reported on NASS, okay. The difference there being within the NASS numbers you only pick up white -- you pick up colored and not
white, and we produce a lot of white cheddar at
that location, so that excluded a number of it.

It is our only -- out of the ten plants,
it's a good scale plant, but we only --
currently right now we're only producing cheddar
in one other location, so it's going -- I don't
know what the number is, but it'll be -- you
know, if it goes up to 85 percent and go down to
21, it's going to be a fairly small number.

Q Are all the others American style, cheddar type
cheeses, though?

A A lot of the other plants are going to be
Italian, mozzarella, provolone, etc.

Q And those would use a different style vat?

A No, actually we use almost exclusively the
Double OO vats in our locations, except for one
location in Wilson which uses a horizontal vat,
but it's not that different horizontal.

Q But there's -- it's still true the cost to
produce is still the same?

A Yes, yep, we're cooking and stretching, yeah,
going through a water bath.

Q In your market, do you pay producers amounts in
excess of the 3 and 4 or the minimum -- I'm
sorry, not 3 and 4, but the minimum prices under
the Federal Orders?

Yes, we do. In relationship to meeting competition in our area, we're pretty much forced to do that. Of course -- and forced may be the wrong terminology there because we want to try to do that also to meet the marketplace, I mean, and for the benefit of our producers.

Now, by the way, I do appreciate the effort made to try to bring to the Department what you thought your -- what you represent to be the value of your butterfat recovery. A lot of plants were unwilling to do that, and I appreciate that. I think it's helpful to all of us.

But one of the questions I have, and I wasn't sure whether you were saying this or not, so the question, I'm going to -- I want to talk about your butterfat recovery.

First of all, do you buy any cream to add to your plant -- your vats?

No. In the Marshfield plant, we are strictly taking in milk and basically producing the full fat cheddar from the domestic supply.

So you're doing a full fat cheddar?

We're doing a full fat cheddar. We also do
some -- as you can see from these things, we do some reduced fats. That's done in relationship to standardization or adding nonfat dry milk.

Q Okay. So you do some fortification?

A Yes.

Q Do you take any of your whey cream and put it back into the vat?

A That's not done in relationship to our American plants. And that's done in relationship to a couple things. You have some issues in relationship to our flavor profile that can happen with a cheddar cheese, and so whey cream is not reutilized at that Marshfield facility.

Q The -- so for the amount of butterfat that comes into the door in the plant from the producers and the amount that goes out in the form of your cheeses at Marshfield, you're saying that 90 -- approximately 90 percent of that shows up in the cheese; is that correct?

A From the attachment there, you can see it actually is 90.25, and it's been fairly consistent with that. I mean if you go back through the years, that's pretty much what we're able to perform at at that location.

Q And the other 9.75 percent is either -- shows up
primarily in whey cream that you sell?

A Yes.

Q Now, you talk about a factor over here on the whey cream of 14 percent less for sweet cream of the same fat content.

Now, there was -- I don't know whether you were here this morning when the gentleman from Twin County testified. Were you here?

A No, I was not, sir.

Q He testified that there was a multiple that he was paid for his whey cream times the CME butter price; is that --

A That's what actually is being reflected here is is that difference in the multiple.

Q Okay. So the multiple might be like 1.28 or 1.3 for the butterfat, the full -- the good cream -- I shouldn't say good, but the fresh cream, and then maybe like 1.10 or 1.12 or 1.15 for the whey cream?

A That is correct, sir.

MR. YALE: I don't have any other questions. Thank you.

JUDGE PALMER: Questions? Mr. Beshore.
CROSS-EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q  Good afternoon, Mr. Greenway.
A  Good afternoon.
Q  Marvin Beshore. I represent Dairylea
    Cooperative and DFA in this hearing.
    Just a few more questions about your
    operations at Marshfield. Can you tell us
    approximately what the volume per day of milk
    receipts are at Marshfield?
A  It tends to be about 1.8 million pounds when
    we're producing. You know, sometimes you have
    some down days, but when it's in operation, 1.8
    million pounds.
Q  That's sort of what, an average year around?
A  Yeah, I get that number actually from 2006
    figures.
Q  Okay. Now, of the production at Marshfield, you
    say 85 percent is cheddar. Was it 21 percent of
    the 85 percent was reported to NASS or 21 --
A  No, you have that correct. Of the 85 percent
    that is in the cheddar category, 21 percent of
    the total production, okay, in total is what
    was -- it's 21 percent of that -- no, excuse me,
    21 percent of the total volume was reported to
Q Of the total volume at Marshfield?
A Total volume, yeah.
Q So roughly a quarter of your cheddar production?
A Yes. Yes, sir.
Q Now, the non-NASS cheddar, are there any differences in production cost of that product versus your NASS cheddar?
A Outside of the -- the stuff that meets the same standard of identity as cheddar, meaning the full fat cheddar that we produce and its color, other than the color, that's basically the same product, and so then what you go down to is basically that they have different packaging, which that's also a consideration if it's picked up in NASS, and -- but other than that, you're running through the same process.
Q So help me. Does color add to the cost or lessen the cost?
A We haven't been able to get our suppliers to give us the color free at this point, so, yes, that adds to the cost.
Q So the NASS is more expensive to produce then?
A Yeah, the NASS is slightly more expensive. It's a very minimum number. The color is not that
expensive in the total picture of things.

Q So your non-NASS cheddar, is it then sold off the block market?

A Yes, it's -- the vast majority of everything that we sell there is based on the CME, the average weekly CME, usually a week delay, and that depends a little bit on the customer then what the actual week is.

Q What, if you know, approximately is the -- is your -- your selling price for your production at Marshfield comparable to the reported NASS selling prices for the Minnesota-Wisconsin region?

A It's going to vary, you know, depending on what area it may be going into and depends on the labeling. Like I mentioned before, we do have a label that goes out East, it's been there for many years, 195127.

Q I'm familiar with that.

A Good. Hopefully you have some. And that gets probably a little bit more premium than your standard nonaged cheddars, so there's -- like most manufacturers, there's a range that you get and that's different from the CME value.

Q Okay. So if I just extend that out, if we
looked at the published NASS weighted average prices for 40-pound blocks for the Minnesota and Wisconsin area, okay, and compared that to the CME price for the same time -- you know, for roughly the same time period, setting aside for the moment the lag there, are those -- are those values representative of the values that you're able to obtain for your production?

A You know, so you're saying the actual price per pound of cheese, is that what you're coming up to?

Q Yes, the published NASS weighted average price for 40-pound blocks in Minnesota-Wisconsin.

A I would say that they generally are higher than that, they're higher than that value. Specifically, of course, from a proprietary standpoint I don't want to say how much higher, but they would run a little bit higher than that from a value stand.

Q With respect to the fat, butterfat retention figure, I want to -- in paragraph 15 of your declaration, you sort of break down I think the method of that calculation, and I want to be sure that I understand it.

Do you start with farm weights and tests of
your member milk?

A Of course we have those in hand. What we're actually starting with here as far as this key measure and measurement goal is actually in the door, so we're scaling -- we're scaling those routes in, and that's what's actually being entered into our system that produces these numbers, so we're looking at a scaled, measured reading at the plant.

Q You scale the truck, scale the weight in, scale it before and after?

A Yes.

Q And that's the -- the butterfat is based on the sample before the truck's unloaded, I take it?

A Right. It's -- what we utilize there would be the sample that is taken. At that particular time the -- there's a little bit of mix here in relationship to what goes on there. We will use that number if we're bringing in vendor milk, non-patron milk. We're going to utilize the value we're sampling right at that point in time.

If we're utilizing our own Foremost Farms milk, it's going to go back to the samples taken at the farm.
Q: Okay. That's what I -- that's what I thought I got from your description here in 15. So the butterfat for your ratio, the butterfat starts with, you know, in essence the gross butterfat measured at the farm?

A: Yes.

Q: With respect to whey cream, you say it's sold from the location to third-party buyers. Do I understand that to be that the -- it's sold FOB Marshfield?

A: Yes, that's correct.

Q: Mr. Yale asked you this, but I want to make sure -- or asked you about this generally. Is -- we had testimony this morning that an FOB plant multiple would be -- and this was from Iowa, was -- for whey cream was about 1.14. Is that -- is that an accurate number?

A: Without saying the specific, because I did not reflect that here, I would say it's actually a touch lower than that in our case.

Q: And the -- and that's times the double -- CME AA market price?

A: That's correct.

Q: Okay. Now, what is a typical -- do you sell -- you sell some sweet cream from Marshfield?
No, we do not -- we don't have a separator there, so we don't sell any sweet cream from that location.

But do you sell sweet cream from other locations?

We do separate in what would be our balancing plants, our butter puff plants, and so in those cases sometimes we will sell cream from those locations, sometimes those will go to our consumer products division, go into different products there, salt cream being one of them, so we both use it internally, of course, to make butter from it and we do also sell the cream.

Now, you made a comparison in paragraph 13 of your declaration which is Exhibit 38 of the price of whey cream versus sweet cream. What did you use for the price of sweet cream for that comparison?

Well, since I wasn't going to specifically reflect what the whey cream was, I'm not going to say specifically what the sweet cream one was as well. But, essentially, again, that value that we're using is a typical number representative of what we're able to get in the marketplace.
Okay. Well, I'm interested -- you used a 14 percent differential, and I'm just specifically interested in what was the numerator, what was the denominator of the 14 percent.

Uh-huh.

Can you help me?

Well, I could, but if I do, in that case I'm basically saying specifically what I'm -- what I'm getting for those, those values, and I would prefer not to do that.

Well, I'm interested in how -- you've got the 14 percent in there. I think in order to be able to use that or for that to be meaningful, we have to have some idea of what the -- you know, is that -- if you took a sweet cream number, say we use the 1.14, I know that's not your number, okay, say we used a -- you know, a 1.28 for sweet cream, is that difference of .14, is that your 14 percent?

That is the type of calculation that would be done to come up to that 14 percent. I'm looking at the divisor of the number which is the whey cream relative to the sweet cream and inverting that minus one to basically come to the
14 percent.

Q So which was the numerator and which was the
denominator, sweet cream or whey cream? I mean
which was the numerator?

A I don't recall right now. I mean I'd have to
physically do the calculation again.

Q It would make a difference, would it not?

A Oh, yes. Yes.

Q But you're not sure which was which?

A No. No. It's been since I did this testimony
for the last time, or when I did that and wrote
this up that I did that calculation, so I don't
recall it at this point.

Q Okay. Do you purchase any of the -- of the whey
cream and use it internally within Foremost?

A No, we -- as a matter of fact, we sell -- any
whey cream we have we sell external, and we do
not process any whey cream internally on our
own.

Q You do make butter, do you not? Foremost does
produce butter, does it not?

A Yes. Yes. We just don't produce any B butter.

Q There's been some testimony I think in the
earlier -- in the earlier hearing, some
indication that the state of Wisconsin does not
require for A butter, for its A butter -- it has its own state A butter designation, AA butter, does it not?

A That could be. I'm -- I have to plead ignorance here, I'm not a butter expert.

MR. BESHORE: Okay. I don't think I have any other questions at the moment. Thank you.

JUDGE PALMER: Thank you very much, sir.

MR. GREENWAY: Thank you.

JUDGE PALMER: And we've received your statement.

Who do we next have as a witness?

MR. ROSENBURG: Jon Davis is next.

MR. YALE: By the way, Your Honor, for information, Mr. Wolfe has been here today and has a three- or four-page statement in the back of the room.

JUDGE PALMER: All right. We'll take him right after Mr. Davis.

JON DAVIS,

having been first duly sworn in by the Judge, was examined and testified under oath as follows:

JUDGE PALMER: We'll mark this statement as 39, Exhibit 39.
(Thereupon, Exhibit No. 39 was marked for purposes of identification.)

MR. ROSENBAUM: Ready, Your Honor?

JUDGE PALMER: Yes.

DIRECT EXAMINATION,

QUESTIONS BY MR. STEVEN J. ROSENBAUM:

Q Good afternoon. Why don't you start by telling us your name for the record.

A Jon Davis.

Q And, Mr. Davis, where are you employed?

A Davisco Foods.

Q What is your position there?

A General manager.

Q And how long have you been with Davisco?

A Twenty-three years if you count my first day I walked in the door.

Q What does Davisco do?

A We make -- we buy milk and we make cheese and whey products.

Q Where do you have facilities?

A LeSueur, Minnesota, Lake Norden, South Dakota, and Jerome, Idaho.

Q And what kind of cheeses do you make?

A We make all forms of cheddar from no fat to full fat. We make mozzarella, we make Parmesan, we
make Asiago, we make Romano, and that's about it.

Q Now, Mr. Davis, you are familiar with the fact that the International Dairy Foods Association has Proposal No. 12 which would amend the Class III and Class IV product prices' formulas by limiting the three cent cost adjustment for cheese manufactured into 500-pound barrels; correct?

A Yes.

Q And you are here, in part, to testify in favor of that proposal; is that correct?

A Absolutely.

Q And we have had marked as Exhibit --

MR. ROSENBAUM: And, I'm sorry, Your Honor, that number again, please?

JUDGE PALMER: 39.

Q -- Exhibit 39 a document that has been posted on the USDA's Web site for more than a week now. These are some spreadsheets that you put together that address this three cent issue in Proposal No. 12; is that correct?

A Yes.

MR. ROSENBAUM: All right. Your Honor, we have distributed copies of Exhibit 39. We also
thought it might be helpful to have it -- it's
only a couple pages, to have it projected and
Mr. Davis can help us, lead us through it.

JUDGE PALMER: Fine. Does he need to step
down to see the screen?

MR. DAVIS: I have a copy right here.

JUDGE PALMER: You can do it that way. I
see it. Okay.

MR. DAVIS: Maybe I can just talk through
it, Steve.

JUDGE PALMER: You're going to have to
stand over there and do it.

MR. ROSENBAUM: Okay. I think I may --

JUDGE PALMER: You're the technical wizard.

MR. ROSENBAUM: I'm not sure I am.

MR. DAVIS: And as we do this, I can give
you a little background as to where these costs
came from.

Q All right.

A In our LeSueur plant, which is in southern
Minnesota, it's regulated, I think it's under
Federal Order 30, I should know that, but I'm
pretty sure it's Federal Order 30, we make
40-pound blocks and 500-pound barrels, and the
nice part about this comparison using it at
LeSueur is we put this system in from an antiquated system in 1999, and we put in the block plant and then we put in the barrel plant, so it's very easy to assess both capital costs, which are very significant in both of those processes, but also obviously operating and variable costs which are shown here, so that's the example in LeSueur.

And there was -- some of the USDA folks were there a couple years ago and we gave a tour and we had it all roped off which was the block -- which was dedicated to block production, which was dedicated to barrel production, and we do both in the same plant, so everything ahead of the packaging room is the same, essentially; the cheese vats, the cheese draining tables, the milk pasteurizer, whatever else you have ahead of the packaging room and everything downstream in terms of whey processing, so it's a nice comparison between the two. And we'll get to the capital on the second page. We'll go through the operating first.

But what you see, the line items, the individual line items you see here on the left
are making the 40-pound block, and those are our actual costs for everything you have to do to put a piece of 40-pound cheese in acceptable packaging and sell it on the -- either commercially in the industry, in the trade, or sell it on CME.

Q All right. So under the heading 40-pound box with liner, you have a series of items. And I take it these are the various items you need to buy and utilize in order to pack a 40-pound box; is that right?

A Yeah. I can walk through them. The first one's a pouch. Out of a cheese tower where you form this 40-pound block, you push the cheese block into a pouch, plastic pouch, and it's 17 cents apiece, so every block that comes through there has to have a pouch on it.

And then you put a cardboard box around it, and that includes a liner and a box that goes around the liner, and you can see the various costs there.

You have to put a label on it, tell, you know, when it was made, where it was made, what vat it's at for product recall and traceability, things like that.
The hot melt is the glue you use to make the box adhere to itself so it stays closed.

The stretch wrap goes on after you have a group of 54 blocks on a pallet. The stretch wrap is what keeps them together so when they go in the truck they don't fall all over.

On that pallet you have a cardboard pallet pad, and then you have a pallet itself.

In addition, when you're talking about 40-pound blocks, when you sell on the Merc., and for the most part when you sell commercially, you have to put color, annatto, in the milk to make colored cheddar, so. Cheese is normally white, so you have to add the color. And I add -- as you can see here, we have a line item for color costs.

In addition to that, in order to make it apples and apples with making a barrel of cheese, you have to get that whey stream back decolorized, you have to bleach the annatto out of what's left in the whey stream, so as you can see, there's a line item there for decolorizing that whey back to white so you can process it into whey products and essentially be on par with barrel production.
Q: All right. So you have a one column called Block, and that's the -- as I understand from your testimony, the absolute cost, for example, a pouch costs 17.5 cents, etc.; correct?
A: Yep.
Q: And then you have next to that a column for Pound, which is simply derived by what, dividing the block column by 40 pounds; is that right?
A: It better be, but, yeah, that's how it is.
Q: All right. And the bottom line is --
A: Elvin makes a good -- thanks, Elvin. I think we used 42, you're right, because that's what most of our blocks are. Thank you, Elvin. I knew you'd help me today.
Q: And the bottom line is what is your per pound cost of packaging for the 40-pound blocks?
A: For variable costs, and this is just what it takes to put packaging around a 40-pound block or 42-pound block, it's .02574 per pound.
Q: And has that -- have you now told us what we need to know about the 40-pound block side of the document?
A: Yes, in terms of variable costs.
Q: All right. Take us now to the right-hand side of this page, which is called Fiber Barrels.
Yes. We also can make barrels in the same production facility in LeSueur, we do it also in Idaho as well.

And what is necessary to make a saleable barrel, both to the Merc. and also to the trade, is on that -- on the right side of the ledger.

You need a barrel liner, which is similar to a pouch except that it's a lot bigger because you're putting it in a three and a half, four foot barrel. You have the fiber barrel itself which is spec'ed and accepted by the Merc. as saleable on the Merc.

We have labels on there. You have to have two different labels on there, and that's required. We have stretch wrap because you put four barrels on a pallet when you ship it, so we have to stretch wrap those so the barrels don't fall over. And then we have the pallet itself.

And those are all per unit costs in the barrel column; right?

Yes. And there's 510 pounds in a barrel.

So, for example, barrel liners cost 99 cents each, if I understand this correctly?

Yep.

And then in the pound column, you're dividing
the numbers in the barrel column by 520 pounds;
is that right?
A 510.
Q 510, all right. And the bottom line per pound
cost, therefore, for packaging 500-pound barrels
is what?
A .022926.
Q Now, this is information with respect to your
LeSueur facility; correct?
A Yes.
Q You've got a little note at the bottom about the
Jerome Cheese Company's barrel cost. Tell us
what that represents.
A Well, Jerome is kind of out in the middle of
nowhere, if anybody knows where Idaho is. In
order to get the barrel to the facility, we have
to add a little bit for freight, and that's 1.57
a barrel more.
Q Other than that, though, as your note indicates,
the costs at Jerome are similar; correct?
A Exactly the same.
Q All right. Have you taken us through the first
page?
A Yes.
Q All right. We're now on the next page of
Exhibit 39. Tell us -- take us through that, if you would, please.

A And, again, we did this in '99, so these were capital costs in terms of construction costs in late '98 and through '99. And we -- obviously we added a building and then the equipment to be able to handle both types of production.

And as you can see in the square footage column, it takes a significant amount more square footage to be able to make barrels than it does to be able to make 40-pound blocks, and the reason for that is 40-pound blocks come nice and flat on a big pallet and you fold them up and your machine takes care of it and wraps a block around your 40-pound block.

You actually have to have the physical 500-pound barrels stored, and it takes a significant amount of area to store them before you use them, and an even more significant amount of area to store them after they're full. So that's why you can see the difference between square footage. Those are actual costs, what we spent when we built both packaging rooms.

Q All right. The first three entries under the heading Building have a (k) in parentheses to
the right of them, and then your footnote explains those are the expenses that pertain to 40-pound blocks; correct?

A Yes.

Q And then your next two entries under Building have an (r) next to them, and that indicates that that relates to the barrels; correct?

A Yes.

Q So basically this is how much it cost you to construct the building with respect to the size -- the area that needed to be set aside for pounds on one hand and 500-pound barrels on the other; correct?

A Yep.

Q All right. The next heading then is Equipment. Take us through that, if you would, please.

A We have 40-pound block cheese equipment, and those are cheese towers, we have a rapid cool, rapid cooler which is necessary when you make 40-pound blocks to be able to sell on the Exchange, and that is like a chill tunnel for 40-pound blocks, and then we have the decolorizing equipment that is necessary when you're going to make 40-pound blocks that have color in them to decolorize.
Barrel room equipment is just filling the barrel and then physically handling it to get it to a capping stage, account for it from a weight standpoint and putting it into the cooler.

JUDGE PALMER: Off the record for a second.

(A discussion was held off the record.)

Q And, once again, these are all actual costs, these aren't estimates?

A These are costs that were taken from invoices.

Q Okay. Now, the -- the next entry says Total, 40-Pound Block Production of $3,931,900.21.

Just tell us how that's -- the math behind that.

A That should be, and I'm sure it is, the three line items, the 40-pound block cheese equipment, the 40-pound block rapid cooler, and the 40-pound decolorizing equipment, and -- excuse me, and the building necessary to house all that.

Q So it's a summation of the entries above that relate to the 40-pound block side of the business?

A The ones with (k) by them.

Q And similarly the total barrel production figure of $5.1 million, roughly, is the same with respect to the barrel side; correct?
Tell us what you did then on this -- with respect to the next couple line items.

Well, if you look down at the bottom under the assumptions, you have an interest rate, which obviously at the time was a lot better than it is today. We have equipment life of fifteen years. And then we have a plant capacity, which in this case is the same for both blocks and barrels, we sized it for that, and we can do 78 million pounds, give or take, of cheese through that plant and ultimately through the packaging equipment both sides. And I used those figures to get the capital costs, and then backed that into a per pound capital cost.

And that -- the per pound capital cost then for the 40-pound blocks is?

.0051 per pound, and for barrels it's .0067.

And then at the bottom I added up the operating variable costs for both with the capital costs for both.

The operating variable costs were the ones that had appeared on page 1; correct?

Yes.

So that the total packaging and capital costs
for 40-pound block production is a summation of
the .025740 on the first page plus the .0051 on
the second page?

Q And the total packaging and capital cost for
500-pound barrel production of .0296 is a
summation of the 0.022926 on the first page plus
the .0067 on the second page; correct?

A Yes. It was when I sent the worksheet to you.

Q Well, believe me, the last thing I would have
done is touched those numbers.

So bottom line, and which of course is
where all this leads us, how do the total
packaging and capital costs compare between the
production of 40-pound blocks and 500-pound
barrels?

A In my world, they're essentially the same, but
they're, you know, .0012 per pound different, so
a third decimal.

Q So you have to go to the third decimal before
you find any difference at all; correct?

A Absolutely.

Q And this -- your analysis certainly does not
support the current three cent adjustment that's
in the formulas; correct?
A No. Contradicts it, obviously.
Q And for that reason, you believe the three cent
cost adjustment that's currently in the formula
should be eliminated; correct?
A Absolutely eliminated.
Q Mr. Davis, anything else you think you would
like to tell us with respect to this specific
issue, the Proposal 12 and the comparison of
producing blocks versus barrels?
A There's a lot more, but you told me I could only
talk on this.
Q Well, no, we'll start with this subject, but
anything else on this particular subject?
A No. No.

MR. ROSENBAUM: Your Honor, at this point I
would like to ask that this exhibit be --
Exhibit 39 be accepted into evidence.

JUDGE PALMER: Any objection? Received.
(Thereupon, Exhibit No. 39 was received
into evidence.)
Q Mr. Davis, you obviously know a lot about the
cheddar cheese manufacturing.
A Some days my father would say no, but, yeah, I
think so.
Q Tell us a little bit about losses that are
suffered during -- losses of fat that are
suffered during the cheese production process.

A: Well, every time you touch a fat globule, you
affect its ability to be retained, so the
more -- the least amount of times you can touch
a pound of milk or a fat globule, the better
chance you have of retaining it in cheese. And
I think -- I've heard a lot of the testimony,
I've read a lot of the testimony, I've read a
lot and heard the dialogue in the past, but at
the end of the day as we're trying to ascertain
values of fat and recoveries of fat, I think you
got to keep your eye on the ball in terms of the
economics of those, and what I mean by that is
when you fill a cheese vat up with milk, there's
a certain -- there's certain pounds of fat in
that, and we measure it every vat we make. We
make 120 vats a day. We measure every pound of
fat that goes in there, and certainly there's
some inconsistencies in the measurements, but
those are just inherent, but what we do is value
that fat that gets in there, and we put a volume
number to it, how many pounds.

And when you're all done, you sell a block
of cheese or a barrel of cheese and you have a
volume number of fat in there that you get paid
for as cheese.

There's a lot of stuff that happens in
between, but when you think about the economics
and what you're trying to do in a formula for
raw material pricing, those two things have to
stand a little taller than some of this minutia,
which is important, but can get in the way of
really analyzing the economic effects and the
economic abilities of a cheese maker to grab a
pound of fat and put it into a saleable product.

Q  And do you reprocess your whey cream?

A  No, we don't. Our -- we have yet to find
customers that accept that. In addition to
that, we've done -- there's an economic issue to
it in addition to a quality issue in terms of
flavor. The flavor of the cheese is not as good
because the fat's been through a lot more
damage, a lot more activity, it's been through a
cheese vat, been through a cheese table, been
through a clarifier, probably, or a fine saver,
been through a separator, been through a
pasteurizer for the second time at a higher
temperature to try to kill all the starter
organisms, gone back into storage and now you're
going to pump it back into the cheese vat.

And when we did trials to see if our customers, from an economic standpoint, not to mention quality and flavor, when we did trials for that, we found that the fat recovery of that whey cream fat was significantly less than the original fat -- ability to recover fat from, you know, a pound of milk. As much as -- if you can get 80 percent of your whey cream fat in your cheese, from the trials we've done, and we did extensive trials because we tried to make it work, you're doing a heck of a job.

So that whey cream that's getting regurgitated and recycled, you don't have the ability not only to separate it in a separator, but you also don't have the ability to catch it in a casein micelle.

Q Some of the fat obviously ends up in the cheese, some in the whey cream. Where else does fat end up?

A You have -- subject to -- when we take the whey off the cheese vats and the cheese tables, there are pieces of fines in there, and in order to properly whey process, you have to get those fines out of there, so you either take it
through a fine saver, which is a mesh filter, or you take it through a centrifuge, and there's fat lost in the decanting or de-sludging of those pieces of equipment, and then you run it into a separator to try to get all the fat out, because when you process whey, you don’t want fat in your whey if you can help it; you can't get it all out, but you try. And in that separator you have de-sludgings and other yield loss. That fat that started, you know, coming out of the cheese vat in the cheese table gets lost, whether it's down the drain, whether it's on the side of the pipes, wherever.

In addition, you have salt whey that you don't recover, for the most part, and there's a heavy amount of fat that ends up in the salt whey.

**MR. ROSENBAUM:** That's all I have at this point.

**JUDGE PALMER:** All right. Questions? Mr. Beshore.

**MR. DAVIS:** Marvin's got his calculator out, that means something's wrong, Steve.
CROSS-EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q  I just want to check my mental vat. Jon, do you report your blocks and barrels to NASS?
A  Yes. Excuse me, we report what is -- the NASS survey has certain requirements over what types of cheeses you can report, and all of our cheeses that meet those requirements we report.

Q  Can you tell us roughly what proportion of your -- what percentage of your production is -- meets the NASS specs and is reported?
A  Off the top of my head, Marv, I'd say 45 percent, maybe 40.

Q  Is that both at Minnesota --
A  That's company-wide.

Q  Company-wide. Fine.

A  We make a million pounds a day, so 450,000 pounds a day.

Q  What is the average moisture content of the barrels you produce?
A  It varies to style, but somewhere between 32 and 35 generally. We make a couple products that are in the 36 range. You can't sell anything over 37 in the trade or to the Merc., so anything over 37 is not -- doesn't meet the CFR.
But yours tend to range from 32 to 35?

And that's all customer driven. If they like the piece of cheese in that area and they like the machinability of it, they like the fitness for use, so we adhere to that. If they want 36, we can run a 36.

How about on the block side?

Well, the -- the requirements at the CME are 36 and 39, and we try to get as high as we can without going over, so, because the more moisture you sell, the better off you are.

So with respect to your -- you know, your unit cost information, the block that you're -- that you're pricing at in terms of capital and variable costs would be roughly 39 percent moisture?

Well, actually the controllability of your system isn't that good. I'd say 38 or just south of 38.

Okay. So we could use 38?

I'd say 37.75.

37.75, okay. Good. And the barrel then that you're -- the barrel -- the pound of barrel cheese that's been priced here, what would be the moisture content of that?
Shooting from the hip on an aggregate average, I'd say 34, but that's priced -- we have a moisture table that prices that accordingly.

Okay. So for your cost per pound of production for a pound of barrels -- for a pound of barrel cheese that costs you .0296 cents to produce, you have .64 --

.66.

.66 dry matter?

Yes, I do.

And for the block, you would have .6225 dry matter?


Okay. So you get more dry matter for the buck in your barrels than in your blocks; correct?

Yes.

So if we were to allocate your costs of production, as you have done here, over the dry matter in that end product, your cost for barrel production is less per unit than for block; correct?

Well, it's less per unit anyways, but you would say it's even more less?

It's even more less.

Your revenue reflects that, because you have a
moisture pricing table on barrels that you don't
have on blocks. The block price is a flat
price. If it's 139 today, that's what it is.
If the barrel price is 136 and you have 34 dry
matter -- or 34 wet moisture versus 35, your
price reflects that.
Right. So the price reflects -- the price
really reflects the amount of dry matter in that
pound of cheese?
Yes.
On the barrels.
Yeah.
Right. And it's standardized on blocks, so it's
not an issue, essentially?
Yeah. You'd just give money away if you're at
36.1 versus 38.1.
Okay. So back to my question, then. I think
the answer is yes, that it costs you less per
pound of dry matter to produce barrels than it
does per pound of dry matter in blocks?
But I don't think it's relevant because you have
to package both. You can't -- you're not
separating the water out and making powder.
Oh, I understand, but your costs include all of
your capital and all of your packaging; correct?
Absolutely, yeah.

Okay. And just so -- if we're really comparing apples to apples, shouldn't we be pricing that out in terms of the cost of packaging a pound of dry matter?

Well, you're selling it as a whole.

I understand, but you -- but it's sold -- you told us the price, and it's reflected in the NASS. It's not any secret. It's reflected in the NASS price.

Inaccurately in the NASS because it uses 38 versus 39, but it is reflected.

In any event, in the barrel, the barrel adjusts -- the barrel prices are higher at moisture?

If you've looked at it from a dry matter basis, Marvin, I can't disagree with you.

Now, traditionally there's been a spread between blocks and barrel prices in the cheese market; right?

Yes.

Okay. And how long have you been involved in the cheese business? You probably testified to that, but --

Well, I mean where I'm privy to that type of
stuff, probably 16, 17 years.

Q And over those -- over that period of time, there's pretty much always been a spread --
A Yeah.

Q -- in the prices?
A Yeah.

Q Barrels lower and blocks higher?
A Well, of late it's been an inverted spread actually.

Q I understand, very recently, but if you look over the 16, 17 year period, there's been a spread with barrels lower, and that's been reflected, according to the Secretary of Agriculture, USDA, that was reflected in the three cents that's built into our price formulas.

A Yeah, and I think if you look at the record, there was never any specific data like this. I think it was kind of an old cheese industry wives' tale that there was three cents' difference. There was never any data that I know of, and, in fact, when we met with these folks in LeSueur, they confirmed that, so I think this is the best data that's been presented subject to the old wives' tale that
three cents is the difference between blocks and barrels.

Q But you don't know what that difference in cost now is if you convert it to per pound of dry matter?

A No, I mean I'd have to look at it. And I don't agree that that's the way to do it, but I appreciate that -- for what you're trying to accomplish, that's the way you want to look at it.

Q Absolutely.

A Absolutely.

Q And the market reflects that because it prices -- as you've indicated, price is varied per pound of dry matter.

A The market reflects it accurately. The USDA survey and the USDA pricing reflects it inaccurately by using the 38 moisture. Nobody in the industry, not one person that makes barrels in the United States cheese industry, uses 38 moisture as a base to reflect their moisture adjustment. Everybody uses 39, but the USDA has chosen to use 38. Why I don't know.

Q But you're not proposing to correct that 38 versus 39 adjustment?
A I'm not, but I think somebody will be.
Q Okay.
A They limited what I can talk about.
Q Okay. You want to --
A And I'm following right to their limitations.
Q Right. You want to eliminate the difference, the three cents that was historically based on a cost difference, you want to eliminate that completely?
A Absolutely. The marketplace prices barrel cheese and prices block cheese today. It does it effectively. That's what should be reported.
Q Now, when you sell your -- would you agree, as some witnesses have testified that, you know, the great majority of cheese is sold off the block market?
A I don't know of any barrel cheese that's sold off the block market, and I think I'm the second largest barrel manufacturer in the country.
Q The great majority of cheese in the -- in the Class III production in the Federal Milk Order system is sold off the block market?
A If you're talking Class III formula, I'd say no. 60-some percent is barrel.
Q No, I'm talking about cheese produced, all
cheeses produced in the Federal Order System.

A Okay, nothing to do with NASS?

Q Nothing to do with NASS.

A Okay. Yeah, I would say that -- I would venture to guess that the majority, especially if you talk about Parmesans, Asiagos, Romanos, mozzarellas, they're certainly priced off the block market.

MR. BESHORE: That's all I have.

MR. DAVIS: Thanks, Marvin. Great to see you, again.

JUDGE PALMER: Yes, Mr. Vetne.

MR. DAVIS: Hi, John.

MR. VETNE: Good afternoon.

CROSS-EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q You used a term that hasn't appeared in this record, and I think hasn't appeared in the prior record, salt whey.

A Yes.

Q Could you describe what salt whey is and how it's produced?

A Well, once you -- you have to salt the cheese for a number of reasons, flavor development and also control of bacteria. You -- that whey
can't be recovered as sweet whey because of the salt content, so you separate and segregate that.

Q In what process of cheese making is the salt whey created?

A In the cheddaring process, on the drain -- in most cases on the drain table or the draining belt.

Q On the drain table after the -- after the sweet whey has already been removed?

A Yep.

Q And the cheese is either draining or being pressed; is that right?

A Yep.

Q And at that point is the cheese warm?

A It's a hundred degrees, give or take, cheddar.

Q Cheddar.

A Yep. Maybe a little less than that at that time.

Q Something close to the melting point of butter?

A No, I'd say less than that, because if you had that, you'd have fat leaching. I'd say closer to 90 degrees. I think we fill our containers at 86 to 87.

Q What do you do with the salt whey that comes off
at that point that's different from sweet whey?

A We have to segregate it, we have different
storage systems for it, and then we try to get
rid of it at the lowest cost possible. It's a
cost. We have to haul it somewhere, we have to
have somebody take it. You know, in a lot of
states you have issues with EPA, DNR, in Idaho
it's called DEQ, in order to be able to put salt
on, say, land application sites.

Q So you take the salt whey as it leaches or drips
from the cheddar, store it for a while and then
dump it someplace?

A Dump it somewhere.

Q You don't put it down the drain because that'd
be --

A The city or our treatment plant would have an
issue being able to treat that effectively, so
land application is the next best thing.

Q All right. You spoke a little bit about the
difference in barrel cheese between 39 percent
moisture and 38 percent moisture.

JUDGE PALMER: Is there a question?

MR. VETNE: Yes, there is. It's coming.

JUDGE PALMER: All right. I'm sorry.

MR. VETNE: It's what I do.
Cheese produced with 39 percent moisture versus 38 or 37 has moderately greater yield simply because of the lower moisture content?

Yes, the 39 versus 37.

Right. So when Mr. Beshore indicated that your price is higher when you have 37 percent moisture cheese than 38 percent moisture cheese, it would be a higher price offset by the cost of lower yield?

Absolutely.

Okay. Do you know how those measure out, if the costs to produce lower moisture cheese offsets the extra income?

It's -- theoretically when we -- we're talking barrel cheese, I assume.

Barrel cheese.

Theoretically it should be near a wash, because you get a moisture adjuster the lower your moisture is, the higher your solids, dry matter is.

Theoretically.

There's inaccuracy in the tests that are inherent and we do samples after samples and study after study. There's a certain inaccuracy just inherent that is going to be there that
Kraft, for example, is going to say they got a hundred million pounds of water from us one year and we're going to say they got 99 million pounds, that's a big difference on that volume, but that formula, if everything was perfect, would immediately -- or exactly match.

But people, manufacturers, nevertheless, are not indifferent to moisture content; they tend to strive toward 39 percent in barrel cheese?

In barrel cheese we strive to what the customer wants, and our customer base likes 34-ish.

Okay. So you have a considerably lower yield and then a price commensurate with that?

Exactly, and hopefully offsets that lower yield.

What do you do with your whey cream?

We sell it to a butter maker. Year after year it gets harder to sell because there's been a considerable consolidation in the cream buying industry and there's less and less of those cream buyers that want whey cream at all, because it's a product that they'd rather not deal with. Our plants have access to only one buyer. It's Grassland Dairy. They've considerably lowered the price for whey cream over the last couple of years as they've
acquired competitors, and I foresee that to
continue, so it's a battle.

Q When you say your plants have access to only one
whey buyer --
A Whey cream buyer.

Q -- whey cream buyer, does that mean that the
plant in Idaho, as well as South Dakota and in
Minnesota, are all selling to the same buyer?
A Yes. It's a lot better to have multiple buyers.

Q All right. You didn't come prepared for this,
but I'm going to ask you anyway. Do you have a
portion, albeit small, of your cheese that
doesn't meet specs or is off grade or for some
reason you can't sell for full market price?
A Absolutely.

Q Did you indicate whether you reported your
cheddar production to NASS?
A We do, yeah.

Q And when you report your cheddar prices to NASS,
do you include prices for off grade?
A No. They --

Q Don't include that volume?
A They don't allow that.

MR. VETNE: Okay. Thank you.

JUDGE PALMER: More questions? Mr. Yale.
CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q  Good afternoon. Ben Yale on behalf of Select
    Milk and others.

    You indicated you were the second largest
    barrel manufacturer in the United States.

    A  I believe it. If we're not, we're tied, but,
        okay.

    Q  So you could be first?

    A  We're not first, no. The partners of your
        clients are first.

    Q  When you -- would you suggest, though, that what
        you've indicated here in the spreadsheet both on
        the paper exhibit and on the screen represents
        one of the higher efficient processing of blocks
        and barrels?

    A  I would say that it's more -- LeSueur is -- at
        78 million isn't a very big plant, I mean in our
        world. It's an average-sized plant I think in
        today's world. Our Idaho factory is about two
        and a half or three times bigger than this, so I
        would say we're -- for our size, we're
        efficient, but I think over the whole scope,
        we're probably middle of the road or just above
        middle of the road.
So there are some plants out there that don't quite have these efficiencies in handling these products?

No, I guess -- I meant from a global efficiency standpoint. Now, these efficiencies are inherent in the size, the size of the plant gets taken into account, because when you talk about a pouch that goes on a 40-pound block, it really doesn't matter if you make a million pounds a day or 20 million because it's a unit cost, so I don't know if the efficiency globally of the plant is relevant as you try to look at the block/barrel costs.

You don't reach -- the volumes to get the cheaper prices are reached much lower; is that what you're saying? To buy the pouches at a cheaper price, the volumes necessary are much lower than the size of your plants?

No, I think we do well that way because we have -- obviously make a million pounds of cheese a day, that's a decent amount and suppliers tend to answer the phone when we call and give us competitive pricing. We have a central buying group for everything.

You talk about the fact you don't use -- or that
you sell your whey powder, you indicate that you lose about 20 percent of the whey cream in the processing of the whey cream that you have for various reasons.

What percent of the butterfat that comes into the plant goes out into the cheese?

A Can you explain, I don't -- 20 percent.

Q You indicated that 80 percent of the whey cream that you recovered was all that you were able to sell.

A No, what I said -- at least what I tried to say, maybe I didn't say it --

Q Well, maybe you said it, I misunderstood it.

A I said when we did studies to see if we could use whey cream in standardizing to full fat cheddar, instead of 90 percent fat recovery on what raw milk would be, if you were able to get 80 percent fat recovery on the fat you used that was whey cream fat --

Q Oh, okay. So this is the butterfat recovery, not so much the percent of whey cream that got into the vat.

A Right. So if somebody used whey cream in their process --

Q They're going to have a lower butterfat
recovery.

A On that fat, absolutely lower.

Q Because it would impact on the proteins in the processing.

A No, it'd impact on the fat globule membrane, it can't get retained; harder to get retained, I should say.

Q Now, on your first page of your exhibit, you had color and decolor for the blocks and not for the barrels, and why was that?

A If you sell to the Merc., you can't -- you can't sell colored barrels, and you have to sell colored blocks, and for the most part, the trade mirrors that.

Q Okay. That was my next question.

A Yeah, I mean you -- there are some people that want white cheddar blocks. It's a very small part, at least in my world. And I should say I think the NASS survey concurs with the Merc. I think if you're on the NASS survey, your blocks are colored, I think.

Q I think you're right.

MR. YALE: I have no other questions.

Thanks.

JUDGE PALMER: Very well. Mr. Beshore, you
have another question or so?

MR. BESHORE: I do.

CROSS-EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q Maybe I missed this, Jon, but were you asked what your fat recovery is, fat retention?

A Well, I think he asked and I moved it away, and I didn't even try to.

It's subject to cheese type, and I would say -- and, again, the way I look at fat recovery, I don't care what happens in the middle, I only care what I pay for and what I can sell stuff for.

I would say it's near 90 to 90 1/2 on an aggregate over all the types of cheese that would be included in the NASS survey and any CME sales we have. Now, we make a lot of other cheeses that have -- all of them have lower fat recoveries, like mozzarella, Parmesan, Asiago, Romano, those all have lower fat recoveries than that.

Q But in NASS cheeses, is there variation between your blocks and barrels?

A No, not a lot. I mean over -- over the aggregate, not a lot. And we have days that are
better and we have days that are worse. And things happen, you got people that are impacting it and computers impact it and equipment impacts it.

Q  Do you --

A  And, in fact, the way dairy farmers handle the milk impacts it.

Q  Do you fortify your production lines?

A  Yes.

Q  With what ingredients?

A  You name it. It's economics driven. If nonfat powder's economically viable at a certain time, which it's not today, we'll do that. If UF concentrates are available out of California or New Mexico and it's economically viable, we'll use that, but all of those recoveries take into that that raw material.

Q  You fortify with cream at times, fat cream?

A  Very rarely. In all of our milk sheds we're fat surplus, so we would bring other solids in. And, in fact, we would just use raw milk, and we rarely use just raw milk. If you would just use raw milk in our plants, I would say that our fat recoveries would probably be south of 90 percent, just raw milk coming out of a cow.
Q  But you don't do that?
A  No, because the other sources, at least for the most part, are available economically.
Q  What is the -- there have been two witnesses who gave some idea of what the selling price of whey cream is. By the way, is that FOB the plant? I take it that this cream buyer picks up the --
A  No, our LeSueur whey cream we haul ourself. And our Jerome whey cream, we -- they pick it up and they pay for the freight. It's all inherent in the multiplier, any multiplier there might be, and it varies times of year. And, as I said, it gets harder and harder to sell whey cream because nobody wants it. It can be anywhere from flat market to just over it, so if the butter market's a buck ten, you may get a buck ten a pound of fat. And there's other times of the year you may get 1.08. It's subject to supply and demand, and, as I said, the buyers have lessened, so you have less market control.
Q  There's a rather modest size cheese plant in Iowa that testified they're getting 1.14 over --
A  Yeah.
Q  -- FOB their plant. Can you do that good?
A  No. And I would imagine they're close in
proximity to whoever is processing that whey
cream. I mean I don't know that, but I would
imagine that.

Q Well, they're buying it FOB the plant.
A Okay. Well, the alternative, that buyer that's
paying 1.14, his alternative might be to drive
up to LeSueur, Minnesota, and he knows what that
freight is, so he's saying I'd rather go to, I
think it's Twin County, I'd rather go there
because they're closer.

Q But you deliver some too?
A We deliver some.

Q You get 1.14 for that?
A No, nowhere near that. And we deliver it
because we happen to ship milk from Idaho to
Minnesota every day and we take it back on a
truck and drop it in Nebraska. In fact, I had
to offer that, otherwise the price would have
been a lot less.

Q Does Grassland have a butter plant in Nebraska?
A Yes. Well, they bought their competitor. The
two biggest -- the biggest bought the second
biggest.

Q So they've got one in Nebraska and one in Idaho?
A No, one in Utah.
Q And of course in Wisconsin?
A Yep, Greenwood.

MR. BESHORE: Thank you.

MR. DAVIS: Thank you, Marvin.

JUDGE PALMER: Yes, sir. You might want to give your full name. I don't think we have your appearance at this hearing. We had it in the previous one.

CROSS-EXAMINATION,

QUESTIONS BY MR. DENNIS SCHAD:

Q Good afternoon. Dennis Schad, S-C-H-A-D. I work for Land O'Lakes out of Carlisle, Pennsylvania.

A Good afternoon.

Q Just a couple questions. You have a plant in Jerome, Idaho?

A We do.

Q And Idaho is no longer -- the milk in Idaho, I guess, would normally be no longer under a Federal Order; would that be correct?

A That's absolutely true. It's amazing we still are alive.

Q I'm just curious, how do you price producer milk in the absence of Federal Order, you know, just
generally speaking?

We do it based on what products we make, end product pricing, cheese yield formula.

Of protein, butterfat, other solids?

No, we know what the cheese yield should be out of a certain test milk, we know what the cheese market is, and we price it according to that.

Okay. A question, and, again, answer it whether you wish to do or not. There was a -- Cornell last year, I guess, did a survey of plants among cheese plants. Was your Idaho plant included in that?

Yeah, I believe it was, and -- I think both our LeSueur and Idaho plant was.

Just curious what your opinion would be --

I don't know that Mark put all that data in because I think it was a regulated -- I think he had to only select the regulated plants. I could be wrong, but I think -- could he do them all? Okay. I know we talked about that, Mark and I, when he was in LeSueur, and I guess I could have followed up better on that, but I thought he was going to keep that out, he just did it for the exercise.

Do you have an opinion whether a non-Federal
Order plant should be included in a Federal Order make allowance survey?

Q I have an opinion that there should be no Federal Orders, so.

A Okay. Given that, do you have an opinion to my question?

A I think there should be no Federal Order.

MR. SCHAD: Thanks.

JUDGE PALMER: Questions? Mr. Yale.

CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q I want to follow up a question about cheese yield. Is this a -- can you describe how you do that, is that priced every day on the amount of the components of the milk delivered by the farmer or is it on an average for the month delivered by the farm?

A We do it -- when we test milk, which is I think the only legal way to do it, we do it based on pounds of components.

Q Every day?

A Every pickup.

Q All right. Do you determine -- is the yield -- your cheese yield formula, is it something that is designed specifically for the milk that's
delivered by that farm or do you just have a
general yield, like, for example, 10.1 cents
times the CME price minus so much? How do
you --
A It's based on a Van Slyke. It's proprietary,
but it's based on, you know, the Van Slyke that
I'm sure you're very familiar with.
Q Right. So you have -- and you have an implied
butterfat recovery and a casein to protein in
that that you decide -- it's proprietary, I'm
not going to ask for it.
A Yeah, and I would say that no matter what you
want to do -- what you do with fat recovery,
casein recovery, other solids recovery and then
moisture, those four components are what matter
in the yield. And they all can be -- one can be
inflated, one can be deflated, and at the end of
the day, your algebra gets you to the same spot.
Q Right. And the same thing between -- you can
even make some adjustments in the make allowance
to cover or mask what you did in the rest of the
algebra --
A I don't use the term make allowance. We call it
an offset.
Q Offset, okay.
Because I golf with dairy farmers a lot, make allowance makes their temperature go up, so I say offset. And, again, if we get rid of the Federal Orders, Ben, we don't have to worry about make allowance.

That's a wonderful thought.

I agree. Seems we agree.

I wish we could have that discussion, but we're in a different environment today.

Ask me when it's Miller Lite time.

A couple of them.

A couple of them.

The question I just want to -- I'm trying to come back and -- let me just set up a preface so that you can understand the question I'm coming from.

Over the years, as you can imagine, I've seen a fair number of milk checks and milk pricing formulas for people to buy either milk from farms or cooperatives, okay, and some of the cheese yield formulas that I have seen, and it seems to be more common today within the larger producers, is that each day milk comes into the plant and it's tested for fat, it's tested for protein, and based upon that
Van Slyke formula that's been established as the basis for pricing the milk, the yield of that particular load is computed, because from load to load, as you know, there's some variations in the fat and the protein, and at the end of the month it's all added up and that's what the producer receives, less or plus his offset.

A Exactly.

Q Okay. Do you have any positive offsets?

A Certainly happens.

Q Okay. For volumes and --

A Are you getting off your question, because I'm simple. You lose me if you get off the question.

Q No, I'm going to come back to the setup, but I mean some of them do it on a load basis, some of them will do it in total for the whole month, they'll look at the total amount of milk that came from this farm and they'll say okay, his butterfat was 3.7, this is the pounds of fat that he brought in, this is the protein, you know, and then using your yield with your Van Slyke formula that you've used with your proprietary information, this is what it's worth, I'll pay him that, plus or minus the
offset, based on the load.

What we do is every pickup we test fat, protein, other solids. We take that times the weight of that pickup based on our scale, we get the pounds. We add up all those pounds, fat, protein, true protein, other solids. At the end of the month we have so many of each of them. We divide that into total milk pounds, and that's the percent --

Okay. So you use --

-- that goes into the cheese yield, so we use a weighted average total.

And that cheese yield is, in a sense, custom for each producer based upon the components that they deliver. I mean it's not an average. I mean every producer gets whatever -- they're basically paid on components?

They're basically paid on components.

All right. Now, you mentioned this idea of scale weights. Do you pay producers on the scale weights at your plant?

For the most part. We have a couple -- in Idaho there are mostly silos, so they don't have sticks, so in Idaho we mostly do scale weights because there's no other way to measure the
milk. In Minnesota we do bulk tanks, and then
we compare that to a meter we have at our plant
because most of those have sticks.

**JUDGE PALMER:** I'm lost on the silos. What
is this, an aboveground silo, like a corn silo,
they pump the milk up into it?

**MR. DAVIS:** They pump it into it, yeah.
And it doesn't have a device on it to measure.
The farms that have the silos at the farm, they
also -- most of those also have their own scales
for testing their own components coming in and
coming out?

**A** And their feed components, yeah.

**Q** So they'll measure that truck coming in, they do
their own weight at the farm, and then you do it
at the plant?

**A** Some of them -- most of them don't watch that
because ours -- we have certified scales and
they -- just as long as they're certified
scales, they understand that -- you know, you're
going to start chasing things around when you're
looking at two scale weights.

**Q** So under your unregulated area, there's no
farm-to-plant shrink that's computed into the
pricing; you pay just what is delivered to the
Delivered to the plant, yep. We do have a little shrink because we do have a few bulk tanks left, but it's a small number compared to the Midwest.

Do you -- this formula that you pay your producers, do you publish that or make it publicly available at all?

No. Our producers, when we have discussions, understand it, I believe. But, again, there's algebra to it and there's things you can manipulate internal of it that can offset one or the other.

Right.

And I've seen a multitude of cheese yield formulas and one guy will give 93 fat recovery but casein recovery will be 80 or his moisture will be 36. It's just -- it's manipulating algebra.

Looking at what the -- the type of components that come in and trying to come up with an end result, however you want to do it?

Yeah.

Does the computation of that yield show up on the check stubs of the producers?
A Yeah, for their individual yields, yeah;
individual tests, yep.

MR. YALE: Very good. I don't have any
other questions.

JUDGE PALMER: All right. Any Redirect?

No.

You're excused, sir. Thank you.

MR. DAVIS: Thank you.

JUDGE PALMER: Off the record. I guess we
ought to take a break. Let's take a five-minute
recess.

(At this time a recess was taken.)

GREG DRYER,

having been first duly sworn in by the Judge,
was examined and testified under oath as
follows:

JUDGE PALMER: All right. On the record.

Mr. Dryer is sworn. Go ahead.

DIRECT EXAMINATION,

QUESTIONS BY MR. STEVEN J. ROSENBAUM:

Q Mr. Dryer, you have provided a prepared
statement; is that correct?

A I have, yes.

Q Which has been made available on the USDA Web
site for several days now; correct?
Correct.

MR. ROSENBAUM: Your Honor, we'd ask that to be marked as an exhibit.

JUDGE PALMER: That's going to be Exhibit --

MR. ROSENBAUM: 40, I believe.

JUDGE PALMER: We'll mark it as 40. I'll take your word for it. It's here someplace.

Oh, here it is. It is 40.

(Thereupon, Exhibit No. 40 was marked for purposes of identification.)

Could you please read the statement.

Very good. Now that I'm under oath, I'm happy to see my wife's not in the audience. I don't want to make the same mistake that Mr. Roetlin made this morning of being so charming as to encourage lots of questioning from people, so I won't do that.

This testimony is submitted on behalf of Saputo Cheese USA, the U.S. division of Saputo Inc., a publicly traded, international, dairy and grocery products manufacturer and marketer.

I'm Greg Dryer, Executive Vice President of Administration and Services for Saputo Cheese USA Inc. I've been directly employed in the
U.S. dairy industry for more than 25 years in a
variety of roles. In my current role, my
responsibilities include procurement of milk for
all of the company's U.S. manufacturing
facilities extending from coast to coast.

My purpose here principally is to testify
in support of the positions presented by
Dr. Robert B. Yonkers on behalf of the
International Dairy Foods Association, our
primary U.S. trade association. We have several
specific statements that supplement the
conclusions of IDFA and one which represents the
opinion of our company individually.

Complexity of the System.

We oppose on principal any proposal that
adds undue complexity to a system that already
exceeds the capacity of most constituents'
comprehension. Progress towards streamlining
and simplicity should be considered prior to the
adoption of any specific proposal.

Make Allowances.

Testimony at last year's make allowance
hearings substantiated significant manufacturing
cost increases that have taken place since the
previous make allowances were established.
Processors do not have the ability to recoup these cost increases under the current system. The recent interim decision appears to have largely overlooked these facts. Establishment of a floor or market clearing manufacturing milk price enables the market to adjust when prices are too low by the payment of premiums above the floor. Establishing too high a minimum price based on unrealistic manufacturing cost data can permanently damage the industry's infrastructure. That generally describes what has in fact been taking place in the industry over the past several years. It's essential for USDA to review and update cost information to the most recently available in order to sustain a viable market for manufacturing milk. The State of California updates cost information on a frequent (generally annual) basis and responds with hearings and decisions in a timely manner. USDA should meet or exceed the California standard.

USDA should not arbitrarily and selectively decide which costs to include or exclude. For example, in the recent Make Allowance Interim Decision, USDA chose to include cost data from
the California survey for cheese but then
excluded the whey cost data. These are joint
products whose costs are inextricably linked.
It is wrong to include just one or the other.
If one is included, then both should be included
and vice versa. We support utilization of all
the California cost data.

CME versus NASS Survey.

Albeit not by design, the linchpin of the
U.S. dairy industry is the Chicago Mercantile
Exchange Cheddar Block Market. That market and
its predecessors, despite years of disparagement
for thinness of trading and susceptibility to
manipulation, remains the basis for the majority
of cheese pricing in the United States.
The NASS survey was mandated to ensure that
the value of cheese which serves as the
principal factor in establishing milk prices is
representative of a significant percentage of
all cheddar cheese sold. It does absolutely
nothing to alleviate underlying reservations
about the vulnerability of the block market. It
simply confirms the fact that industry generally
follows the block market with their pricing
practices. It is, however, evident that to some
degree the NASS survey has been successful in deflecting attention from, and defusing the level of disgruntlement with, the cheddar block market.

Given that there is no obligation to do so, then why do processors continue to cling to this block market based pricing practice? Because they always have. It's their longstanding tradition.

Because they rely on it to correlate to some degree with their principal cost, that of raw milk.

Because it provides customers with a basis of comparison between suppliers and with published, open-market, commodity values.

Because experience has shown that unilateral attempts to depart from the practice have characteristically ended in dismal failure.

Because the industry -- finally, because the industry is precluded from discussing the issue due to antitrust implications.

Employing the NASS survey as a pricing base addressed certain concerns regarding end product pricing but created new ones. We now have the issue of circularity. Cheddar manufacturers'
attempts to recover rising costs with price
increases are automatically offset by higher
milk prices. Furthermore, price increases
implemented by cheddar manufacturers relative to
the block market narrow the disparity between
the NASS cheese price and the block market,
resulting in compressed margins for makers of
other cheeses.

The NASS survey has produced another
unwelcome side effect known as "the lag." The
built-in time delay or "lag" in collecting and
reporting price data disrupts the correlation
between prices based on the current block market
and milk costs derived from cheese prices from
several weeks in arrears. This often puts
cheese companies in the unenviable position of
selling cheese on declining prices while at the
same time paying milk prices that may in fact be
rising.

Finally, with the introduction of the NASS
survey came the inclusion of both block and
barrel cheese in the combined NASS cheese price.
An arbitrary three cent figure was added to the
barrel price to arrive at a supposed block
equivalent price. Others have or will testify
to the unfairness of this three cent barrel addition, especially after accounting for 30 percent moist adjustment. From our perspective, we do not make barrel cheese. When the market becomes inverted between blocks and barrels (as it has so often recently) we see an increase in our cost of milk with no mechanism in place for us to recover it.

Our first preference is for a system that allows us to purchase milk at a price that is fair to producers and, after converting that milk efficiently into the desirable products, provides both a good value to our customers and a reasonable return to our owners, many of whom are our own employees. We observe the futures market with great interest and wonder whether ultimately there could be a similar auction market for current milk where large numbers of buyers and sellers come together to arrive at prices that reflect current market conditions. Such a market could establish the value of milk for all of its alternative uses - not just current cheddar in the form of blocks and barrels. Until that is feasible, we prefer pricing similar to that employed by the State of
California: End product pricing based on as current a block market as possible that would eliminate circularity, the block/barrel controversy, and the dreaded "lag." The NASS survey could be maintained as an independent verification that the block market continues to fairly represent the current market value of the commodity cheddar.

Failing that, we would defer to the will of the majority of our associates who prefer to maintain the current NASS survey, work to lessen the "lag" impact, improve the accountability, and eliminate the three cent barrel price adjustment.

We would support any initiative undertaken by the Government to assist the industry with the migration away from milk prices derived from end product values to one where a fair value is established for the price of milk based on the supply and demand for it. End product prices could then be established by the processor after due consideration of cost, competition, and value. To decouple milk cost from end product prices, however, without first enabling the industry to extricate itself from block market
based pricing, would be a great injustice.

Other Solids or Whey Factor.

None of the proposals before USDA today addressed the critical problem confronting the processing sector relative to the Class III other solids or whey factor. I would be remiss to leave here today without sounding the alarm about the economic hardship it is inflicting and will continue to inflict on cheese manufacturers. The presumed value to be recaptured by the Class III formula with today's unprecedented whey market is well beyond reason, especially for smaller companies that have neither the scale nor the capital to justify whey processing facilities. Without some type of corrective action, we'll likely experience significant fallout and accelerated consolidation in what has been the largest outlet for U.S. milk.

Q Does that complete your statement, Mr. Dryer?
A Yes, it does.

MR. ROSENBAUM: At this point I'd like to ask that Exhibit 40 be entered into evidence.

JUDGE PALMER: Any objection? It's received.
(Thereupon, Exhibit No. 40 was received into evidence.)

Q Mr. Dryer, maybe we'll just have you elaborate a little on the last point, if we could, in your testimony about the whey situation.

The current formula assumes that a cheese maker, for example, is able to extract a certain amount of money in the marketplace for dry whey; correct?

A Correct.

Q And in your experience, is that reflective of the reality that you're facing?

A I think the incorporation of the whey factor was well intentioned, in that it was acknowledging a value for by-products, products other than cheese, in the operation of cheese facilities, and I think it was viewed as probably the lowest common denominator type of market to base the factor on, but what's happened is the rise in the base commodity market has been disproportionate with the value of other alternative by-products that cheese manufacturers make, and because these businesses are so capital intensive, you have to make a choice up front as to which types of products
you're going to manufacture when you invest that capital.

Most manufacturers have viewed higher ended whey products as providing a better long-term return, so they've oriented in that direction and are unable to make dry whey because of the volume of solids. In a dry whey facility, you need very large driers and it's a different process altogether, so a lot of people are really suffering that don't have the ability to make dry whey, or even dry whey people I talk to are having a hard time recouping as much value as what's presumed in the formula.

And when you look at smaller manufacturers like in Wisconsin who are selling their whey as a liquid by-product, maybe it's concentrated to some degree, they're typically getting paid some percentage of the market, and yet the milk formula's assuming a hundred percent of the market increase above the make allowance is what they're making, and they're not, so it's putting the squeeze on cheese manufacturers.

Q Now, there's not a specific proposal before us today to adjust the whey -- the use of dry whey as the assumed product; correct?
That's correct.

But you have testified to a generalized desire on your part that make allowances be set as minimum prices and they not unduly enhance the value; correct?

Absolutely.

And is this the kind of concern that you have that drives -- drives that desire?

Right. And, you know, I think a good representative of that was this morning with Mr. Roetlin, who's making liquid whey products, and you could hear from his testimony the economic squeeze that he's feeling.

And just to be clear about this, the formula assumes that you're going to be making dry whey and therefore pays prices -- assumes you're obtaining the value in the marketplace of dry whey, when in fact right now the value of dry whey is substantially in excess of the alternatives that, in fact, many people are producing with their whey; is that right?

That's correct. And that's one of the problems with trying to regulate the way we are. You have to anticipate changes that take place in the marketplace, all these other alternatives,
and it's a very difficult thing to do.

MR. ROSENBAUM: That's all I have,

Your Honor. He's available for

Cross-Examination.

JUDGE PALMER: Questions? Yes, Mr. Yale.

CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q Good afternoon.

A Good afternoon.

Q I want to follow up on the questions that
Mr. Rosenbaum asked about the whey issue, and
I'm glad that you've brought that up in the
record, although unfortunately we're not -- we
don't have proposals out there to address it,
but I have some questions that as a person in
the industry, that maybe you can answer.

There's no doubt that, you know, when you
go through the process of producing cheese, one
of the things you get at the end of it is a whey
product; whether it's an acid whey or a sweet
whey, there's a whey out of cheese; right?

A Correct.

Q Okay. Now, I'm going to make cheese, whatever,
and I got this whey product. What are my
options as a cheese maker?
A Well, generally today -- well, there's a wide variety.
Q That's what I'd like to cover, if you could.
       Just kind of give me the ballpark.
A Well, you know, that part of the cheese business is very sensitive to scale, where -- I think you can be a smaller cheese manufacturer and be relatively efficient, but when it comes to whey processing, scale is very important. So a lot depends on what your scale of whey generated is or if you have the ability to buy whey from other manufacturers in an area, although transportation of whey is very inefficient, but typically people make dry whey, although there hasn't been a lot of orientation towards that direction in recent years, or you may filter the whey and make various forms of whey protein concentrate, up to and including whey protein isolate, and then you're left with the permeate stream or the lactose stream, which you talked about, and there investing money in processing is a risky enterprise because a lot of time the value in that product is below the costs to manufacture it. Recently that's turned around to be not the case. It's very high value today,
but it's a temporary situation. To make a
decision to invest millions of dollars in
processing for that and taking the market risk
is something that's beyond many people's
capability.

Q What -- you say scale. Do you have a ballpark
number you think that you ought to be reaching
to -- before it becomes --

A No, I guess I wouldn't have a rule of thumb,
but, you know, the bigger the plant, the better
off you are because you have no transportation
costs in the whey that you generate on site.
There's a big savings in that compared to people
who --

Q What are the standards for whey? I mean are
there any real standards for whey, I mean in
terms of composition and the like, or is that
something that the marketplace dictates and pays
accordingly?

A Well, there's standard of identity for whey
protein concentrate, 34 percent, you know, that
has criteria. I'm not familiar whether -- you
know, there are different standards to different
whey products.

Q Okay. The difference -- let's talk about the
whey protein concentrates. There are -- the dry
whey is just simply taking the retentate out of
whatever process and just drying that, RO or
whatever, you get as much water out and then you
just dry it down to a powder of what, about
97 percent or something; have I got that right?
A Right.
Q So whatever it is, it is, and that's sold as a
dry sweet whey?
A Right.
Q When it comes to the concentrates, there's --
you got WPC 40 -- or 34 and -- the common ones
are what? That, and what are the other --
A 34 we heard this morning; 50, 55, and then
typically 80 is a very common product, and then
once you get above 90, you get into the
isolates.
Q That's into the isolates. So let's talk for a
moment about the concentrates. You understand
what I mean by the term arbitrage, ability to
move, you know, a commodity to a commodity or
something?
A Uh-huh.
Q Is there an arbitrage between the WPC 35 or 34
and the 40s and the 80s or are they two separate
A Well, it's interesting that you raise that point because there's a difference in the capability to produce the product and, yes, there's different markets that these products are sold into, so a typical Wisconsin manufacturer, specialty manufacturer that wants to make cheese may have a salesperson, may have the plant manager sell the cheese, is now forced with having to get into the whey business, and the market is entirely different. The type of salesperson, the type of people you're dealing with are totally different than what they are with concentrating in the cheese business, so you have to make choices, and the more sophisticated the product, the more sophisticated the buyer that you're having to deal with, so typically you have scientific people dealing with scientific people, you know, on a technological level with these customers, so it's dramatically different.

Q What about the difference between, say, WPC 34 and WPC 80, is there a wide difference in that market as well?

A You know, I mean the majority of the products on
the 34 arena may be feed oriented, where the
higher you go, they're food oriented.
Q Okay. That was my next question. They have
different -- completely different markets?
A They can, you know, although they can be
similar.
Q And then the WPIs, the whey protein isolates,
those are very much a specialized market,
different from the others?
A Nutritional products, you know, health-oriented
products, bars or drinks, things like that.
Q And that's an issue, this issue of -- and
there's a wide disparity of the return to the
plant for the same volume of whey -- fluid whey
that comes into that process and whatever
product they choose. Today I think we are
saying there's a wide disparity in the end value
of the products that come out at the other end;
is that what you're saying?
A Yeah, and, you know, because if you make dried
whey, all of the solids are going into your
finished product which you're selling and
getting a higher return for. When you make
these other products, you're separating streams.
Most people are oriented towards the protein
stream. Some people are not oriented towards
putting a lot of processing into the lactose
stream and therefore aren't recovering much
money from that stream, whereas if they were
drying whey, they'd be getting a higher return
for that, so, you know, things like that have
happened.

Q Do you have an estimate of the difference in the
values between the higher -- well, right now
what is the highest value whey protein that --
A I think if you look at it on a per pound of
protein basis, dry whey today is probably valued
higher than any of these high-end products, you
know, and it changes from week to week,
obviously, as markets change.

Q But it takes more money to make the higher end
products as opposed to the --
A I would say that's typically true, although it's
not cheap to produce dry whey either. It
requires a big drier.

Q So you've got plants out there that have no whey
processing at all, you have some that are
producing the simple sweet whey, some that are
producing some whey protein concentrates, some
who are producing WPIS, some with mixes of all
of that, some that are dealing with the lactose

and some that aren't; right?

(Witness nodded head.)

There is a potential added value, though, to the

plant for those products; is that correct?

Much of the time.

Right.

At times it can be a cost.

Right. Well, that's true. So the question

then -- and historically it was a cost until

recently right?

Correct.

Okay. So the question comes how then do you --

how does the Department, how do we come up with

a methodology to, on the one hand, have that

added value, whatever it is, available to

producers, but at the same time not create

the -- the issue that you're talking about with

the plants, that it's an issue that you feel

needs to be discussed, do you have any ideas how

that could be addressed?

No, and I think that's what I was trying to get

at in my statement. When we try to regulate

these things into the minutia that we're

discussing here, before you were talking about
dry matter and talking about fat recoveries, and
the more you get into it, the more complex it
becomes. I was relatively interested when
people started talking about a different
methodology entirely for price discovery of milk
and someone floated the idea of something based
on futures or -- you know, I think we need to do
something radically different ultimately so that
we don't get caught up into this regulatory
minutia.

Q So, realistically, the issue of dealing with
make allowances in and of itself is not an
answer to the problem. It might provide some
relief to the symptoms, but it's not an answer
to the problem with the whey; is that --

A Yeah, and I think my perception of what's
happening here is because, as I said, the block
market is the linchpin for everything, that's
basically determining the value of milk, there
may not be enough money on the table there to
sustain both processors and producers at times,
and I think that's what's been encountered in
the last year, so then we -- the producers and
processors are at odds because there's not
enough money to sustain us both.
Q I don't know if you were here today, I think Mr. Beshore asked that question, is the problem that we should be paying less for the milk or is it that we should be getting more out of the market, and I think the answer for both of us I guess would be if we got more out of the market, we might not be having the fights that we have.

A That's true, but if the market is the market --

Q I understand. We're there, because I want to talk about that in a second. You also talk about this issue of suggesting that in light of the pros and cons of the CME and the NASS as it stands today, the preference would be to use the CME as the -- and I'm trying to paraphrase this, so please correct me, and I'm going to ask the question about how you agree and how you disagree, but to use the CME as actually setting the value of the milk and then let the NASS provide that necessary safeguard to insure its validity of doing that; is that a fair statement?

A That's right. I guess my statement is implying or saying that we prefer the California system, which is based on the CME platform.

Q And they do an adjustment or two, I think, to
theirs, do they not?

A Well, there's a factor in there to account for
the fact that product has to be transported back
to prominent.

Q Now, you also state in here, and, again, this
is -- I think we're all here trying to solve the
problem. We have different views on where we go
and stuff, but you mention this idea that the
CME because -- right now because all of the
reasons you mentioned, institutionalized and
it's the way we've always done it and, you know,
there's too much market pressure to keep us from
doing it, we all price on that CME price, but
you can't talk about solutions because it
becomes an antitrust issue; right?

A (Witness nodded head.)

Q Now, you're aware that discussion of those
issues in a hearing such as this is not a
violation of the antitrust. I don't know if you
know that or not.

A No, I didn't.

Q I'm not going to give that. You might want to
ask your own lawyer for that advice, I mean.
But, you know, is that a situation where we
should be asking the Department to allow such a
wide open hearing to look at those alternatives
in order to find that?

A I certainly would advocate something like that.
You know, I think we've been entrapped in this
system for so long and there's really no way out
on an individual basis. To me it's an industry
issue. I'd like to see us get away from block
market based pricing. And I attended a seminar
at the CME and the question was raised and the
CME people said we don't want you to price your
product off our markets, you know, and then it
comes down to everybody looking at each other,
saying well, how do we get away from this.

Q Why would we need your market if we're not going
to price off of it. That would be my question.

A Well, it's -- I guess we need some indication
of, you know, the current market.

Q Have you looked at any concept of any kind of
futures trading of cheese?

A You know, I got excited when that idea was
floated, because one of the problems we have,
both producers and processors, when you're
making a very perishable product, it's difficult
to have a lot of backbone when it comes to
negotiating a price when you know your product
will be worth nothing in a matter of days. And with futures, people are looking forward, and there you're seeing producers come to the table and indicating what they're willing to produce milk for and buyers indicating what they're willing to buy it for, which I find intriguing.

The problem is -- and the problem was pointed out to me by other associates, that as far as current conditions are concerned, you need to have a very current market so that products will clear. If you have a price that's unrealistic, you have no guarantee that you'll be able to move the product, so I mean that's the challenge in that kind of thinking, but I think it has some appeal, some variations.

Q Do you see that, though, as a trading off of the futures of cheese or do we look at a trading off the futures of milk or of milk components, or do you do both?

A Actually, I was thinking of it in terms of what we have today, which is Class III milk.

Q Right.

A You know, I suppose it would make sense to look at the components of the milk, but, again, you know, one of my comments was we want to try to
avoid complexity. We're so embroiled in all
this complexity, it's overwhelming I think for
most people.
Q Of course, one of the problems with the CME is
it's a cash market, you have to accept delivery
or be able to deliver product, and that reduces
the number of potential players.
A Right.
Q Do you see that as a problem in terms of the
value of that market?
A Yeah, I mean I -- the CME is -- it's a thin
market. It doesn't -- you know, we're selling
almost ten billion pounds of cheese in this
country today, and I can't off the top of my
head quantify the amount that that market
represents, but it's a small fraction.

MR. YALE: I have no other questions.
Thank you.

JUDGE PALMER: Other questions?
Mr. Beshore.

CROSS-EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:
Q Good afternoon, Mr. Dryer.
A Good afternoon.
Q I'd like to explore with you just a moment the
comments about your ultimate preference for using the block market in a manner similar to California perhaps.

And on the next to last page, unnumbered page of your testimony, you indicate that would eliminate the block/barrel controversy.

What all is involved in that block/barrel controversy that would be eliminated by using only blocks?

Well, today we're using a NASS cheese price, which is a combination of barrel cheese and block -- or block cheese and barrel cheese adjusted to 38 percent moisture with a three cent addition, and there's some controversy as to the -- you know, the moisture adjustment and the three cent addition. And today we're seeing barrel prices as high or higher than blocks in the NASS survey and that in the CME, so a system like California's ignores barrels and uses strictly cheddar blocks as the basis, so to me that then avoids that whole controversy. It's what we had done previously.

Does the use of both barrels and blocks embed risks in the system for market participants, you know, such as your company that would not be
present if there were the use of blocks only?

A I guess I'm not understanding the question.

Q Well, when you're -- if transactions, as

you've -- your testimony indicates are

predominantly based off the block market;

correct?

A Correct.

Q Okay. Those are the marketplace sales of

finished cheese; correct?

A Yes.

Q But the price, the milk price, uses both the

barrel and the block. Does the use of the

barrels put a variation, a risk factor in that

for the players such as yourself?

A It does, and it's one that we don't have the

ability to hedge against, so like right now

barrels are adding to our milk cost, and yet

we're selling the majority of our products on

the block market, so our costs have increased.

It's difficult for us to go to a customer, say

we need more money for our product because

barrels are higher. That's a hard argument to

make. Customers are very resistant to price

increases in today's economy.

Q And I guess when that price relationship is more
traditional with barrels being less, you've got
a different kind of dynamic in the --

A That possibility exists, but we would prefer to
have a business where we can run with a
consistent margin instead of having to endure
all of these uncontrollable ups and downs that
we're faced with.

Q Would it be fair to say that having barrels in
the price formula in a block dominated market
builds in winners and losers at all times
depending on whether the barrel price is higher
or lower at a given time?

A I can imagine a person who makes and sells
barrels on the barrel market would like to see
his milk cost follow the product that he's
selling, but even for them it doesn't because
it's influenced by blocks, so it's kind of in
between. You know, it doesn't accomplish what
he needs and it doesn't accomplish what I need.

Q Do you have any information with respect to your
judgment as to the proportion of cheese that's
priced off the block market?

A I really don't, although we follow, and I think
there was testimony to the level of correlation
between the NASS and the block markets, and if
you adjust for the timing differences, it's very, very high, so that to me indicates a high correlation. In our own business, we sell into all channels with our products and a certain percentage of our business is sold on a fixed price basis, but the majority is sold relative to the block market.

Q I don't know if you've enumerated in your statement, and don't repeat if I've missed it, but how many plants do you have in the Federal Order System and what products do you -- does Saputo manufacture?

A We have fifteen plants in the United States. Eleven of those plants receive and process milk. Six of those are in Wisconsin. We have two in the eastern United States and we have three in the state of California.

And we produce a wide range of cheese products. We produce Swiss cheese, bleu cheese, mozzarella. No cheddar. Parmesan, Romano, Asiago, ricotta, produce a cheese called Lorraine cheese, which is a specialized lacy Swiss type of cheese. A large quantity of string cheese for the retail market. Appetizer stick cheese, a wide range of cheeses. So, you
know, we get into all these debates about regulating cheddar, and we're trying to manage our business relative to what cheddar does to our cost of milk and it's very complicated.

Q You produce no cheddar, but all your milk cost is determined by the --

A That's right. Cheddar is dear to us because of milk.

Q And the majority of your production is sold with respect to the cheddar block market?

A Yes.

MR. BESHORE: Thank you.

JUDGE PALMER: Yes, sir, Mr. Smith.

CROSS-EXAMINATION,

QUESTIONS BY MR. DANIEL SMITH:

Q Good afternoon. My name is Dan Smith. I'm representing the Maine Dairy Industry Association.

A Good afternoon.

Q You indicated in your statement that the current system allows for the payment of premiums when the clearing price is low enough.

Since the component pricing system has gone into effect, can you point to the time when there have been over-order premiums in the
market?

A It's very typical in the upper Midwest for
over-order premiums to exist. There's more
plant capacity there than there is supply of
milk, so people are chasing, you know, an
adequate supply to run their plants.

And in the eastern United States, we
operate a plant in Vermont and another in
Maryland, recently milk has been less available
than in the past and we've seen some increases
there in over-order premiums.

To us -- you know, there's different
perspectives here. There's over-order premiums
from the perspective of a producer receiving
them and there's a perspective of a buyer paying
them.

To us an over-order premium is the amount
paid for milk that's above the Class III price,
so that may encompass, to some degree, a service
charge that goes to the cooperative for managing
the milk, lab tests, delivery and that kind of
thing, and then the other element that the
farmer actually receives in his check, that's
another thing.

Q And my question dealt more specifically with
that latter net over-order premium, so you would say in the recent time in your plants in Vermont and Maryland, just --

A  There's been price pressure there because of inadequate supplies, but, you know, those things come and go. We do not buy milk in the U.S. direct from producers, so we're not involved with establishing premium programs, if that's what you're getting to, protein premiums or volume premiums, quality premiums. We're not involved with that.

We're focused on our product and our customers, and we leave the servicing of farmers to cooperatives, who can do a better job than we could.

Q  There's currently quite a volume of unregulated milk in Idaho, so with regard to your testimony about trying to price off a supply and demand environment, would that volume of milk at this point be at all representative of supply and demand in the larger marketplace?

A  When you're saying that, are you talking about price levels, when you say representative of supply --

Q  Yeah, the price level, yes, for the milk. It's
a new development in the --

A Right. And, you know, it's a cause of concern because one of the things we like to have is a level playing field for everybody to compete in, and now that we have part of the country that's -- we have different regulatory systems, obviously; we have California, we have USDA, and now we have unregulated areas, and everybody's operating on a different basis. That's a concern when you're competing on a national scale for business, and even to some extent, for instance, in the upper Midwest today, what I see happening is people that buy their milk directly from producers are, in many cases, reducing the amount they're paying on the other solids factor to compensate for the fact that they're not making as much as it presumes they should make for whey, and they're able to do that because they have enough built-in premiums that they can do that and still stay above the regulated price. And then we're competing against those people, we don't have that ability, or we're competing against unregulated areas where we're paying on cheese yield factors and other formulas that may result in a lower cost to them
than our cost, so that's a concern.

Q  So you do see that volume of unregulated milk starting to have an impact on the market? It is enough volume to begin to have an impact?

A  Oh, there's definitely -- Idaho is a huge milk producing state all the sudden and, you know, there are people that we compete against that are located there, yes.

Q  This question may be too dense. If it is, let me know, but you indicated you have some plants in California subject to the California pricing program and plants in the Federal Order System. Given the different criteria that the two programs operate under, how does your business account for taking product to market on the Federal Order System for the program in California, number one? How do you rationalize that within your business?

A  Well, we try to pay attention to, you know, continually having to update calculations on which is the most efficient way to service our market, so we may at one time be wanting to produce and distribute more cheese out of California than say the rest of our plants or vice versa, but, you know, as these conditions
change, and they change on milk from month to
month, that's something we have to continually
look at. We see it as a strength for our
company to have a broad base where we're located
in lots of different geographies, you know, but
we do balance, you know, and we try to make sure
that our customers are accepting of product from
all of our plants in any region so that we can
switch back and forth when the economics
dictate.

Q Would you say that the dynamic between the two
pricing programs has more of an impact on your
business decisions than the imperfections you
described in the block market, the CME, NASS
reporting?

A Not really, because the systems have become
very, very similar. I mean the pricing formulas
are -- you know, you have the same -- the same
base commodity products driving the cost of
each. Each has a whey factor, each, you know --
so depending on whether markets are moving
dramatically one direction or another, usually
there's a fairly predictable measure of
difference between the two, unless markets start
moving. Then California is much more responsive
to current prices than the USDA is, so then you might open up disparities in one way or another.

And it was talked about earlier, what difference does it make if it balances out over time. We find that a customer controls the buying decision, when he wants to buy the product. We as producers and manufacturers -- cows generate milk every day. We have to take possession of that milk every day, so we're producing products on a daily basis. We find that our sales are stronger at times when it's to our disadvantage than it is to when it's our advantage, so over time it doesn't balance out because the customer has the ability to take advantage, because he's the one calling on the phone making the order, as to when he does that, so it doesn't average out, in our experience.

MR. SMITH: Thank you.

JUDGE PALMER: Any questions at all?

MR. ROWER: No.

JUDGE PALMER: Thank you, sir. We've got your two witnesses done.

MR. ROSENBAUM: Yes, those are our witnesses for the day.

JUDGE PALMER: Mr. Wolfe, if you'd come
forward, sir.

BRYAN WOLFE,

having been first duly sworn in by the Judge,
was examined and testified under oath as
follows:

(Thereupon, Exhibit No. 41 was marked for
purposes of identification.)

JUDGE PALMER: Mr. Wolfe has just handed me
his prepared statement submitted on behalf of
Ohio Farmers Union, and we're marking it as 41
for identification. Does everybody have a copy
of it?

I see there's a few over there perhaps.
Does anybody need a copy? Looks like it's
coming. All right.

Sir, if you would be so kind as to firstly
state -- really, it looks like it's pretty much
statistical.

Would you give your full name and
identification and who you're affiliated with.

MR. WOLFE: My name is Bryan Wolfe. I'm
vice president of Ohio Farmers Union, and I'm
representing Ohio Farmers Union today.

JUDGE PALMER: And you have a statement to
give, sir?
MR. WOLFE: Well, I think I should probably give a little history on this.

JUDGE PALMER: Go ahead.

STATEMENT OF BRYAN WOLFE

MR. WOLFE: Back in September of 2006, we submitted a proposal to USDA's AMS on Class III and Class IV. February 13th of 2007 we had received a letter from Mr. Lloyd Day saying that our statement was not accepted.

On February 28th I went to Strongsville and read a statement that we were disappointed, not just that our proposals were not accepted, but 40 out of 41 proposals submitted by dairy farmers and farm organizations were denied.

At that time I thought Mr. Stevens from USDA had kind of given us the opportunity to possibly resubmit our statement, because he'd asked me if I wanted to make a statement that day.

So we went back home and we called and e-mailed Mr. Day again, we haven't got a response from him, whether we could resubmit this, so we went ahead and made some of the changes that he said that were reasons why they couldn't submit -- or accept our proposals at
that time, so what I have today is some proposals that Ohio Farmers Union kind of redid, and I hoped that you would put them in the record.

JUDGE PALMER: Well, I'm not sure if there's an objection. Is there any objection to this?

MR. ROSENBAUM: I have to object, Your Honor. It's not part of the noticed proposals. In fact, it was submitted to USDA, and USDA determined not to include it in the notice, as I understand it.

JUDGE PALMER: Does the USDA have any comment on that?

MS. PICHELMAN: It is not part of the hearing notice, but we will not be objecting to it.

JUDGE PALMER: You don't have any objection to it?

MS. PICHELMAN: No. To it coming in, we don't have any objection to it coming in.

JUDGE PALMER: Well, I'm not so sure how it's coming in. Is it coming in as a proposal or is it coming in as a --

MS. PICHELMAN: Your Honor, we don't have
an objection with his statement being received.

JUDGE PALMER: Okay, I understand about
that, but I'm just trying to see where it goes.
There's no proposal on the floor, I take it.

MR. ROSENBAUM: Well, page 4 contains a
proposal, Your Honor.

JUDGE PALMER: Let's take a look.

MR. ROSENBAUM: It looks like it's labeled
"Proposal" and at the bottom of the page it
provides a formula, and it just -- you know, the
whole purpose of going through this advanced
publication of -- is -- it's actually a legal
requirement, not merely a courtesy.

JUDGE PALMER: What we'll do, we'll let the
statement -- let him put the statement in as
kind of an offer of proof I guess. I haven't
read it, that's one of my problems here.

Are you also objecting to the other
proposals that have been made? Is that part of
what you're doing?

MR. WOLFE: No. No. When we were at
Strongsville, what we were trying to convey was
our disappointment that none of the -- there was
41 proposals submitted by farmers and farm
organizations and only one of those were
accepted into this hearing, so we feel that
our -- our concerns with farmers' cost of
production issues aren't being heard at these
hearings.

JUDGE PALMER: I understand. So this is a
specific proposal?

MR. WOLFE: Right.

JUDGE PALMER: All right. Well, I agree
with Mr. Rosenbaum. I don't think we can
consider it as such since it wasn't noticed for
the hearing, but I'm going to -- I've marked the
document as 41 and it will go along with the
record and we'll take it as an offer of proof.

MR. MILTNER: Your Honor, this is Ryan
Miltner with Yale Law Office.

I've tried to look at the transcript from
when Mr. Wolfe appeared in Strongsville. As
Mr. Vetne pointed out, it's not exactly the
easiest thing to search through, but Mr. Wolfe
recalls, and I happen to recall also, that when
he testified, the Department asked if he had
specific language to propose about the issues he
wanted to talk about, and so he's come back in
direct response to that inquiry from the
Department.
And I appreciate that you're going to allow his testimony to be offered, but, you know, I think given that he's responding to an invitation of the Department, he ought to be allowed to have it actually admitted, and to the extent that there are comments in response to it, people are certainly welcome to do so, and the Department, of course, can respond to his proposal accordingly.

**JUDGE PALMER:** Well, I mean as Mr. Rosenbaum said, we have a procedure, we're supposed to do these proposals in a certain way, and if he makes a proposal and the Secretary said we're not going to consider it, that's pretty much where we are.

**MR. MILTNER:** Well, but, Your Honor, the purpose of an administrative hearing such as this, as you know, is to flesh out the issues related to a topic, not to rigidly consider the particular language that may be included in the hearing notice.

Once the issue itself becomes open for debate, proposals and concepts tend to develop, and in this case they developed in response to a question from the Department itself.
JUDGE PALMER: That may be, but I'm not going to receive it. I'll let it go along with the record as an offer of proof.

Yes, sir.

MR. YALE: Well, just an additional argument. There is a process here. I mean the Department says they're not going to object. It's out there and it has its own value as a statement vis-a-vis the proposals that are there. It can be viewed as testimony as regards to the officially noticed proposals the Secretary's going to consider.

JUDGE PALMER: I just asked and he said no.

MR. YALE: Well, he doesn't understand the sophistication of what's going on here, so. And I feel awful uncomfortable, I'm sitting here defending -- you know, it's really not our position, it's not our proposal, but there's a sense in the field that we have to establish a sense, to whatever degree it is, that the farmers have a voice, and he's presenting a voice, and it isn't the artful, articulate, legal thing that we would like to see, but on the other hand, it is in response to a question asked by the Department. They aren't going to
object to it. It can be viewed in a sense that
says this is how we'd like to have it and this
does this for us, so that when the Department
says okay, we're going to do this one way or the
other with yields, it does have at least a voice
out there that says well, we can't give them
their proposal, but we can at least address one
of their concerns in that because we're
addressing it over here.

I mean it has a value other than just
simply something that we have to take on that is
going to be accepted or rejected. It's -- it
says something to the Department, this is what
producers are thinking, so that the Secretary,
in looking at the proposals that are noticed,
can at least be responsive to it, and that's
where I think it has a value away from this
sophisticated -- you know, I think we got to be
realistic of where it would go in terms of
proposals. I mean I understand the rules, but I
just think that --

JUDGE PALMER: I'm still going to do it the
same way. It'll accompany the record as an
offer of proof, but not as a -- an exhibit
that -- that makes a proposal.
And at that point, sir, I think we've concluded.

MR. WOLFE: Okay.

JUDGE PALMER: Thank you, sir.

MR. YALE: Well, can we ask questions?

JUDGE PALMER: No. No. I mean, I do what I can with the situation where we're trying to have something like a formalized hearing and things keep changing about and I try to accommodate, but there has to be a certain amount of order. And if he doesn't have a proposal that was noticed by the Secretary for this hearing, I'm not going to hear it, because I go through this almost every hearing we have where somebody wants to put in a separate proposal and we either shoot them down or we don't, and unfortunately he doesn't have a proposal, and that's where it stands. And you can -- you can brief it, put it in a brief, say the judge was wrong, whatever you want to do.

MR. YALE: Well, I just take again the exception that we have to accommodate the level of sophistication.

JUDGE PALMER: He's pretty sophisticated. He understood he put in a proposal. He's not an
unsophisticated man. It's got nothing to do with sophistication. His proposal was denied when he put it forward. Now, somebody said well, why don't you bring it up at the next hearing, he did, we have it here, they can look at it, and if I'm wrong, the Secretary can say well, let's reopen the hearing and take evidence on that, but at this point in time it's not open to it and that's where it stays. Now, let's go on.

Thank you very much, Mr. Wolfe.

MR. WOLFE: Thank you.

JUDGE PALMER: Who else do we have as a witness today? Do we have any other witnesses today? I think our next witness is probably Mr. Yale, but he wants a short recess.

MR. ROSENBAUM: Your Honor, Mr. Metzger is available.

JUDGE PALMER: Would you like to do it now, Mr. Metzger?

MR. METZGER: Certainly, right when everybody's testy.

ERICK METZGER,

having been first duly sworn in by the Judge, was examined and testified under oath as
follows:

(Thereupon, Exhibit Nos. 42 and 43 were marked for purposes of identification.)

JUDGE PALMER: Mr. Metzger is sworn. His statement as such is Exhibit 42 marked for identification, and then there's some tables that he has in a separate document, there's quite a few tables, I'm not going to go through it, but the tables are Exhibit 43.

Is someone working with you, Mr. Metzger?

MR. METZGER: Nope, I'm flying without a net.

JUDGE PALMER: You don't have an attorney?

MR. METZGER: No.

JUDGE PALMER: You may acquire one before it ends, you never know. All right. I think you can just start by reading from the statement. I looked at it, you have everything in your statement.

STATEMENT OF ERICK METZGER

MR. METZGER: Yes. Thank you, Your Honor. However, I would point out that --

JUDGE PALMER: Let's keep down the noise of everybody, please.

MR. METZGER: I would point out that one
point showing my -- shall we say my inexperience with Federal Order testimony is that I didn't put in a statement that this is in support of Proposal 16 which was submitted by National All-Jersey.

JUDGE PALMER: All right.

MR. METZGER: In addition, in the header, I don't know how critical it is, but obviously this is the week of April 9th, 2007, not February 26th. This was originally drafted for the Strongsville hearing.

JUDGE PALMER: Why don't we just scratch February 26 and put in April 9, just so that somebody doesn't become confused later. I'll do that on the one that I have here, and I presume the one that's going to be the official version that the reporter has, if you do the same where it says up at the top. Do you follow me?

THE REPORTER: Yes.

JUDGE PALMER: Okay. Go ahead, sir.

MR. METZGER: Thank you. My name is Erick Metzger, and I serve as the General Manager of National All-Jersey, Inc. (NAJ), a position I have held for approximately three years. I was raised on a dairy farm in Indiana, earned a
Bachelor of Science degree from Purdue University in 1982 and an MBA from Franklin University in 1999. I was employed by the American Guernsey Association for ten years, including five years as its CEO. I have been in the Jersey organizations for the past 14 years. I have testified and filed comments in conjunction with previous Federal Order hearings.

NAJ is a national membership organization of over a thousand producers and other people interested in supporting equitable milk pricing. Approximately 30 percent of NAJ members own cows other than Jerseys. NAJ's milk marketing policy is to advocate for milk pricing programs that will price milk based on its most valuable components in accordance with their use in consumer products. It is this policy that compelled NAJ to submit a proposal to value dry whey on a protein basis instead of the current other solids basis.

However, in life, as the old expression goes, timing is everything. In the six months since the September 30, 2006, deadline for submitting proposals to be considered at this
hearing, the dry whey price as reported by NASS more than doubled from 29.65 cents per pound in August 2006 to 60.05 cents per pound in February 2007. During the same time period, the lactose (mostly) price reported by Dairy Market News has increased from 33.89 cents per pound to 59.3 cents per pound. These unprecedented price increases and price levels bring an entirely different dynamic to the whey solids market. Yet the underlying principles behind NAJ's proposal remains sound.

In analyzing this proposal, the most important questions to be asked are:

Which price series for whey products and lactose is more representative of their true market, the six-and-one-half years from January 2000 to mid-2006, or the few months since 2006?

Which whey solids are the most valuable today and will be in the future?

If we were designing a formula from scratch today, as opposed to eight years ago, to convert the value of whey solids to producer milk values, what would the ideal formula look like?

The definitive answers to these questions
are most likely beyond the predictive powers of anyone involved in this hearing, including myself. However, regardless of the answers, the formula used for converting whey prices to producer pay prices needs to be, at the very least, changed to recognize the value of protein in whey solids. Prices in recent months indicate that the whey solids should be priced on a protein and non-protein basis separately, instead of both portions of whey solids being valued equally, as is done in the current price formula. Prices prior to last fall justified whey solids being valued simply on a protein basis, given that the non-protein whey solids prices (basically lactose) were not much, if any, higher than the cost to process lactose.

During the past four years, production of the most -- more protein-concentrated forms of whey products has increased, while the production of dry whey has remained virtually unchanged. Table 3 in Exhibit 43 shows that from 2003 to 2006, production of dry whey has increased only 1.5 percent. Production of WPCs (25 percent to 49.9 percent) has increased 6.6 percent; production of WPCs (50 percent to
89.9 percent) has increased 40.7 percent; and
production of whey protein isolates has
increased 45.5 percent.

In addition, assuming:

WPCs (25 percent to 49.9 percent) average
34 percent protein,

WPCs (50 to 89.9 percent) average
70 percent protein, and

WPIs average 90 percent protein,

The total pounds of whey protein in WPCs
and WPIs have increased by 24 percent during the
past four years and now exceed the pounds of
protein in dry whey by approximately 82 million
pounds annually. The annual differences in the
amount of whey proteins processed in dry whey
versus the WPCs and WPIs is further illustrated
in Graph 3. Clearly buyers of whey solids
prefer products that are protein rich and
protein standardized with lower levels of
lactose. These production and buying trends are
evidence that whey's value lies in its protein.

In addition, product yields of WPCs and
WPIs are dependent on the protein levels in the
whey stream resulting from the cheese making
process. Higher protein milk results in higher
protein whey, which leads to increased yields when producing WPCs and WPIs.

Protein is consistently worth more than lactose. Dairy Market News reports monthly prices for whey protein concentrate 34, (WPC 34) and dry whey, which are sources of protein. Dairy Market News also reports prices for lactose. In Table 1, Exhibit 43, compares the monthly values of these two whey products per pound of protein with the value of lactose since January 2000. WPC 34 is assumed to be 34 percent protein, while dry whey is assumed to be 13 percent protein. Dividing the product price by its percent protein (columns titled "Protein Parity") shows the cost of buying a pound of protein in that product assuming the value of the non-protein solids portion of the product is zero. In all cases the average price based on protein parity far exceeds the average price of lactose. The cost to buy a pound of protein in dry whey or WPC 34 is consistently higher than the price for a pound of lactose. These same data are represented graphically in Graph 1 of Exhibit 43.

Lactose purchased in whey products is more
expensive per pound than buying -- than
purchasing lactose directly. Table 1 in Exhibit
43 also shows the month-by-month per pound
lactose parity price for WPC 34 and dry whey
along with lactose prices. Lactose parity can
be calculated by dividing the product price by
its percent lactose. Lactose parity shows the
cost of buying a pound of lactose in a given
product assuming the non-lactose portion of the
product has no value. On average, a pound of
lactose purchased in the form of WPC 34 costs 71
cents more than a pound of lactose purchased in
dry whey. In turn, on average a pound of
lactose purchased in dry whey costs nearly six
cents more than buying lactose itself. Even in
the past 12 months when lactose prices have
increased from 23 cents per pound to 55 cents,
the cost of buying lactose in the form of dry
whey has remained higher than simply buying
lactose. Therefore, dry whey and WPC 34 are not
being purchased for their lactose because it's
cheaper to buy lactose directly. Again, these
same data are shown graphically in Graph 1 of
Exhibit 43.

Whey proteins are the preferred source of
protein in the dry dairy products. Nonfat dry milk and dry buttermilk can also serve as protein sources. Table 2 in Exhibit 43 compares the protein parity prices for nonfat dry milk, dry buttermilk, WPC 34 and dry whey. Both nonfat dry milk and dry buttermilk were assumed to be 34 percent protein. From January 2000 through December 2005 protein purchased in WPC 34 and dry whey was less expensive per pound than protein purchased in nonfat dry milk and dry buttermilk. The economy of protein purchased in whey products made them the preferred source of protein. These same data are graphed in Graph 2 of Exhibit 43.

Protein parity prices for dry whey and WPC 34 track each other more closely than do the lactose parity prices for those two products. Graph 1 in Exhibit 43 shows that the lines for protein parity prices for dry whey and WPC 34 are very close together, indicating that buyers are willing to spend approximately as much per pound of protein in the form of either dry whey or WPC 34. On the same graph, the lactose parity values for the same two products do not closely track each other, and both are shown to
be more expensive than lactose itself. If the
value of WPC 34 and the dry whey was due to the
lactose content, buyers would pay about the same
amount per pound of lactose in the two products.
Clearly lactose purchased in WPC 34 is far more
costly than lactose in dry whey, indicating the
products are not being purchased for their
lactose content.

In addition, recent high prices for lactose
reflect a shortage of lactose processing
capacity, not a shortage of lactose. If the
lactose processing capacity were doubled in a
short time frame, the price of lactose would
fall precipitously. Lactose processing is very
capital intensive, leading processors to be
reluctant to add lactose processing capacity
unless they believe prices will remain at
profitable levels long enough for them to recoup
their investment. In fact, much of the current
lactose processing capacity was developed simply
to reduce the costs of disposing of lactose.
The costs incurred in processing lactose were
less than the costs of meeting all the
environmental regulations to dispose of it
otherwise. If the current record high prices
for lactose are expected to maintain for an extended period of time, processors will be developing additional lactose processing capacity and prices will, in all likelihood, decline.

The value of dry whey serves as the proxy for all whey products. Graph 1 in the protein parity -- in Graph 1, the protein parity value lines for WPC 34 and dry whey show that dry whey served as a very good proxy for WPC 34 until the fall of 2005. Even though dry whey is not as good of a proxy for WPC 34 now as it was, it remains the only proxy available in the current system. Whey products include the milk components of lactose, protein, ash and limited amounts of butterfat. The value of dry whey is assigned to "other solids" in converting whey values to producer milk value. However, when producer milk is tested for other solids, only the components of lactose and ash (including non-protein nitrogen) are measured. Therefore, the major component of value in -- and correct that to saleable, S-A-L-E-A-B-L-E; therefore, the major component of value in saleable whey products, protein, is not being considered in
converting whey value to producer prices.

Producers can purposely impact the protein production of their cows and herds through culling, feeding and breeding decisions, but they cannot impact lactose production.

Approximately one-half of the nation's milking herd participates in Dairy Herd Improvement (DHI) production testing, which includes among its services measuring the protein production for individual cows. Dairy producers can use DHI data to identify low protein-producing cows and if they -- let me start over.

Dairy producers can use the DHI data to identify and cull low protein-producing cows if they so desire. DHI testing does not include lactose testing.

USDA's Animal Improvement Programs Laboratory (AIPL) calculates predicted transmitting ability (PTA) genetic estimates for cows and bulls. These PTAs include genetic estimates for protein production. Producers can use these PTAs to make genetic selections for protein improvement through their breeding decisions. AIPL does not calculate PTAs for lactose production.
Significant research has been done regarding feeding programs that increase protein production. Herd owners can use the results of this research to modify their feeding programs and increase their herds' protein production. Very little, if any, research has been done reading feeding programs that increase lactose production.

Producers have many tools at their disposal to affect protein production but virtually no tools to affect lactose production. Updating the price formulas, including the producer pay price, for dry whey to be based on protein instead of other solids will give dairy producers more incentive to improve their production of milk's most valuable component, protein.

However, given the recent high prices associated with other solids in producer milk checks, questions are being asked whether the time is right to offer lactose testing as part of the DHI production records program and AIPL genetic evaluations. The fact that other solids are contributing nearly $2.00 a hundredweight to the Class III price has piqued producer interest
in how they can affect their other solids
production, which could mainly be accomplished
by affecting lactose production.

Proposed Price Formula Modification.

Assigning the value of dry whey per pound
of protein instead of per pound of other solids
can be accomplished as follows:

\[(\text{Dry whey price} - 0.1956) \times 1.03 \times \text{yield factor} = \text{Other Solids Price.}\]

\[\text{Other Solids Price} \times 5.69 \text{ pounds of Other} \]
\[\text{Solids per hundredweight in standard milk} = \]
\[\text{Value of Other Solids per hundredweight.}\]

\[\text{Value of Other Solids per hundredweight divided by} 2.99 \text{ pounds of true protein per} \]
\[\text{hundredweight of standard milk} = \text{dry whey value per pound of true protein.}\]

Combining these three formulas results in
the following formula:

\[(\text{Dry whey price} - 0.1956) \times 1.03 \times 5.69 \]
\[\text{divided by} 2.99 = \text{dry whey price per pound of} \]
\[\text{true protein.}\]

Combined further, the formula becomes:

\[(\text{Dry whey price} - 0.1956) \times 1.96 = \text{dry whey value per pound of true protein.}\]

\[\text{The dry whey value per pound of true} \]
protein would be added to the protein price derived from cheese. The revised protein price formula would be as follows (modification in bold):

\[
\text{Protein Price} = ((\text{Cheese price} - 0.1682) \times 1.383) + (((\text{Cheese price} - 0.1682) \times 1.572) - \text{butterfat price} \times 0.9) \times 1.17) + ((\text{dry whey price} - 0.1956) \times 1.96).
\]

The Other Solids price would then become zero.

Other Solids Price = 0.

Currently the other solids price is used in combination with the protein price to determine the Class III skim milk price using the following formula:

\[
\text{Class III Skim Milk Price} = (\text{Protein price} \times 3.1) + (\text{Other solids price} \times 5.9).
\]

The revised Class III skim milk price formula would become:

\[
\text{Class III Skim Milk Price} = \text{Protein price} \times 3.1.
\]

Impact of NAJ's Proposal.

This proposal was revenue-neutral for Federal Order average component milk from April 2003 through September 2006. Table 4 in Exhibit
43 compares the whey value per hundredweight of milk using actual monthly other solids and protein test data in combination with NASS dry whey prices. This proposal would have resulted in less -- in a less than 1 cent per hundredweight change, on average, to the Class III price up until September 2006. In the months since this proposal was submitted, the previously mentioned record dry whey prices would have resulted in marginally higher Class III prices.

If the answer to the previously posed question regarding the future of whey solids prices is that future prices will be more in line with recent prices, then this proposal lays the groundwork for further modifications and flexibility in milk valuation. If in the future it is determined that whey products other than dry whey should be included in FMMO price formulas, this proposal provides the mechanism through which their protein values can be easily incorporated. Having moved whey's value to be protein based, the next steps could include using WPC 34 prices instead of or in addition to dry whey prices. This could lead to WPC 34
prices being included in NASS surveys as well as the inclusion of WPC 34 processing cost data in plant cost surveys.

If lactose prices remain at their recent levels, the value of whey solids could be expanded to be based on a combination of whey protein values using WPC 34 and/or dry whey, and non-protein whey solids values using lactose prices and associated processing costs.

Conclusion.

Federal Order Reform in 2000 was designed to price milk to producers in accordance with the value of dairy products purchased by consumers. Thus, the value of products -- the product values for cheese, butter, nonfat dry milk and dry whey are converted to milk component values for butterfat, protein, other solids and nonfat solids to be used in the classified pricing system to determine minimum regulated prices for producers. In the time since Federal Order Reform was enacted, the market for whey solids has evolved to the point where today their value is due to their protein content and not lactose content. Therefore, if dry whey remains the product of choice to
convert whey solids value to producer pay
prices, the formula needs to be updated to be
protein based instead of being lactose and ash
based. If the industry determine that the value
of whey solids should be separated into protein
and non-protein values, this proposal provides
the framework for that development.

JUDGE PALMER: Do you have anything to add
to your written statement?

MR. METZGER: Unless I miss my mark, I'll
be adding things in Cross-Examination.

JUDGE PALMER: All right. So we should
open it then to Cross. Are you ready for it?

MR. METZGER: Yes.

JUDGE PALMER: Okay. Who wants to start?

Mr. Yale.

CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q Good afternoon, Erick.

A Good afternoon.

Q First off, I want to congratulate you on putting
together a very provocative, thought provoking,
an issue I don't think is talked about enough.

I have a couple questions, though, in terms
of -- I think the math and stuff I think we can
get into, but I want to talk in general about
what's in other solids, okay.

    Now, what we call other solids is
everything other than protein and fat; is that
right? I mean isn't that what's in the Federal
Order right now, or do you know?

A Well, when I started looking into this, it
seemed like there were two different definitions
of other solids.

Q That's why I'm asking what you're referring to.

A The other solids from the producer milk side,
when producer milk is tested for other solids,
it's primarily tested for -- well, it is tested
for lactose, ash and non-protein nitrogen.

    However, on the processor side, everything
that ends up in the whey stream, including trace
amounts of butterfat and a portion --
approximately 20 percent of the true protein is
lumped into an other solids value, so the
current formula, we've got this disconnect
between the processor side of other solids and
the producer side of other solids.

Q So let's call them by specific names. Let's
talk about the first one, the ash or the -- you
know, the -- that smaller amount. In your
research and looking at the Jerseys and the DHI
records that track this, is that a fairly steady
number that comes out in the milk?
A  The ash?
Q  Yes.
A  Yes.
Q  And what does that number generally run?
A  I think it's about .7 percent.
Q  And it varies more from a regionality to
regionality?
A  If it varies at all, yes.
Q  If it varies at all. Okay. Now, let's look at
the lactose. What about the amount of lactose?
A  The lactose in raw producer milk would be
somewhere 4.7, 4.8 percent. There's some
seasonality variation in there as well.
Q  All right. I know you promote the Jerseys,
okay, so you're always --
A  We promote equitable milk pricing, and we
represent producers of all breeds. Thank you.
Q  All right. And you do a good job of it. If you
look at the issue of lactose, isn't -- lactose
is one of those things that's -- in the bovine
species is pretty much the same from breed to
breed, is it not?
A There is -- the variability of lactose is not as great as the other milk components.
Q It's more variable than ash?
A Yes.
Q But it's less variable than the protein or --
A And the butterfat.
Q Do you have any numbers that talk about the variability of the lactose in the milk?
A No, I don't. I actually did rather -- asked a lot of questions of a lot of places, and I was getting heritability estimates on lactose production, but could not get any concrete variability numbers.
Q Because you've testified that producers were looking to produce more lactose. I mean is that really a productive and likely effort?
A Given the -- given the heritability level of lactose, which runs about .26, or 26 percent, compared to heritability of milk production, which is about .30, it's in the same ballpark. Now, granted, the variability is less. However, if we consider the genetic side of the cattle industry, we have -- and to make genetic progress, it depends on both the heritability of a trait and the variability of that trait within
a population. We have genetic evaluations for fertility that are labeled daughter pregnancy rates. The heritability of daughter pregnancy rate is about .03, and yet we calculate genetic estimates for that and incorporate that into breeding programs, so I would not dismiss the potential to develop genetic evaluations for lactose given that the heritability of it is so much greater.

It's got its own problems in that I'm -- when producers -- you know, for a long time looking at milk checks, so many pounds of fat times fat price, so many pounds of protein times that and so many pounds of other solids times an other solids price, other solids price was pretty low, didn't pay any attention to it. Now that we're pushing up $2, $2.50, you know, they're starting to look at that, and it does raise a concern that if we keep going down the path that we're going down now, we're going to take essentially whey protein values, convert them into producer lactose values. Producers will find additional lactose for Mr. Wellington to spread on the fields of New England, and that's -- I mean he testified to that effect in
the Strongsville hearing, and that can be a problem for the industry; not just producers or processors, the industry.

Q Right. So going back to that, though, you talk about the inheritability, but even through the inheritability, the amount of impact in terms of raising that amount of lactose, the amount of actual lactose that could be increased would be relatively small, would it not?

A Compared to the other milk components, yes.

Q Okay. So we talk about the ash, that's fairly stable, and we have the lactose, which is relatively stable, not as stable as other things, but in terms of component; the next item that you mentioned in there, in those other solids, was NPN, the non-nitrogen protein; right?

A Correct.

Q Okay. And what -- how does that normally run in milk? What's the amount of non-protein nitrogen?

A Well, I believe when we went from crude protein to true protein, what we were trying to do was subtract out the non-protein nitrogen, and I believe that's a constant of .19.
Okay, .19. So that's -- based on what you understand the testing to be, that's -- those other solids include the NPN, the lactose; right?

Yes.

And the ash; right?

Yes.

Okay. Now, in that number -- or in that total that you just have there, where do the proteins come from that we're going to pay for? Because they're really -- there's no protein in any of that that's just been mentioned; right?

Correct.

Okay.

On the producer side.

On the producer side.

Correct.

But what happens on the plant side is is that -- and we see that in the formulas that we've been talking about, is that you have -- right now there's an implied 82.2 percent of casein that's in true protein; right?

Correct.

Okay. And the other side of the whey proteins are the casein proteins; right? I mean there's
really those two sets. Isn't that how we divide
the proteins in milk between the whey proteins
and the casein proteins?
A Yes.
Q Okay. And the casein proteins are the ones that
show up and stay in the cheese; right?
A Correct.
Q All right. So what's left are the whey proteins
that go to the producers; right -- or not go to
the producers, the whey proteins that are
available to be processed; right?
A Yes.
Q So, in reality, at the plant level the other
solids includes the ash, the non-protein
nitrogen, the lactose and the difference between
the true protein and the casein that's in the
milk; right?
A Yes. The casein that's in the -- retained by
the cheese.
Q Retained by the cheese.
A In addition, I mean the cheese yield formula has
a constant of minus .1 casein that ends up in
the whey stream as well.
Q That's right. You're to my next point. So we
get that extra factor in there, and then you
have to subtract out of that that factor of .09
that seems to encompass all the other solids,
fat and protein that seems to show up in the
cheese in addition; right?
A Yes.
Q Okay. So going back to from the producers'
standpoint and the formulas we have today, we
measure the non-protein nitrogen, the lactose
and the ash, and that total -- I think if you
were to look at the statistics, I think you've
done that, but if you look at the Federal Order
statistics on other solids, that number rings
just pretty steady month in and month out order
to order; right? It's a fairly --
A Yes.
Q So what we have left over that you're wanting to
price are the proteins that are the difference
between the casein that is kept in the cheese
and --
A And the true protein.
Q -- and the true protein?
A Yes.
Q Okay. Now, let me -- I want to jump ahead to a
little different subject and we're going to
circle around, so bear with me, okay.
A: I'm here all week.

Q: These are not trick questions, because I think this is something that needs to be understood by all of us, so. And you're the smartest person on this issue, so we need to get this through, okay.

A: I decline that characterization, thank you very much.

Q: So if we take -- let's look at this protein issue. I want to back up. We talk about sweet whey. I know you mentioned 13 percent protein in sweet whey, but is there really a standard of identity for sweet whey?

A: I don't know. I'll be the first to admit that. I know from looking at, I believe it was U.S. Dairy Export Council's Web site where they describe whey, I think it gave sweet whey, they gave kind of a range, and that actual -- quite frankly, the amount of protein in sweet whey can vary depending on the level of protein going -- that's in the cheese milk that starts into the -- starts into the vat. That ties into, you know, the statement I made that higher protein milk results in higher protein whey because of essentially the 20 percent of true protein that
ends up in the whey stream, so if you start with higher milk, you end up -- start with higher protein milk, you're going to end up with more protein in the whey stream.

Q Okay. So isn't -- but WPC 34 does have a standard, at least it says it requires 34 percent protein; right?

A Correct.

Q Okay. So the question comes -- as I understand your proposal, it's basically starting with the dry whey price and backing into the value of the protein; correct?

A Right.

Q Okay. Why not -- and then dividing that by the -- I think coming up with a factor dealing with the 2.99 -- or 2.9916, which is the amount of true protein in milk.

Why not take -- have a determination of what the amount of true other solids are in the milk such as the plants do and subtract out the ash and the lactose and the non-protein nitrogen, which are fairly stable numbers, and that way the variability of the whey protein that individual producers have, and price that off of the WPC 34 protein equivalent, or is that
what you're doing anyhow?

A I'd have to see your formula to know for sure if
I was -- if that's what I'm doing. I don't
think that's what's in the proposal. Certainly
that would be an alternative approach.

Q Because, really, what you're trying to do is to
recognize that the value that's driving the dry
whey today in large part -- although it's both
markets, but in large part is the protein, and
that's what the long-term market is for is for
the protein in there; right?

A That's what we would expect the long-term market
to be given the volume of raw lactose that
simply isn't being processed at this point. If
it were to be processed --

Q That market would drop.

A Correct.

Q Right. Which is one reason those who are
looking to process lactose are unwilling to do
so because they know that once that volume comes
on, they'll be on the other side again; right?

A Yes.

Q All right. So -- but coming back to this issue,
if we measure just the amount of the whey
proteins or the non-casein, sometimes you'll see
the term non-casein nitrogen or non-casein protein, right, and if we measure that and pay for that, that would result in the same thing that you're seeking to do ultimately, and that is give enhanced -- is to tie the value of the other solids to the value of the protein and nothing else?

A I believe that would meet the big picture objective, yes.

Q Now, I think in terms of the analysis that you've done and at least I maybe have seen in the past and discussions we've had, I didn't see that so much here, your expectation on the average by the way you've done the formula results in not too much in the way of producer price enhancement?

A On average, that's correct, yes. It's more or less revenue neutral.

Q All right. But the value up -- goes up and down based upon the amount of protein that the producers produce; right?

A To an individual producer, yes.

Q Now, does DHIA or the Jersey Association test for all solids -- other solids in the milk in the same way the plants do?
I don't believe that the DHIA system tests for other solids at all. I think the Federal Order -- to the best of my knowledge, the Federal Order System is the only place where other solids per se is tested for.

Now, of course, in California where milk is priced on solids not fat, you could arrive at other solids because some producers also, for purpose of inclusion of their records in genetic evaluations, test for fat, solids nonfat and protein, and by doing the subtraction of the protein from the solids nonfat you would have what the Federal Order defines as other solids.

So to kind of tie things up, if you do a fat/nonfat in terms of the solids in the milk, that's the only -- that's your first true division, the solids not fat include the ash --

Yes.

-- the lactose, the non-protein nitrogen, the --

And the true protein.

And the true protein and the whey proteins -- or the true proteins?

Correct.

And if you divide out the whey proteins, it would be the casein, the whey proteins, the
non-nitrogen -- non-protein nitrogen, the
lactose and the ash?

A I believe that's correct, yes.

MR. YALE: Okay. I have no further
questions. Thank you.

JUDGE PALMER: Any other questions? John.

CROSS-EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q Mr. Metzger, good afternoon.

A Good afternoon, Mr. Vetne.

Q Help me out here. I always thought nitrogen was
a gas. Is non-protein nitrogen in milk in a
solid form?

A I don't know that I can help you with that.

Q So to the extent that non-protein nitrogen has
been referred to as one of the solids in the
category of other solids, you don't know whether
it's actually a solid or a gas when thus
isolated?

A That would be correct.

Q Okay. Now, some of the proteins in milk, as you
discussed with Mr. Yale, are called casein
proteins.

A Yes.

Q Which is one category of protein produced by a
cow. The other proteins, which we call the whey proteins, are, in fact, a number of different protein molecules or protein combinations. Casein is one type, but within the whey proteins there are different subdivisions; correct?

A Yes, and there are also different subdivisions within the caseins. Alpha, beta, kappa.

Q With respect to the non-casein proteins, those are proteins of a structure and function that are different than casein. They don't -- for example, they don't provide the glue that binds fat and moisture together to make cheese.

A That would be correct.

Q Okay. And the whey proteins have different functions and different market uses?

A That's correct.

Q And, in fact, one of the recent market uses for the non-casein protein is in various nutritional supplements.

A Yes.

Q With respect to the relationship between casein proteins and whey proteins, is that relationship also variable in the producer milk? You talked about the variability of protein as a whole.

Now let's look at the subcomponents, the two
major categories of protein components, the whey
components and the -- the whey protein and the
casein protein. Is that variable in
relationship?

A I would assume that, yes, there is some
variation in there. To what degree I don't
know. Most things in nature have some
variation.

Q Okay. But the primary -- the primary protein
ingredient which is valued by cheese makers is
the casein portion?

A In the -- yes, in the cheese side, although you
will occasionally hear reports that we're
processing cheese in order to get whey; hope to
break even on the cheese and profit from the
whey.

Q That would be a recent development?

A Yes, it would be a recent development.

Q It has been within our lifetime that whey,
including the whey proteins, used to be spread
out in the field.

A It's been even within my working time that that
has happened. And, again, you know, whey should
be, and is, one of the real success stories of
the dairy industry, taking something that was a
useless by-product and creating value from it, and yet we hear repeated statements that whey is causing a problem for cheese, the cheese processors.

Q Now, your proposal essentially would take all of the value that is now assigned to what's called other solids and assign that value to protein?

A Yes.

Q And when that is assigned to protein generally, that value is distributed evenly among the proteins having various functioning, including the casein portion and the whey protein portion?

A Yes.

Q Under the current system of pricing the value of whey, including the whey protein component, does -- compared to your proposal, does one system or the other tend to reward or fail to reward producers of protein content that varies from the national average?

A Well, as I understand the current system, the protein that winds up in the whey stream for all intents and purposes is considered to have evaporated because the whey is valued out to the producer on a essentially lactose and ash basis, whereas the protein that ends up in the whey is
not accounted for.

Now, if we took -- comparing -- now, to get back to your specific question, higher protein milk will receive more than the average and lower protein milk will receive less than the average.

Under my -- under the NAJ proposal, it would shift some dollars from below average protein test milk to above average protein test milk.

Q You also talked about non-protein nitrogen and an assumed ratio, I think assumed ratio, of non-protein nitrogen, or assumed content?

A Assumed content.

Q Assumed content. Based on your study of the issue, have you observed that the non-protein nitrogen content is not variable?

A Yes.

Q It is not variable?

A It is not variable.

Q It is not variable. It remains relatively constant regardless of the true protein content of milk?

A That's my -- actually, that's my understanding going back to the days when the DHIA system was
changing from measuring crude protein to measuring true protein, and to -- even though I wasn't -- I was working at the Jersey organizations but not specifically in NAJ at the time, and the work that NAJ staff at the time was doing to modify the Van Slyke formula to accommodate for measurement of true protein as opposed to the previous crude protein, and everything I remember from that time frame was a constant .19.

Q  Constant .19 in the test or constant .19 employed by those doing the math?

A  I would -- by those doing the math, which I would assume then would be both.

Q  You don't know whether they separately tested?

A  I do not know, correct.

Q  Now, under your proposal, there would be a change, I think it's on Table 4, in the Class III price; is that right? The table that you referred to, that was almost revenue neutral.

A  Yes. That would be Table 4, and up through August of '06, the change was, for all intents and purposes, negligible and, of course, the proposal's being due at the end of September, the August component values were the most recent
data that were available.

In the time since then, the proposal would have -- on average test milk, would have averaged -- or added in the last four months five or six cents to the Class III price, but, again, we're dealing with a market dynamic that we've not seen before.

Q All right. One of your objectives here is to transmit price and component value signals to producers; is that correct?

A That's correct.

Q Now, is it -- isn't it true that that can be done in how the pooled producer values are distributed among producers without affecting the price that handlers are charged? You're proposing to do it both on the handler side and the producer revenue distribution side.

A That is correct.

Q What you propose, and to meet your primary objective, can be done only on the producer side; correct?

A I suppose it could be. I didn't think of that particular approach.

MR. VETNE: Okay. Thank you.

JUDGE PALMER: Any more questions? Yes,
Mr. Rosenbaum.

CROSS-EXAMINATION,

QUESTIONS BY MR. STEVEN J. ROSENBAUM:

Q Do I -- if I understand correctly, your proposal would shift the whey yield over to the protein component; is that right?

A That's correct.

Q And you would assume a whey yield of 1.96 pounds per pound of protein, is that what your formula does?

A In the narrow sense, yes. However, in the broader sense, what -- what we're trying to accomplish here is to recognize that the majority of whey solids are going into the concentrated forms of whey product, WPCs and WPIs. The yield of those products is dependent on the protein in the milk or in the whey stream.

The yield of dry whey is not as -- is marginally dependent on the amount of protein in the whey stream. There is -- but, again, the dry whey is serving as the proxy for the WPCs and the WPIs, which are the majority use of whey proteins.

Q Let me take, as an example, milk that has a --
that contains 2.9 pounds of protein per
hundredweight; okay?

A Okay.

Q Now, do I understand that under your formula,
the assumption would be that there would be
5.684 pounds of whey, and I derive that by
multiplying the 2.9 pounds of protein by the
assumed 1.96 pounds of whey per pound of
protein?

A I'm sorry, again, please.

Q I'm multiplying 2.9 pounds of protein, which is
my assumed composition of the milk, and
multiplying it times what I understood you to
say was the assumed whey yield per pound of
protein, namely 1.96 pounds of whey -- of whey
per pound of protein. Is that how the formula
works?

A Well, the formula -- okay, dry whey price minus
the make allowance times 1.96 would be the value
per pound of true protein.

Q My question is if you assume -- given that
formula, if you assume that there is 2.9 pounds
of protein in the hundred pounds of milk, does
the formula for pricing purposes assume that you
are going to get 5.684 pounds of whey?
And the reason -- and I'm getting to that
calculation by multiplying the 2.9 pounds of
protein per hundredweight, which I'm asking you
to assume is the composition of the milk we're
looking at, and multiplying it times what I
understand to be the assumed whey yield per
pound of protein of 1.96.
A Okay, yes, now I'm with you, and then by
extension, that is serving as a proxy for yields
of protein concentrated forms of whey products
which are the majority use of whey solids at
this point.
Q But am I correct in my math that it's 2.9 pounds
of protein per hundredweight times 1.96 pounds
of whey per pound of protein, resulting in 5.684
pounds of whey product?
A That would be correct.
Q Now, let's assume that instead the milk has a
protein of 3.4 pounds --
A Okay.
Q -- which would be representative of some -- some
of the -- some Jersey cows potentially; correct?
A And higher testing herds of any breed.
Q Okay. Now, if we assume that there's 3.4 pounds
of protein in the hundred pounds of milk and we
multiply now that number times the assumed
1.96 pounds of whey produced per pounds of
protein, the result, by my math, would be 6.664
pounds of whey product, just simple math. Do
you agree with that calculation?
A I would agree with that calculation, and, again,
with that serving as a proxy for products that
are more protein dependent on their yield than
is dry whey.
Q Now, the -- the implication of this is that if
one has milk at 2.9 pounds of protein, your
formula assumes that you get 5.684 pounds of
whey product, we went through the math of that a
minute ago; if you assume instead the milk has a
composition of 3.4 pounds of protein per
hundredweight, then you're assuming through the
formula 6.664 pounds of whey product. As you
can see from the math, your calculation results
in approximately one pound extra of whey product
as a result of a half a pound more of protein in
the milk. And is that a -- do you see -- do you
follow my logic at least? You can tell me I'm
wrong, but do you see my logic?
A I understand your logic, and now what I'm trying
to do is to take that a step further, the
concept being that yours -- that calculation is
on dry whey, and one of the attempts of this
proposal was to recognize that the majority of
whey solids, particularly whey proteins, are
going into protein concentrated forms of whey
products, the WPCs, the WPIs, and obviously
the -- the yield of those products which serve
as the majority product for the whey stream are
more dependent -- are almost entirely dependent
on the protein in the whey stream, whereas dry
whey is not, so we've got dry whey, which is --
we've got an established process to collect
prices on that serving as a proxy for all whey
products.

    Well, here recently the majority of the
whey stream is going into the more concentrated
form of whey product and not just dry whey.
Q If one were looking at dry whey itself, you
A certainly would not anticipate --
Q Dry whey itself?
A You wouldn't anticipate an extra pound of
product resulting from an extra half pound of
protein; correct?
A That is correct. That's why it's important that
it serve as a proxy for the others.
Q And, in fact, the other major nonfat solid component of milk, of course, is lactose; correct?
A Yes.
Q And you would not -- and unlike protein, lactose is, relatively speaking, a flat component of milk; is that right?
A Flatter.
Q Flatter. And so you certainly would not expect a simultaneous increase in the amount of lactose going from 2.9 pound protein to 3.4 pound protein, you wouldn't expect the lactose simultaneously to experience that kind of change in milk; correct?
A That would be correct.
MR. ROSENBAUM: That's all I've got.
JUDGE PALMER: Other questions?
Mr. Beshore.
CROSS-EXAMINATION,
QUESTIONS BY MR. MARVIN BESHORE:
Q Mr. Metzger, we heard testimony today from several cheese manufacturers with respect to their concerns with the current pricing of other solids.
A Yes, sir.
Would your proposal address that in any way?

It would -- yes, the answer to that is both yes and no, okay.

The yes part is from the standpoint that it recognizes that significant valuation of whey products is due to protein content, whereas the no part is -- and this, again, is the development that's happened in the market since proposals had to be submitted last September, doesn't recognize what's happened in the lactose market in that period of time. And I believe as I stated in the testimony, I think this proposal gives us a good first step towards a more comprehensive approach to valuing whey product, should we recognize over time that lactose prices are going to stay at or near current levels.

As I view the situation with -- you know, the current whey valuation situation is if we -- if we go to, I believe it's Graph 1 of Exhibit 43 where we look at the value of a pound of protein in dry whey compared to the value of a pound of protein in WPC 34, from -- they tracked each other very closely for quite a period of time. Sometimes one was higher, sometimes the
other was higher. As we got into about the '04, '05 time period, the value of a pound of protein in WPC 34 exceeded the value of a pound of protein in dry whey, so obviously if you're a cheese manufacturer and you're thinking what am I going to do with my whey stream and I've either got to, you know, develop something or revamp something, if I can buy whey proteins at the dry whey price, which is here, sell it at the WPC 34 protein price, which is above here, I'll realize additional returns, and so the logical business decision was made by many cheese plants to put in WPC 34 processing capacity. Well, supply and demand took over and what happened was, you know, dry whey production has stayed virtually flat, which I believe was demonstrated in Table -- I believe it's Table 3, whereas the amount of proteins going into the more concentrated forms of WPC and WPI went up, so we had more of that on the market, dry whey was staging flat, and so then that price -- that price changed. And what's happening now is we've got cheese processors that are selling whey proteins at the WPC 34 price, which is less than the whey protein price in dry whey, and
that's causing a significant amount of the
strain right now, in my opinion.

Q Right. That's what we heard about. But your
proposal would still price all the protein off
the dry whey market, so it wouldn't really
address that issue at all; right?

A It would start to address that issue, because I
think it -- like I said, it lays the framework
for us to go forward, and inertia is a very
powerful force, and I think the proposal gets us
off of this inertia of, rather interestingly,
you know, the cheese processors who are having a
problem with other solids valuation or whey
valuations, we've not yet seen a proposal, other
than perhaps make allowance changes, to address
that.

This proposal would get us moving in a
direction to more comprehensively address what's
happening in the whey solids market.

Q Let me ask you one other question. Have you
calculated the impact of your proposal on the
average Jersey producer versus the average
Holstein producer?

A No, because that's not really what we're looking
at. It's -- it's not a breed-based proposal.
It's an economics-based proposal.

Well, let me take the breed base out of it and just say, you know, the average -- say the top 10 percent of producers in the Federal Order System in terms of protein percentage in their milk versus the lowest 10 percent in terms of percentage of protein in their milk, have you calculated what the impact of your proposal would be with those -- with those sets of producers?

With those sets, there would be a transfer from the lower protein producers to the higher protein producers.

I gathered that from your testimony, but I'm looking at whether there are any numbers.

I don't know where I would cap the top 10 percent and what I would -- you know, what would be the floor on the top 10 percent and the ceiling on the bottom '10 percent.

You've done a lot of calculations here, you've got done a lot of chart work and very sharp pencil work.

Have you made any -- can you provide any information for the record in terms of what that transfer of income among producer groups might
be under your proposal?

A Marvin, it depends on what the whey price is. It also -- there is variation in other solids tests among producers. We see that even amongst our Jersey board.

Q I'm not telling you what assumptions to make. I'm saying have you made any assumptions, run any numbers that you can provide for the record in terms of evaluating the impact of your proposal?

A In all honesty, Marvin, we have looked at it from a perspective of a -- one of the things that we provide for our National All-Jersey board members, and they meet three times a year, is a milk -- milk check comparison, because they're from all across the country and different revenues, different costs, different co-op costs, different hauling costs, etc., so there's kind of a competition, if you will, among board members, and also to show the impact of different -- we still have NAJ board members in fat skim orders.

We have on two occasions run the analysis of this proposal on the board members that are getting -- or receiving an other solids price
through their milk check. I am -- when I say
we, I say that liberally because Sara actually
runs them. And I honestly don't recall what
those differences were.

I think -- if I remember one time, I think
it was last November, for our November meeting,
we were working off of September pay prices, and
I think at that point the difference for those
producers gaining on protein, losing on other
solids was a dime or twelve cents a
hundredweight.

MR. BESHORE: Okay. Thank you.

JUDGE PALMER: Other questions? Mr. Yale.

CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q You saw the testimony that I had yesterday where
I did the charts that looked at, first of all,
the percent of casein that was in true protein;
do you recall that?
A Yes.

Q And the point was was that the level was set at
a different level of protein than what was the
average being delivered to plants.
A I recall that, and in looking at your level, I
know from work done by -- again, work done by
NAJ staff prior to me joining that staff, when we were going from the crude protein to the true protein measurement, I believe we used -- or recommended using in the Van Slyke formula a .829. I believe your formula was --

Q Yeah, .822 now, we were proposing .825 but you're proposing .829.

A .829, I believe that's what we've got out on our Web site.

Q Right. And that was based upon an average test of producer milk and the casein in producer milk; is that where the basis of that was?

A I believe so.

Q Okay.

A There may be a witness later in the testimony hearing that I may ask a few questions of.

Q My point is -- we will not identify him or her. We want to make sure that they appear on the stand.

A Yes, so they don't run screaming into the night.

Q But that's on test. I mean your proposal is to divide by the .29915 or 2.99?

A 2.99.

Q That's the standard.

A Yes.
Q  Do you have a problem if that was divided by the average of the amount of protein at test in the producer milk?

A  No. In that formula we used the standard for both the other solids and for true protein. If we -- if it were to be done by the average, certainly that would be acceptable.

MR. YALE: All right. Thank you.

JUDGE PALMER: Any other questions? That table over there?

Did you wish to add anything to your statement?

MR. METZGER: No, thank you.

JUDGE PALMER: Correct anything that you think might have got confused?

MR. METZGER: That's what I have Sara back there for. She was supposed to do Redirect if I misstated anything too much.

JUDGE PALMER: She thinks you did a good job. Thank you very much.

MR. METZGER: Thank you.

JUDGE PALMER: Let's go off the record for a second.

(A discussion was held off the record.)

JUDGE PALMER: On the record. We're
receiving Exhibits 42 and 43. Thank you.

(Thereupon, Exhibit Nos. 42 and 43 were received into evidence.)

JUDGE PALMER: Let's take a little recess.

(At this time a recess was taken.)

DR. ROGER CRYAN,

having been first duly sworn in by the Judge, was examined and testified under oath as follows:

(Thereupon, Exhibit No. 44 was marked for purposes of identification.)

JUDGE PALMER: We're marking the doctor's statement as Exhibit 44, and he's been sworn, and Mr. Beshore will now examine.

Go ahead, sir.

MR. BESHORE: Proposed Exhibit 44 is not a statement. Dr. Cryan has a document which he would like to offer for the record in supplementation to his testimony at the -- in Strongsville in February, and this is a piece of information that has come into his possession since that time.

DIRECT EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q And with that, Dr. Cryan, could you tell us what
Exhibit 44 is.

A Yes, sir. Let me just preface -- let me repeat what Marvin said. This is not a written statement. I do not have a written statement.

My name is Roger Cryan, C-R-Y-A-N, and I represent the National Milk Producers Federation which put forward Proposal No. 17 in the original notice of hearing. I testified in Strongsville in favor of energy cost indexing to make allowances.

At that hearing there was data presented on costs of processing and discussions of updated cost -- processing cost data from the California Department of Food & Agriculture.

In order to complete my testimony, I needed data from the department -- California Department of Food & Agriculture regarding electricity and gas costs that are an element of the overall costs of processing that were presented at that hearing and presented more -- or published more extensively following that hearing.

I made a request -- this particular -- this document -- and by the way, there are copies on the back table. This particular document
contains -- it has two parts. The first part -- let me start with the back part. The back part is a series of -- string of e-mails starting with my e-mail to Venetta Reed, who is the supervisory auditor at the California Department of Food & Agriculture in their dairy offices who was responsible for overseeing the manufacturing cost of processing studies that the state of California does for the dairy industry.

I sent her an e-mail requesting the same -- requesting this detail on electricity and gas costs for these processors. She had provided the same sort of data, or at least confirmed the same sort of data in a previous proceeding. And I asked her to provide the same sort of data.

I believe that what she provided is self-explanatory, but let me go over this briefly. There is -- there's a published study by the Department of Food & Agriculture on Manufacturing Costs, Annual, 2006, which contains data for 2005. That's the latest data published by the Department of -- the California Department of Food & Agriculture on manufacturing costs.

I asked her to provide the utility costs,
specifically the electricity and gas costs that
are relevant elements of those costs in order to
update our proposal for energy cost indexing of
manufacturing cost allowances in the Federal
Order, Class III and Class IV price formulas.

The e-mail also contains her response
confirming that this is what I -- this is what I
asked for, and the letter contains all the data,
all the data that I requested.

And that's all I have to say about it right
now.

JUDGE PALMER: Do you have any questions?

Pretty self-explanatory, but we may have some
questions. Do we? Mr. Beshore.

QUESTIONS BY MR. BESHORE:

Q Did your prior testimony, Dr. Cryan, explain I
think how these data would be utilized in the
formula on Proposal 17?

A Yes, Mr. Beshore, I believe that they did. I
believe my statement in February went through a
methodology to which these numbers could be
readily applied --

Q And are the --

A -- if the Department chooses to apply the
updated California manufacturing cost numbers.
Q  Are the figures cost per pound of product?
A  Yes. Yes, they are. Yes, they are. Thank you
    for the clarification. I appreciate that. That
    is not in the text. For clarification, I would
    repeat that, that these numbers are all cost per
    pound.

    JUDGE PALMER: Anything else? Doesn't
    appear to be anything else, so thank you very
    much.

    We'll receive the document. So Exhibit 44
    is received.

    (Thereupon, Exhibit No. 44 was received
    into evidence.)

    JUDGE PALMER: And I guess we now close
    down until tomorrow morning at nine o'clock.

    (At 5:43 p.m., Tuesday, April 10, 2007, the
    hearing in this matter was recessed, to
    reconvene at 9:00 a.m., Wednesday, April 11,
    2007.)
STATE OF INDIANA  )
COUNTY OF MARION  ) SS:

I, Dianne D. Lockhart, a Notary Public and Stenographic Reporter within and for the County of Marion, State of Indiana at large, do hereby certify that on the 10th day of April, 2007, I took down in stenograph notes the foregoing hearing;

That the transcript is a full, true and correct transcript made from my stenograph notes.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this 17th day of April, 2007.

My Commission Expires:
July 22, 2007

County of Residence:
Marion County