VOLUME IV

BEFORE THE SECRETARY OF

THE UNITED STATES DEPARTMENT OF AGRICULTURE

AGRICULTURAL MARKETING SERVICE

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

National Public Hearing

January 24, 2006

Sheridan Suites

801 North St. Asaph Street

Alexandria, Virginia 22314

BEFORE:

PETER M. DAVENPORT

U.S. ADMINISTRATIVE JUDGE

UNITED STATES DEPARTMENT OF AGRICULTURE

APPEARANCES:

On Behalf of United States Department of Agriculture:

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Babak Rastgoufard
Jack Rower
Henry H. Schaefer
Jason Nierman
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On Behalf of Agri-Mark:

John Vetne
Robert Wellington
Richard Langworthy
Dennis Schad

On Behalf of National Cheese Institute:

Steven Rosenbaum

On Behalf of Select Milk Producers, Continental Dairy Products and Dairy Producers of New Mexico:

Benjamin Yale
Ryan Miltner
Kristine H. Reed

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

Marvin Beshore

On Behalf of Upstate Farms and O-At-Ka Milk Cooperatives

Timothy Harner

On Behalf of Dean Foods:

Charles English

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January 27, 2006, 8:30 a.m. - MORNING SESSION

THE JUDGE: We are back in session. Welcome to Day 4.

Mr. Rosenbaum.

MR. ROSENBAUM: Your Honor, yesterday at the end of the hearing testimony, Dr. Cryan distributed copies of his proposed testimony which, as Your Honor knows, is the subject of the motion that we raised earlier in the hearing and ended up resolving, that it will be raised anew when the time came for that testimony to be presented. We are prepared to address that at this time since that makes the most logical sense.

Since we have written testimony, it seems to me it makes more sense to raise it in the context of that document, and I think --

THE JUDGE: And it also helps to have any objection raised prior to its being admitted. So I'm ready to hear you.

MR. ROSENBAUM: All right. Thank you very much, Your Honor. I'm going to have a couple of handouts, and let me start with one.

THE JUDGE: This will be marked as Exhibit 59.

[Whereupon, Exhibit 59 was marked for identification by the judge.]

MR. ROSENBAUM: Thank you, Your Honor.

Your Honor, let me just say that, to explain the basis for our motion, I will just mention very briefly, as I set forth on Exhibit 59, the basic fundamentals of how the Federal milk marketing system deals with different classes of milk, as set forth in Exhibit 59.

And Your Honor may want to follow along looking at the document, if that's of any assistance, but we have four classes of milk --

THE JUDGE: Actually, Mr. Rosenbaum, I can see it from here.

MR. ROSENBAUM: You have much better eyesight than me, Your Honor.

THE JUDGE: I'm going to interrupt you just a second.

MR. ROSENBAUM: Okay.

[Whereupon, there was a discussion off the record.]

MR. ROSENBAUM: Your Honor, the point from this document simply is there are four classes of milk. The Class IV price, which is for butter, also for nonfat dry milk, uses a price formula that has a make allowance in it, the term, of course, that's been used over and over in this hearing.

The Class III price, for cheese, is a different price formula, but it also includes its own make allowance.

The Class II, which is the class paid for milk used for ice cream and similar products, is the Class IV price plus 70 cents. So there is no make allowance for the Class II, per se.

Of course, any change in the Class IV price automatically affects the Class II price since it's the Class IV price plus 70 cents. The 70 cents is commonly the Class II differential.

And the Class I, which is milk that you can actually consume in fluid format, is the higher of the Class III or Class IV price plus the fixed amount.

Now, that fixed amount actually varies in different parts of the country, so there is one number I can give you. It ranges from $1.60 up to, I think, three dollars and something under the current set of regulations, depending upon where you are located, and that's known as the Class I differential. And once again, there is no make allowance for Class I prices because the

Class I price simply floats, if you will, on top of the Class III or IV price with the fixed amount added to whatever is the higher of those two prices.

Now, Your Honor, the question here is what is encompassed by the hearing notice and, therefore, what is the proper scope of the hearing.

As I mentioned when I raised this issue earlier, Section 900.4(a) of 7 CFR states, and I quote, "that the notice of hearing shall define the scope of the hearing as specifically as may be practicable."

And I think here, USDA was quite diligent in fulfilling that obligation.

On Exhibit 1, which is the hearing notice, the very first sentence of the summary, which is really the first thing in the document, essentially says, and I quote, "A national public hearing is being held to consider and take evidence on a proposal seeking to amend the Class III and Class IV milk price formula manufacturing allowances applicable to all Federal milk marketing orders."

The term manufacturing allowances and make allowances are synonymous in this context.

And similarly -- that was on page 545 of Exhibit 1, the published Federal Register notice. And then, when it comes time to actually describe Proposal No. 1, which is on page 551 of the Federal Register, USDA accurately describes the Agri-Mark proposal -- the nomination of the Agri-Mark proposal as, "This proposal seeks to amend the manufacturing allowances for Class III and Class IV product formulas as enumerated in Section 1000.50," and continues on to describe the basis for Agri-Mark's proposal.

And then it goes to say, "Specifically, this proposal seeks to amend

Section 1000.50 milk price formulas by revising the existing manufacturing allowances for butter, nonfat dry milk, cheeses and whey powder," which are in fact the manufacturing allowances that have been the subject of discussion thus far.

And I would note that Proposal No. 2, which is the standard proposal that USDA inserts into every Federal Register notice with respect to hearings, states -- and this is proposed by AMS itself, the Agriculture Marketing Service -- and I quote, "For all federal milk marketing orders, make such change as may be necessary to make the entire marketing agreements and the orders conform with any amendments thereto that may result from this hearing."

In other words, this is a technical conformance provision saying that, to the extent changes are being made, because of Proposal No. 1, the Agri-Mark proposal, we have to make additional changes necessary to conform with those amendments, then we will do so.

As is perfectly clear from the materials I have quoted, everything in this notice is based upon changes to Class III and Class IV make allowances. There is nothing about changing the Class I and II formulas which are in the handout that's been marked as Exhibit 59, namely, that the Class II price will be the Class IV price plus 70 cents. And there is nothing about changing the Class I formula, namely, that the Class I price will be the higher of Class III or IV price plus the Class I differential as set forth in the document.

And indeed, all of USDA's analyses, the econometric model that's reflected in Exhibit 1, the analysis in Exhibit 13 put on by the AMS witness on the first day of the hearing, all assume that whatever changes were going to be made, they were going to be limited to the Class III and IV make allowances, and the analysis was based on that assumption.

Now, Your Honor, I -- my next handout is Dr. Cryan's proposed testimony, but marked up in a certain fashion. So let me distribute that.

Your Honor, what I have done in Exhibit 58 --

THE JUDGE: This will be marked as -- tendered as Exhibit 60.

MR. ROSENBAUM: Yes. And, Your Honor --

[Whereupon, Exhibit 60 was marked for identification by the judge.]

DR. CRYAN: Your Honor, could I have a copy of the marked-up copy of my own testimony?

THE JUDGE: Please give him a copy.

DR. CRYAN: Thank you, Your Honor.

MR. ROSENBAUM: Your Honor, what Exhibit 60 is, it is -- it's Exhibit 58, which is Dr. Cryan's proposed testimony, but I have marked it through to eliminate those sections of this testimony that I believe are improper. So, in essence, I believe -- it is our motion that Dr. Cryan be permitted to read the portions of his testimony that I have not marked through.

And if I could call Your Honor's attention to a specific page of Exhibit 60, it is page 17.

THE JUDGE: You have changes on 1, 3 --

MR. ROSENBAUM: Yes, Your Honor, but --

THE JUDGE: -- 5.

MR. ROSENBAUM: The changes I have made are on pages 1, 3, 4 -- excuse me, 1, 3, 5 --

THE JUDGE: 13.

MR. ROSENBAUM: -- 13. And those are all --

THE JUDGE: 15.

MR. ROSENBAUM: 16.

THE JUDGE: 16, 17.

MR. ROSENBAUM: 17, 18 and 19, Your Honor.

THE JUDGE: Okay.

MR. ROSENBAUM: And I think that I can most easily point out the point I'm driving at if --

THE JUDGE: Well, suffice it to say that all of those changes deal with the decoupling of the make allowances to the current system.

MR. ROSENBAUM: That's exactly right, Your Honor.

And, for example, on page 17 -- and what Dr. Cryan did, and it's very helpful, I think, in focusing us on the issue, Dr. Cryan has actually provided explicit amendatory language to the existing orders to carry out the changes he wants to carry out.

And so, for example, on page 17 -- this is -- his changes are indicated through new language which was bolded and underlined. Of course, I have crossed that out, but you can still read it so you can see what I'm talking about.

For example, 1050.(g), that is the Class II butterfat price. And he is proposing to amend the language with respect to the Class II butterfat price.

Well, I could not, myself, come up with a clear example of the very problem that is the source of my motion. There was no notice that there was going to be a proposed change to the Class II butterfat price, which is essentially a change to the Class II formula, as part of this hearing.

Similarly, on page 18, there is, under (q) -- this is 1000.50(q). This is part of the regulation that addresses how you compute both Class I and Class II prices.

And, in fact, the very first sentence says, "For the purposes of computing the Class I skim milk price, the Class II skim price, the Class II nonfat solids price and Class I butterfat price," etc., etc. And you'll see that Dr. Cryan has added -- and this is really on page 19 -- just, you know, sentence after sentence after sentence that is a change to the Class I and Class II formulas.

The -- and accordingly, I think it is just perfectly clear on its face that what Dr. Cryan is doing here is something completely different from changing the make allowances for Class III and IV. What he is doing is changing the Class I and II formulas, which was never part of the hearing notice. And he is doing so by substantially increasing the differentials between the

Class III and IV prices, on the one and, and the Class I and II prices, on the other hand.

And, you know, those questions involve enormous considerations that are wholly apart from those that we have been dealing with here, which is the make allowance issues.

USDA actually -- when the current Class I differentials were put in place January 1, 2000, after a five-year, I think, process by which USDA engaged in enormous study, you know, sort of going to basic economic principles as to how big the Class I differential should be and how do you come up with it and how should they be in different parts of the country, etc., and it was a source of enormous controversy and enormous attention.

But those differentials were ultimately set as they are. They formed special committees. There was a Class -- and

I forget what the -- I think it was called a Class I differential committee or words to that effect. And similarly, you know, how big the Class II differentials would be was the subject of a lot of controversy and attention, ultimately addressed and put into place January 1, 2000.

You know, my point simply is, these issues involve a lot of consideration that are of enormous importance, obviously, to the Class I and II industries. And --

THE JUDGE: The thrust of your argument is that they have not been adequately evaluated prior to this hearing?

MR. ROSENBAUM: They have not. They have not been evaluated at all, Your Honor --

THE JUDGE: All right. Let me hear --

MR. ROSENBAUM: -- not adequately.

And so, Your Honor, for that reason, we -- there are obviously substantial portions of Dr. Cryan's testimony that does go to make allowances, and we -- you know, from a -- the majority of his testimony is perfectly appropriate, and we have marked it accordingly.

So everything that I haven't crossed out -- and I don't think I have missed anything. So I guess I have to make sure --

THE JUDGE: I'm sure that others will point out any errors that you might have made.

MR. ROSENBAUM: They will let me know. But I think for that reason our motion is that Dr. Cryan be permitted to testify only with respect to those portions of his exhibit that I did not mark as crossed out so that he be limited to what appears in Exhibit 60 without the crossouts.

THE JUDGE: Very well. Mr. English.

MR. English, is this the first time we have heard from you in this hearing?

MR. ENGLISH: On the record, yes, Your Honor.

MR. ROSENBAUM: I think I said he should be limited to Exhibit 60 without the crossouts. I meant to say he should be limited to Exhibit 60, certainly, with the crossouts.

MR. ENGLISH: Charles English for Dean Foods Company and the New York State Dairy Foods Association, an organization with 126 members who sell dairy products in New York, but really appearing on behalf of the New York State Dairy Farmer National Dairy Foods Association members who are processing Class I and Class II.

And frankly, Your Honor, I am reluctant and disappointed to have to enter my appearance because Class I and Class II handlers had clearly understood that they were not affected by this hearing in any material way.

Moreover, certainly there are a number of Class I and II processors that I don't not represent, and my entry of appearance is for the limited purpose of opposing -- that is to say, we did not have sufficient notice, and there is no way within the context of this hearing to cure that.

George Orwell said that the enemy of clear language is insincerity. This is not the status quo. This proposal cannot be the status quo. And I join Mr. Rosenbaum in his objection, and I will not repeat what he said. I may refer to it, but I will not repeat it.

But the bottom line is, there is no way that this proposal is the status quo. It is changing decades of policy. We are here today on a limited proposal to consider changing make allowances. The Department has said its policy is those make allowances should reflect, not a hundred percent, but a significant portion of the cost of the cheese and powder and butter manufacturers.

None of the proponents, to my knowledge, are seeking to change that policy. They are merely coming in and saying, under that existing policy, we are being hurt because those costs are not being reflected.

And so, the hearing is about that. What Dr. Cryan, and maybe others -- and I wish to extend the objection to anybody else who would try to do the same thing. What Dr. Cryan proposes to do is to turn this hearing into something else. And as Mr. Rosenbaum pointed out, that isn't what we were told --

THE JUDGE: Just a second. Let's say Dr. Cryan's organization as opposed to Dr. Cryan himself.

MR. ENGLISH: I'm sorry. I accept that, and I apologize. The National Milk Producers Federation. What the National Milk Producers Federation and other organizations purport to do is to turn this hearing into something else.

And this is not a normal hearing notice and is not a normal hearing. And it is important to go over a little bit of history of what happened because of certain Fourth Circuit law about hearings. And we happen to be in the Fourth Circuit today. And any future proceeding may be in the Fourth Circuit, so it might be useful to consider actual law.

And the fact of the matter is that this proceeding was called after certain proposals were submitted, a proposal initially by Agri-Mark, for changes in the make allowance. And Agri-Mark made it very clear what sections would have to be amended and merely changed some numbers within those paragraphs, within Section 1050.

The Department sent out a notice to interested persons saying, this is what we may consider and it may be limited.

As Mr. Rosenbaum pointed out, we have a hearing notice with a very lengthy preamble. And I understand that Dr. McDowell testified about the analysis that USDA did. And in answer to one of the questions he had or colloquy he had with Mr. Rosenbaum, the only analysis I know of done by USDA is the one contained in the hearing notice. And that analysis was done under the assumption that we were not going take the proposal from National Milk. That is to say, it wasn't there.

Moreover, Proposal 1 speaks to price changing for all classes of milk. Again, I wish not to duplicate Mr. Rosenbaum.

But to simplify this, Your Honor, regarding the status quo, in 1984, the United States Department of Agriculture, in a different proceeding, sought comments -- and I notice comment. This is a notice in rule-making. It's a different proceeding, kind of proceeding -- regarding whether or not chocolate milk -- actually, the proceeding was what could be considered for the Women, Infants and Children's program, what would be a lawful product to sell.

And the concern at that time was sugar allowances. And the Department put out a notice as to what might be limited, and they left out chocolate milk, which for decades had not been considered an issue. That is to say, they were going to limit what could be included in WIC.

And after they put out the only notice that was ever put out -- and again, I emphasize this was notice of comment on rule-making, not formal rule-making. I think formal rule-making requires more with the notice because in a notice of comment, obviously, people can be commenting in.

But having taken in the comments from

various persons and never once told the industry, the Department issued or proposed a rule, a final rule, a final rule that would exclude chocolate milk from the Women, Infants and Children program. And the Chocolate Manufacturers of America went down the street to the Eastern District of Virginia, and they sued. And they sued on the grounds that the hearing notice was not adequate.

And using the standard that we now all know is the logical outgrowth test, ultimately the Fourth Circuit, that is to say, of course, the court above the Eastern District of Virginia, concluded that while what had happened was the outgrowth of the proceeding, it wasn't the logical outgrowth of the proceeding.

And I have that case here, Your Honor. I'm certainly happy to pass that out. It's a 1985 case entitled, Chocolate

Manufacturers Association of the United States vs. John R. Block.

THE JUDGE: I think the cite is probably sufficient.

MR. ENGLISH: All right. The cite, Your Honor, is 755 F. 2nd 1098, 1985.

And I bring that case to your attention, Your Honor, because in that case, the Department, like in this case, even before they issued a proposed rule, did an investigation and, as a result of that investigation, provided a lengthy preamble about what would be included. And nowhere in that preamble did they indicate that chocolate milk was at risk for not being included in the Women, Infants and Children.

Similarly, here, nowhere in the lengthy preamble of this notice, including the analysis by Dr. McDowell, was there any indication that there would be a change in the formulas for Class I and Class II, which --

THE JUDGE: Actually, the contrary is true, is it not?

MR. ENGLISH: That is right. The contrary is they told us, the opposite.

THE JUDGE: Doesn't the notice contain the language, "While the proposal seeks to amend the product pricing formulas used to price Class III or Class IV milk pooled under Federal milk marketing orders, changes in these formulas also would affect the prices of Class I and Class II milk pooled on Federal milk marketing orders"?

MR. ENGLISH: That is correct, Your Honor. You are absolutely correct.

And similarly, back in 1985, there was a similar preamble that went out of its way to suggest that chocolate milk wasn't at issue, just as we today say this notice went out of its way to tell us that Class I and Class II were not at issue.

The Department was ultimately enjoined from having that rule in place, and I suggest that we ought not to undergo that risk here.

Finally, Your Honor, I am concerned that the logic underpinning the argument -- and I certainly contest the idea this is the status quo. War is not peace. Red is not green. This is not the status quo.

THE JUDGE: Very well.

MR. ENGLISH: But beyond that, if you were to rule that is -- the National Milk proposal is in order, I have to ask, how is that fair to others, others with whom I actually disagree, that, for instance, yield factors shouldn't be considered or other larger issues? How is it fair to the Class I and Class II manufacturers who might wish to argue that the Class II differential is too high as opposed to too low, that the class differential is too high as opposed to low?

At what point do we stop? There is no stopping point.

We urge you to accept the objection of Mr. Rosenbaum, although I would extend it to include any other testimony that might come before us so we don't have to hang around and continue objecting. This proposal is out of order.

THE COURT: Very well. Let me hear from Mr. Vetne first.

MR. YALE: Well, I'm in support of their motion.

THE JUDGE: I understand, but I guess what I would like to hear is from the proponent and see what their view is.

MR. YALE: Oh, that's fair. I didn't know if you understood where I stood on the issue.

THE JUDGE: I anticipated where you stood.

MR. YALE: Thank you, Your Honor.

THE JUDGE: Or, actually, where you are sitting.

MR. Vetne. Mr. Vetne, part of the issue before me as well is, in other words, that this hearing was sought on an expedited basis. And on the expedited basis, it was to consider the proposal. In other words, how do you -- in that light, how do you feel that -- what is your comment?

MR. VETNE: Your Honor, the proponents are not prepared to take or express a position either way on the National Milk proposal or Mr. Rosenbaum and Mr. English's objections.

However, I think it is appropriate to refer back to the testimony of some of our witnesses who addressed a tweak in the proposal that was actually noticed, that tweak being one to, in the future, index the make allowance for energy costs. And although we indicated we supported that, the continuing index, we also expressed concern that consideration of that element of what was noticed might delay the hearing.

We have asked for an expedited decision by the Department. We want to keep it as simple as possible. And our goal is to get it done as simple as possible.

As to the legal merits of the proposal or objections, we have no comment.

THE JUDGE: Very well. Thank you, sir.

MS. DESKINS: Judge Davenport.

THE JUDGE: Yes, ma'am.

MS. DESKINS: The government has reviewed the proposal. We would it object to it as being beyond the scope of the notice. If there would be a -- if National Milk Producers Federation would want to put in a proposal that just covered the indexing of the make allowance, we believe that would be in the scope. But from his testimony, that proposal is not included.

THE JUDGE: Very well. All right, Mr. Yale. Is this a teleprompter?

MR. YALE: Yes. No, it's got numbers. If I write them, I can't read it, so I thought I'd read it off this.

I just wanted to add several points to the arguments, factual arguments already made prior to this. And that is that, in talking about Dr. McDowell's testimony, there was a specific question, several specific questions that he answered that are germane to this. Number one was the impact of Class I or II in terms of how his formula works, and he made this comment that it raises and lowers everything equally; it doesn't make any difference what the utilization was. His testimony was that he did not see this as a separate issue.

There were also questions regarding whether his analysis was regional or not.

And he said, no, it's national in scope. And this is one of the points that I want to make, and that is that, using what is found in John Rourke's testimony at Exhibit 13, there was an analysis done order by order at our request on the proposal scenarios that were out there. And it showed an even -- basically an even distribution of the impact, plus or minus a penny here or there, but throughout all of these order.

And National Milk's proposal is a little heavier in terms of the impact. It is about 50, 51 cents on all the milk.

But what's interesting, though, is that when you start to take out the Class I and Class II, a new thing starts to happen. And that is that the variation between orders -- first of all, it does bring down the national average to 30 cents, but it ranges from about 12 cents impact in Order 6, which is Florida, to as much as 38 cents in

Wisconsin or the Upper Midwest. And each of the orders has its own different impact.

So now we have significant, distinct, regional impact from what the economic analysis was, and it brings on issues that are no longer just, well, producers get less money, processors get more or whatever, which seems to be kind of the scope of this -- this hearing has been so far, but it goes one step further, and it is now starting to pit regions of producers against regions of producers.

Now, the Department in the last five years has held numerous hearings on the issue of pooling. I think Your Honor has sat through some of those hearings. And --

THE JUDGE: I hope that I participated.

MR. YALE: I was not suggesting anything less than full participation.

But the point is that those deal

with, you know, blend prices and how blend prices in one region attract milk from other regions, and we need to change the pooling because we're doing -- you know, the effect is -- the effect of this is to rearrange the dynamic of the blend prices in these various regions that undermined a great deal of what was done at those hearings, and it just throws everything in topsy-turvy.

The other part that I would like to draw the court's attention -- and it's kind of a little more in line with Mr. Rosenbaum's argument. But Exhibit 16 has a -- is the price formulas that were put together, prepared by USDA, and they are on their website. And there is no separate formula for calculating the skim price for Class I or the butterfat price for Class I, or the skim price for Class II. Rather, it refers to the formula in III and IV.

So this would show a change, and just

kind of the analogy I would give is like if somebody calls up and says, I want to paint my house. You know, a tenant calls up and tells the landlord, I want to paint the house, and the landlord says that's fine. That doesn't mean that they have authority to change the walls or the size of the rooms or the locations of the rooms. They have got to paint the walls.

The make allowance, in a sense, is an -- I don't want to use the word update because I think that implies that it's a good thing, but it is a change in the color of what's already there. What Dr. Cryan's testimony is, is a change in the structure, and very, very significant.

And then one final comment. I think there is a significant element of fairness here that needs to be addressed. We have heard, by my count -- and I may be off a few, some of them went pretty quick, but about two dozen to 28 witnesses that testified so far. Many of them --

THE JUDGE: Actually, there are 31.

MR. YALE: I must have been out of the room longer than I thought I was.

But 31 witnesses who have testified up through today, and this issue wasn't before them. And many of them needed to come in and leave. And their testimony may have been fundamentally different if they knew that this was an issue.

And I think in particular, I would point out the guy from Family Dairies of America only because the Upper Midwest has historically opposed this idea of higher Class I differentials, which effectively we'd be doing. We'd be adding another 50, 60 cents to the differential. And that -- they had no opportunity to testify to that effect.

And then, also, USDA's attorney asked a number of people who supported National

Milk's proposal, what is National Milk's proposal, and they said it's an energy adjuster and it's RBCS, you know, whatever the study is. So there has been this real hiding of the ball up through this point that suddenly now is --

THE JUDGE: Let's not characterize it that way. Let's say that we didn't get to Dr. Cryan until this point. And he --

MR. YALE: That's fair, but the --

THE JUDGE: And he was accommodating enough to give us his proposal prior so that we could have an evening of evaluation of it.

MR. YALE: Right. And that part was fair. The idea, though, that --

THE JUDGE: Let's pass away from any potential attack against Dr. Cryan or National Milk.

MR. YALE: All right. I'm not trying to -- the issue of the fairness is not the character of the people or the organization.

In fact, my clients are members of the organization and supporters of it, in most cases, this just being one of those few that we are not.

The point that I want to point out is that the order in which it comes out creates an inequity in the process for other participants. That's the point that I'd make. And with that in mind, we really believe that the hearing really should be limited to just that. Thank you.

THE JUDGE: Thank you.

Mr. Beshore or Dr. Cryan.

MR. BESHORE: I will defer to Dr. Cryan.

THE JUDGE: Very well.

DR. CRYAN: Roger Cryan with National Milk Producers Federation.

Your Honor, our counsel is unavailable today, and it is unfortunate. He is out of town. So I will be -- I have been very kindly assisted in some aspects by Mr. Beshore and by the cooperatives he is representing here. Nonetheless, I will offer some arguments myself on this very important issue.

First of all, National Milk has made no secret of our intention to recommend this approach. Our members arrived at a final position on this just two weeks ago today --

THE JUDGE: Slow down.

DR. CRYAN: Our members arrived at a final position on this just two weeks today, which was only eight days after publication of the hearing notice. We issued a memo to all of our members the very same day, including Continental and Select, outlining our support for this position.

So the ball has not been taken from Mr. Yale. Dairy trade press picked it up within a few days, and I spoke on a national dairy radio program more than a week ago outlining our position.

Clearly, Dean Foods and IDFA were well aware of our proposal before they got here. If we were keeping a secret, we're not doing a very good job.

Mr. Rosenbaum's explanation of the class prices is really a gross oversimplification. For one thing, the Class II and Class I prices are based on separate, in effect, decoupled price series. They do not use the same price series as the Class III and IV formulas. So there is already a substantially variable difference between the Class III and IV formulas and Class I and II formulas. The prices that they use are a month or a month and a half older than the ones they use for Class III and IV, and they are not the same weeks and not the same prices.

The Class I and II prices, including their component prices, are separate definitions that incorporate the Class III and IV calculations in part and by reference. These can certainly be reconstituted in the Class I and Class II calculations.

And a perfect example of that reconstitution is the Class I butterfat formula, which is based on a separate advanced butterfat calculation which is entirely independent of the Class III and IV make allowance definitions. It is identical to the Class IV formula, but it is separately stated and legally distinct. It is laid out separately within Section 50.

I would point out that Dr. McDowell's analysis as well as Mr. Rourke's analysis broke out separate impacts on Class I, II, III and IV prices. There is some distinction in all of these analyses of what the impacts would be of the application of these changes to separate classes. And, of course, Dr. McDowell could not possibly run every possible scenario and publish that in the hearing notice.

Ms. Deskins believes that it's outside the scope of the hearing. I would, of course, like you to -- we suggest to USDA the option to change their mind.

Mr. Yale points to Exhibit 16 as the formulas that are laid out. Those define the calculations correctly. However, they are also -- those formulas are also simplifications with respect to the -- compared to the order language itself that are there for illustrative purposes on the website.

I would also point out that other proponents of our position who have testified already didn't raise the Class I and II issue, in large part because they were scared off by the attorneys from the other side. They did not want to be on the stand when this was first raised. And I believe they will indicate that in their briefs, many of them. That's an assertion I will not look at.

Very fundamentally, National Milk believes that applying the make allowance changes to Class III and IV only is the most logical method of implementing Proposal 1.

Proposal 1, as noticed, begins, and I agree it begins, "This proposal seeks to amend the manufacturing allowances for Class III and Class IV product formulas." And it ends, "Amendments to these manufacturing allowances would directly affect the milk component values used in Federal order milk price formulas for all classes of milk."

Clearly, the Secretary would be within his rights to amend the Class III manufacturing allowances and maintain a status quo for Class IV. This is because the status quo in whole or in part is always within the scope of the hearing.

By the same token, the Secretary is within his rights to apply the changes to Class III and Class IV, on the one hand, but to leave the Class I and Class II price formulas intact, because doing so would simply be maintaining the status quo with respect to those classes. This is an eminently appropriate modification to the proposal, as discussed in the preamble.

All the changes required to implement Proposal 1 in the way we recommend are contained in the language of my statement, and all these changes would be contained in Section 1000.50, which is the notice section. They all pertain to maintaining intact or changing manufacturing make allowances as applied to the four classes of milk, and that is what is in the notice.

The purpose of this hearing is to provide relief to the makers of cheddar cheese, butter, nonfat dry milk and dry whey to establish more orderly milk marketing. All four of these products are in Class III or Class IV. There is no need to apply the proposed changes beyond these two classes.

We assert that the stated purpose of the proposal under consideration might be just as fully met through a partial implementation of the proposal as it would be through its full implementation. This would substantially mitigate economic impact on dairy farmers without directly affecting the Class I and II handlers, whose relief is not at issue here today. The Secretary should have the opportunity to consider whether or not that's true.

Again, status quo, in part or full, is always within the scope of the hearing. We are not proposing to expand the scope of this proceeding. What we are recommending is clearly a narrowing of the scope of the proposal.

I also insist that the Class I and II handlers clearly had full notice that this decision would apply to their prices as well as to Class III and IV. Again, Proposal 1, as noted, ends, "Amendments to these manufacturing allowances would directly affect the milk component values used in Federal order milk price formulas for all classes of milk."

This was clear notice that the Class I and II formulas would be changed or maintained. An interested party's assumption that only one outcome is possible is unfortunate, but it should not define the scope of the hearing.

Changes to the Class I and II formulas do not necessarily follow from changes to the Class III and IV make allowances. Although the language as it is currently written would apply the Class III and IV make allowance changes to Class II milk and Class I milk, changing the formula to Class I butterfat would require a separate language change, as I indicated earlier. And as I said, Class I skim milk and Class II component formulations could certainly be reconstituted separately to maintain the status quo in effect for those two classes.

Again, all these changes would be contained in Section 50, the section that was noticed in the hearing, and those changes are attached to my statement.

Finally, if it is out of the scope of the hearing to limit the impact of adjusting Class III and IV make allowances to Class I and Class II, then it also has to be out of the scope of the hearing to make any changes to Class I butterfat prices since it depends on completely -- a different provision in the language. This provision is a stand-alone calculation of the advance butter price, as I indicated. And according to the hearing notice, this proposal seeks to amend the manufacturing allowances for Class III and Class IV product formulas. That's the end. I mean, that's it.

Section 1000.50, paragraph 2, subsection whatever, 3, is neither. It is more easily argued that the Class I butterfat price formula cannot be changed at the proceeding than that the Class I and II formulas must be changed. This is almost as absurd as the motion under consideration, but it is, I believe, more valid.

In fact, Mr. Rosenbaum has not objected to the status quo in my language for that section, which maintains the existing make allowance applied to the Class II butterfat formula.

And now I would defer to Mr. Beshore. Thank you for the opportunity to discuss this.

THE JUDGE: Thank you, sir.

MR. Beshore.

MR. BESHORE: Thank you, Your Honor. I appreciate the opportunity to make some comments before Your Honor rules on the issue.

I think we need to make absolutely clear and that you understand, that we communicate to you as clearly as we can what is involved here.

What is on the table on the motion here is, according to Exhibit 2, the first document placed in the hearing record, the transfer of, under Scenario 1, $89 million from producers to Class I and II processor; or under Scenario 2, $98 million -- this is in the first year -- from dairy farmers, Dr. Weaver and Mrs. Cochran alike, to Class I and II processors. That's what's involved in the motion.

From the Class I and II processors, you know, we have heard so much, so -- such earnest, you know, and high-pressured comments.

THE JUDGE: I'd say emotionally charged.

MR. BESHORE: Emotionally charged, thank you, Your Honor, comments because it's a beggar's dream, Your Honor, for the Class I and II processors, a beggar's dream. They are contending on their motion that these transfer payments must be adopted by the Secretary of Agriculture. If he adopts the proposal, without them having -- being obligated to make any case for it, without anyone having the opportunity to oppose it, they must be adopted, the transfer of $98 million, a hundred million dollars from dairy farmers to Class I and II processors. I guess that's what Washington law firms are for, perhaps.

We don't believe that the scope of this hearing or the law relating to these hearings confines the Secretary of Agriculture in addressing the distress of the processors of cheese powder and butter, confines the Secretary, in addressing their distress -- he should have all -- he should be able to address that issue with the expertise he has and with the tools of a surgical scalpel in his hand, and not a chain saw.

Now, legally, the status quo is on the table. It is always on the table. And that is all that is involved for Class I and II, as was observed in the hallways at a hearing here for Class I and II in a conversation I had. A shoulder shrug, the price is going to be the same or it's going to go down. That's what's involved. It's going to stay the same or it's going to go down for Class I and II. And the Secretary should be able to keep it exactly the same.

The difference between this situation

and the chocolate manufacturers' case, for instance, chocolate milk was changed under WIC. They weren't going to be able to make the product available under the WIC program in the same way that they had before. Their price was going to be the same.

The dairy farmers throughout the country, the 50,000 dairy farmers in the program, are going to be required to have their income reduced for the benefit of the Class I and II processors, who have made no case for it, and we are not going to be able to say anything about it if Dr. Cryan is not allowed to present his testimony on behalf of the National Milk Federation and all its members, including the cooperatives in the Association of Dairy Cooperatives in the Northeast, who I represent.

It is certainly within the hearing notice, as Dr. Cryan has more ably explained on a technical analysis basis. And, you know, Mr. Rosenbaum put a boldly printed exhibit up here which purports to represent what these formulas are, and Dr. Cryan pointed out it's wrong. It is wrong. Look at Exhibit 16, okay. The formula that creates Class I and II prices is not the Class III and IV make allowance formula. I asked Mr. Rourke about that the first day.

Your Honor, the Secretary should have the latitude of this hearing record to hear the proposal and make his expert decision upon how these difficult economic issues should be addressed, how the losses can be mitigated as to dairy farmers for whom this program is intended to benefit.

THE JUDGE: Mr. Harner.

MR. HARNER: Good morning. Tim Harner representing O-AT-KA Milk Products Cooperative and Upstate Farms Cooperative, which owns and operates plants marketing Class I and Class II milk.

Upstate and O-AT-KA support Agri-Mark's proposal at this hearing, and we oppose the motion to prevent National Milk, the largest organization representing dairy farmers in the United States, from testifying about every aspect of Agri-Mark's proposal, including how best to implement the emergency changes in the Class III and Class IV make allowances. I agree with the arguments made by Dr. Cryan and Mr. Beshore against this motion.

The notice and the Department's prehearing analysis of the proposal made it clear that this hearing would involve issues such as impacts on Class I, on Class II, and on producer income resulting from the emergency changes in the Class III and Class IV make allowances that were being proposed by Agri-Mark.

Furthermore, whenever a change is proposed in the status quo, it is necessary and desirable to discuss how best to implement and interface the proposed change with the status quo, as National Milk's testimony would do. Testimony about such implementation issues will certainly benefit the Department as it analyzes how best to respond to the emergency conditions addressed by Agri-Mark's proposal.

Finally, I want to stress the immense importance of permitting National Milk to testify regarding how best to mitigate the reduction in dairy farmer revenues that will result from Agri-Mark's proposal.

At this hearing, we have listened to testimony from a number of dairy farmers, emotionally charged testimony from a number of dairy farmers, talking about the impact that a reduction in their income would have on their farms and in their lives.

Therefore, I respectfully submit that National Milk, the largest organization

representing dairy farmers in the United States, should be allowed to testify fully about how best to reduce the adverse impact of Agri-Mark's proposal on dairy farmers.
Thank you.

THE JUDGE: Others I have not heard from?

Very well. At issue before me is whether a modification of the proposal should be entertained. It has been objected to as being beyond the scope and parameters of the notice. The modification contained in the statement which has been tendered as Exhibit 58 would apply the adjustment to the make allowance only to Class III and Class IV milk, arguing that the products that are affected are Class III and Class IV.

Prior to this hearing, the analysis of the proposal that was done by the Department of Agriculture as part of the prehearing process clearly did not consider the impact of such a modification. And indeed, the hearing notice contains the language that I exchanged with Mr. English. The argument of counsel further highlights the problems injection of such a modification might precipitate.

I further note that this proposal, which was noticed as being heard on an expedited basis, and that many witnesses have attested to, that a decision at the earliest possible date is critical to their continued existence.

Due to the significant financial impact which will likely follow any adjustment, consideration of a modification which has not been subjected to a thorough and deliberate analysis, I think, is unwarranted. For that reason, I'm going to sustain the objection at this time.

At this point, if Dr. Cryan wishes to modify his statement, in other words, I will allow him to do so rather than accepting the deletions which have been suggested, although, certainly, they may guide him in what may or may not be done.

As far as proceeding further at this time, Mr. Pittman indicated earlier that he had to leave by noon. So I think at this time we'll take him and his testimony. This will allow any time for Dr. Cryan and the supporters of his proposal to make any necessary adjustments. Alternatively, if you wish to recess at this time, we may do that.

MS. DESKINS: Judge Davenport, maybe a five-minute recess for people to determine what witnesses they want to call based on your ruling --

THE JUDGE: Let's go ahead and do that, then. Let's take a five-minute recess.

[Whereupon, the hearing recessed at 9:28 a.m. and reconvened at 9:36 a.m.]

Whereupon,

THOMAS PITTMAN,

having been first sworn by the judge, was examined and testified under oath as follows.

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

THE WITNESS: My name is Thomas Pittman, P-I-T-T-M-A-N.

THE JUDGE: Very well, Mr. Pittman -- excuse me. Mr. Rosenbaum.

MR. ROSENBAUM: Your Honor, I don't represent Mr. Pittman or his company, I just want to point out Mr. Pittman has a written statement, the last paragraph of which covers the issue that we just got through resolving. I talked to Mr. Pittman during the break, and I think his intention is not to read that last paragraph --

THE JUDGE: Very well.

MR. ROSENBAUM: -- as a result of Your Honor's ruling. But I think since the document may be entered as an exhibit I would just, you know, ask that we would treat the last paragraph as being stricken.

[Whereupon, Exhibit 61 was marked for identification by the judge.]

THE JUDGE: Very well.

MR. Pittman, you have a written statement which has been marked as Exhibit 61. Are you prepared to read that portion of it into the record?

THE WITNESS: Yes, sir.

THE JUDGE: Very well. You may proceed.

STATEMENT FOR THE RECORD OF THOMAS PITTMAN

THE WITNESS: My name is Thomas Pittman and I am employed as Director of Milk Accounting and Economic Analysis for Southeast Milk, Inc. The business address is 1950 SE Highway 484, Bellview, Florida 34420.

Southeast Milk, Inc., (SMI) is a dairy cooperative that markets milk for almost 300 dairy producers in Florida, Georgia, Alabama and Tennessee. The cooperative markets over 2.9 billion pounds of milk annually in Florida and the Southeast orders combined and is the twelfth largest cooperative in the United States. The predominant market for SMI's is Class I, regulated, bottling plants.

The Class I utilization of Federal Order 6, the Florida Federal order, averages over 82 percent throughout the year. The remaining Class II, III and IV utilization in the order is comprised of some ice cream manufacturing by Class IV pool plants, inventory classification, small manufacturing plants milk usage, dumped milk, shrinkage, etc.

The Class I price that accounts for the majority of the producers' pay price in Florida is based on the advance Class III and IV Federal order prices. Annually, the Class

I mover accounts for about 65 percent of a dairy farmer pay price in Federal Order 6. If a change is made to the Class III and IV product price formulas without regard to the impact on the Class I market, the pay price to the dairy farmers of Florida is directly impacted. Exhibit 13, page 3, as presented by USDA, represents the calculated impact to the Class I mover and the Class I prices under all proposed scenarios for Federal Order 6.

Under the best-case scenario, SMI producer income would be reduced by $6.3 million annually, and under the worst-case scenario producers will lose almost $14 million in revenue in one year alone. SMI producers located in Federal Order 6 and 7 cannot sustain this loss.

Under each scenario, economic analysis provided by the Department demonstrates little change in the price of fluid milk at the retail level. The change that is predicted by the model shows a fluid milk price decrease to the consumer. The dairy farmers concentrated in the Class I market are absorbing the price decrease experienced by the consumers, which is at the expense of the southeast dairy industry.

Although the Florida and Southeast Federal Orders do maintain a reasonable level of over-order premiums, the revenue lost by the change in the Class I mover and subsequently the Class I Price and Uniform Blend Prices will be very difficult to make up through additional premium. The revenue will be a direct loss to the dairy farmers supplying the Class I market. The dairy industry in the Southeast and Florida is struggling to maintain a local supply of milk to meet consumers' fluid milk needs. Since 1990 to 2004, milk production decreased from 16.2 billion pounds to 11.4, or 11.7 billion pounds. That's a 28 percent decrease, while in that same period U.S. milk production grew over 15 percent to 170.8 billion pounds. Alabama, Arkansas and Louisiana, which reside in the Southeast Order, cannot even produce enough milk to supply even 50 percent of the consumers' Class I or fluid needs.

The southeast dairy producers, especially producers located in Florida, face unique challenges not present in other regions of the United States. Weather conditions such as hurricanes, long spells of hot, humid weather, escalating land values and stringent environmental regulations have led to the decline in dairy farms. Any reduction in the Class I price will expedite the decline in production to the point that the southeast dairy industry will have no chance of recovery.

Florida's population from 1990 to 2000 grew almost 24 percent according to the U.S. Census Bureau. With the projected increase in Florida's population in the year 2030 at 80 percent growth from 2000, it will be very difficult for local milk production to keep up with consumer consumption of fluid milk. Georgia is expecting a growth of 48 percent from the year 2000 to 2030. The southeast and Florida will be one of the fastest growing areas in population in the United States. The fundamental challenge, as provided by the AMA, is to insure a sufficient quantity of pure and wholesome milk and be in the public interest. SMI believes that the southeast must focus on maintaining a long-term, local supply to meet the stated objectives. It is vital to the southeast diary industry to keep dairy farmer income levels in this region at levels that will sustain local milk production and support the needs of the growing population.

I have attached a table from the U.S. Census Bureau indicating that by the year

2030, the population in Florida and Georgia is projected to increase by 80 percent and 47, respectively, which both are in the top eight states for population growth.

SMI operates an ultra-filtration (UF) plant located in Baconton, Georgia, from December through July of each year. This balancing plant operates to process surplus milk only when the fluid market does not need the milk or cannot hold the milk during the holidays or extreme weather conditions. SMI's own plant does experience the same issues with energy and labor cost increases that the rest of the manufacturing plant community encounters.

While SMI recognizes and appreciates the need to adjust the make allowances for the plight of dairy manufacturing plants, the Class I market cannot be sacrificed at the same time. The Department cannot solve one issue in the manufacturing arena without earnestly evaluating the impact on the entire industry. The dairy farmers that supply the fluid needs of the country should not be asked to subsidize the manufacturing market. Therefore, SMI opposes Proposal No. 1.

THE JUDGE: Examination of this witness? Mr. Yale.

Exhibit 61, with the deletion of the last paragraph, will be admitted at this time.

[Whereupon, Exhibit No. 61 was received in evidence.]

EXAMINATION

BY MR. YALE:

Q. Benjamin F. Yale on behalf of Select Milk, Continental Dairy Farmers, Zia Milk Producers, Lone Star Milk Producers and Dairy Producers of New Mexico. Good morning.

A. Good morning.

Q. Just a couple questions. You have sat through this hearing, I think the entire hearing, have you not?

A. No, just yesterday and this morning.

Q. So you did not hear Dr. -- or I guess he's not a doctor, I guess I'm imposing a Yale degree on him, but Mr. Wellington testify?

A. No, I did not.

Q. Based on your testimony, are you indicating that the economic conditions for the dairy industry in the Southeast differ from other regions of the country?

A. Yes, I am.

Q. And are you also indicating that -- I mean, does the Southeast have concerns about the cheese plants or other plants like that in this market?

A. There are no others. There's one cheese plant in Alabama that would do a little business, would supply some surplus milk from time to time, but otherwise we really have no other concerns.

Q. The other thing I noticed in here, you talk about you balance with a UF plant?

A. Yes.

Q. And that is, you concentrate the milk and remove some lactose and some minerals, and then you move that milk to other parts of the country. Is that correct?

A. That is correct.

Q. And under the current order system, is there a consideration to you to cover the cost of that balancing plant under the blend pricing system?

A. There is nothing under the Federal order system that helps us recover any cost.

Q. There's no make allowance?

A. No make allowance at all.

Q. Approximately what is the cost to concentrate milk? Do you know what that is, by any chance?

A. We have a standard that we assign for the plant. The exact cost at this point, I can't recall right off the top of my head what it is. But I will not share the standard cost. That would be confidential.

Q. I understand that. But it is a significant cost?

A. Yes, it is.

MR. YALE: I have no other questions.

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

MR. BESHORE: I have no questions.

THE JUDGE: Very well. Mr. Vetne.

EXAMINATION

BY MR. VETNE:

Q. Hello, Mr. Pittman. John Vetne, counsel for Agri-Mark.

Can you share for the record information about the average size, either by cow or production, of producers in Florida?

A. The average for Florida only or for SMI?

Q. Oh, for SMI.

A. For SMI. The average size, I believe, is right around 700 cows.

Q. Is the Florida portion greater than that?

A. The Florida portion would be slightly greater than that, yes.

Q. In paragraph 5, you provide some numbers on scenarios of income reduction. Are those from the McDowell model?

A. Those were supplied in Exhibit 13 for page 3.

Q. Exhibit 13?

A. Where the Class I mover was calculated as to what that change would be.

Q. So those numbers, to your knowledge, don't factor in however the marketplace may respond in the future to the changes in these relationships?

A. No, they don't. And that just represents the first year of what the losses would be.

Q. Okay. And that is a reference to the portion of producer income that comes from minimum prices and blend price. It doesn't reflect the factor for any other portion of income?

A. That would reflect the reduction based on that analysis, reduction of income based on that analysis on an annual basis.

Q. It's just a class regulated-price portion of the --

A. Correct.

Q. And the last full paragraph, you refer to milk production decrease between 1990 and 2004. What geographic region are you encompassing in that analysis?

A. That is the Southeast region, which we refer to as east of the Mississippi and south of the Mason-Dixon Line.

Q. So it includes Alabama, Kentucky, Tennessee and the Carolinas as well as Florida?

A. Correct.
Q. You joined the SMI staff when?
A. Eight, nine months ago.
Q. Prior to eight, nine months ago, what were your responsibilities?
A. I was senior supply manager for Unilever based out of Green Bay, Wisconsin.
Q. For how long?
A. For almost four years.
Q. The manufacturing outlets that SMI has for its seasonal surplus production in the Southeast are extraordinarily limited. Would you agree with that?
A. Yes, they are.
Q. Do you have any knowledge of how the availability of Southeast manufacturing capacity has changed over the last 10 or 15 years?
A. From my observance in the industry for that period of time, the disappearance of the plants did occur in the Southeast. And I

think at the rate they disappeared, it was more in conjunction with milk supply decreasing in that area.

Q. All right. Are you aware of any analysis that has been done with respect to that issue providing us a chicken and egg, which came first, milk supply disappearing because of lack of available plants or plants disappearing because of lack of milk? Are you aware of any study?

A. No, I'm not.

Q. It is true, nevertheless, that as a result of disappearance of manufacturing capacity in the Southeast, that producers, including SMI producers, incur greater costs than in the past because they have to haul their surplus milk longer?

A. That is correct.

THE JUDGE: Mr. Schad.

EXAMINATION

BY MR. SCHAD

Q. Dennis Schad, Land O'Lakes. Good morning.

Just one question. I heard you say that your former employer was Unilever. Could I ask some general questions, and tell me whether I'm out of bounds, please.

A. Okay.

Q. But in your capacity for working for Unilever, did you buy and sell cream?

A. Purchase cream only.

Q. Purchase cream. Could you share with us the details and the form of transaction, how -- how was it priced?

A. It was priced off the CME butter market times a multiplier.

Q. Thank you.

THE JUDGE: Other questions of this witness? Very well. Thank you, Mr. -- excuse me. Dr. Cryan.

EXAMINATION

BY DR. CRYAN

Q. Roger Cryan.
Tom, do I understand your opposition to this is based largely on its impact on Class I and Class II milk prices?
A. Mainly based on the Class I milk prices, yes.
Q. Thank you.
THE JUDGE: Other questions? Mr. Yale.

EXAMINATION

BY MR. YALE:
Q. Mr. Pittman, just to follow up on that last question, had the issue of decoupling Class I and II gone differently this morning, would you still oppose the proposal?
A. We still would have opposed the proposal because the testimony was prepared before this morning's ruling.
THE JUDGE: Other questions?
Thank you, Mr. Pittman. You may step

down.

It's -- I'm sorry. Mr. Beshore.

MR. BESHORE: Do I understand that Exhibit 61 in its entirety will be made part of the record?

THE JUDGE: Exhibit 61 is in the record. However, there is a notation that the last paragraph is deleted.

MR. BESHORE: And I ask that because the rules of practice specifically require that any material ruled out by, you know, Your Honor accompany the record because the Secretary has the opportunity to review those rulings in the course of the decision-making process and, therefore, shall be afforded the opportunity to have that information.

THE JUDGE: Well, it obviously is still readable.

MR. BESHORE: And it is part of the record?

THE JUDGE: Yes, sir.

MR. BESHORE: Thank you.

THE WITNESS: Thank you, Your Honor.

THE JUDGE: At this time, it is five minutes of 12:00. Let's go ahead and take our morning break at this time. And let's be back at 10 minutes after 10:00.

MR. ROWER: Ten, Your Honor.

THE JUDGE: I'm sorry?

MR. RASTGOUFARD: Five minutes of 10:00, not five minutes of 12:00.

THE JUDGE: It is five minutes of 10:00. Let's be back at 10:10.

[Whereupon, hearing recessed at 9:54 a.m. and reconvened at 10:09 a.m.]

THE JUDGE: We are back in session.

Whereupon,

DR. ROGER CRYAN,

having been first sworn by the judge, was examined and testified under oath as follows.

THE JUDGE: Please tell us your name and spell your last name, please.

THE WITNESS: My name is Roger Cryan. It rhymes with Ryan. It's spelled C-R-Y-A-N. I represent the National Milk Producers Federation. I will, in my testimony, refer to my statement as it has been amended by Your Honor and Mr. Rosenbaum.

STATEMENT FOR THE RECORD OF ROGER CRYAN

THE WITNESS: Again, my name is Roger Cryan. I have been Director of Economic Research for the National Milk Producers Federation for five years. Before that, I was the economist in the Atlanta Milk Market Administrator's office. I have a Ph.D. in agricultural economics from the University of Florida, I am a member of the Secretary of Agriculture's Advisory Committee on Agricultural Statistics, and I have been involved with agriculture and agricultural economics for 25 years.

NMPF is the voice of America's dairy farmers, representing over three-quarters of the country's 67,000 commercial dairy farmers through their memberships in NMPF's 33 member cooperative associations.

The National Milk Producers Federation supports the proposal of Agri-Mark, Incorporated, to adjust the manufacturing cost, or "make," allowances for cheddar cheese, nonfat dry milk, butter and whey -- the benchmark products in Federal order pricing -- in order to account for rising costs and provide emergency relief to the manufacturers of these products.

At this point, there is a deletion reflecting the outcome of this morning's motion.

Further, NMPF urges that an indexing mechanism for energy costs be used to adjust these make allowances each month.

Since 2000, manufacturers of cheddar cheese, butter, nonfat dry milk and whey subject to Federal orders have faced manufacturing margins whose maxima are defined under Federal order price formulas. The "make allowances" for these products are the margin that their makers are allowed between the average surveyed price of their product and the minimum price they must pay to the producer pool for the milk they use to make those products.

The make allowances included in the current Federal order price formulas are derived from manufacturing cost surveys conducted in 1998. Those make allowances initially provided a reasonable return to the makers of those products. However, changes in the cost of production, most especially fluctuating energy prices, have made them less and less valid, until today they prejudice the ability of federally regulated plants to compete with unregulated and state-regulated plants.

Federal order milk prices are

minimums, so that if the demand for milk is strong enough, the market will produce price premiums above the USDA-set minimum. By contrast, make allowances define a maximum milk-to-cheese margin that the average cheddar cheese maker, for example, can get for his trouble. Since the current formulas define milk prices as a fixed function of the product prices, the milk price rises when the average product price rises. If the fixed margin becomes inadequate to cover the costs for the average plant, there is no room for processing premiums. That is, while market forces can correct regulated milk prices that are too low, the make allowance can only be adjusted by USDA. Under current conditions, these make allowances are too low for Class III and Class IV.

This undermines the ability of Federal order-regulated, Federally regulated plants to operate. This, in turn, undermines

Federal orders, which rely on manufacturing plants, including especially cooperative plants and cooperative-supplied plants, to balance overall milk supplies. If these outlets are pushed into state-regulated or unregulated markets, they cannot effectively provide those services, putting all participants in Federally regulated markets at a disadvantage.

Following the especially sharp run-up in energy costs in recent years, there is a general consensus that Federal order make allowances need adjustment with respect to Class III and IV. NMPF Supports the Two-Step Implementation of Proposal 1 to Update and Index.

We support Proposal 1 as noticed, and agree with the reasoning articulated by Agri-Mark in its original petition. The current Federal order price formulas contain fixed make allowances for manufacturers of cheddar cheese, whey, butter and nonfat dry milk powder. When market prices increase for these benchmark products, the Federal order formulas dictate that they must automatically pay a higher price for their milk. Their margin is fixed, even if their costs rise. We agree with Agri-Mark that the current fixed make allowances have become increasingly inequitable and support change to the make allowances for Class III and Class IV milk handlers, as requested in the proposal.

We urge the implementation of this process through a two-step revision of the make allowances.

First, NMPF supports a recalculation of the underlying make allowances, using the cost of processing data from the regular survey conducted by the California Department of Food and Agriculture and comparable results of the recent survey conducted by

USDA's Rural Business Cooperative Service.

The data contained in these surveys should be combined according to the same basic methodology developed and used by USDA in the November 7, 2002, final decision, cited here. This methodology was well-justified in that decision and provides the soundest basis for speedy decision in this proceeding. NMPF urges that USDA implement the recalculated make allowances immediately and on an emergency basis.

Second, NMPF urges the inclusion of a monthly indexing adjustment to the energy cost components of the recalculated make allowances. The most volatile element of cost by far has been energy. Increases in other costs have been more gradual and have been partially offset by increased productivity in the manufacturing process. Energy price increases in recent years have overshadowed other cost changes and gains in productivity. These increases have not been covered by the fixed make allowance. The drastic rise and fall of these costs makes a one-time fixed increase in the make allowances inappropriate beyond an interim emergency decision. When energy prices rise dramatically, fixed make allowances will fail to provide adequately for plant costs; and when they fall precipitously, they would similarly provide an unfair windfall to processors at the expense of producers. NMPF therefore urges USDA to adopt a mechanism that would adjust the make allowances on a monthly basis for changes in energy costs, using the most recent Producer Price Indexes for Industrial Energy and Industrial Natural Gas.

NMPF urges USDA to avoid unnecessary delay in implementing energy indexing; however, NMPF also acknowledges the need to provide manufacturers of the benchmark products specifically with immediate relief from inadequate manufacturing cost allowances. For those reasons, NMPF asserts that USDA should proceed immediately and on an emergency basis through an interim final rule to implement recalculation of the make allowances based on updated 2004 costs. If, for some reason, the issue of adjusting for energy costs cannot be included in that interim final rule, then that issue should be subsequently addressed in the final rule that results from this proceeding.

In an attachment to this statement we have included proposed language that would effect the make allowance revisions that we are recommending, including language for an interim final rule that would not include provisions for energy cost indexing.

Following is a long, stricken section as a result of this morning's proceeding.

A dairy product priced-based formula

for milk prices depends upon a reasonable make allowance, which in turn depends upon good cost of processing data. As mentioned previously, the cost of processing data upon which the Federal order make allowances are based were, mostly, data reflecting 1998 plant operations. The data sources used at the May 2000 hearing were the annual dairy product manufacturing costs survey conducted by the California Department of Food and Agriculture and a similar but voluntary survey conducted by K. Charles Ling of the USDA's Rural Business Cooperative Service (RBCS). And that is cited. That 2000 decision based on the 2000 hearing is cited.

This data is now eight years old, and inadequately represents the costs of processing in 2006. As a result, the current make allowances impose an undue burden upon processors of Class III and IV benchmark products, as previously explained and as demonstrated by a comparison of the current make allowances with the estimated costs of processing.

The California Department of Food and Agriculture conducts an annual cost of dairy processing survey in order to define make allowances in minimum price formulas very similar to those used in the Federal orders. This survey is audited and participation by California processors is nearly 100 percent for butter, powder and cheese and nearly 80 percent for whey.

The most recent results of this survey -- I'm sorry. That first Exhibit 25 is the data discussed in this testimony. This is an aside, and I would ask that the transcript reflect my verbal testimony. Thank you. This refers to Exhibit 25, and Exhibit 26 is also on the record. This data from the California Department of Food and Agriculture is all relevant to consideration of my testimony.

The most recent results of this survey were released on November 18, 2005, and amended on January 13th, 2006. This data is based upon "unadjusted cost studies for periods between January and December 2004." The amended survey results are summarized in context in Table 1.

And in addition, I have attached a Table 3 that provides in one place more clearly the detail on energy costs for the California plants based on Exhibits 25 and 26.

K. Charles Ling of USDA Rural Business Cooperative Service conducts a periodic cost of dairy processing survey as technical assistance to participating dairy farmer cooperative associations. Revised data from this survey was also released on January 13th, 2006. This data is based upon a voluntary survey of dairy farmer cooperative associations that process cheese, nonfat dry milk, butter and dry whey. Methodology -- Regarding the Methodologies for Pooling Survey Data.

The CDFA and RBCS surveys provide non-overlapping data of comparable value. Taken together, they are representative of U.S. processors of cheddar cheese for which surveyed plants in these two studies represent 41 percent of U.S. production; butter, where they represent 51 percent; nonfat dry milk, where they represent 81 percent, even after excluding the high cost of California plants, as they recommend below; and dry whey, where they represent 45 percent of U.S. production.

The data contained in these surveys should be combined according to the same methodology developed by USDA and used in the November 7, 2002, final decision cited here with a single minor exception detailed below.

In 2002, the lower-cost group of butter plants from the California survey was excluded from the calculation of the average plant cost. Cited here. That cites the 2002 decision.

The butter plants in this California survey are still represented by CDFA in two groups, but the lower-cost group represents more than 75 percent of the total volume surveyed in California, which is more than 45 percent of the total volume in both surveys and 23 percent of total U.S. butter production.

And here I cite the Dairy Products report from USDA National Agricultural Statistic Service. The most recent issue is 2006, and I listed a website which it could be found.

We believe that the justification for excluding this volume no longer exists, as it appears to be representative of a very large share of U.S. butter production and of the available data. NMPF's calculation of the updated make allowance, which is included in Table 1, does not exclude data about this group. This is the only departure that we propose to make from the 2002 USDA methodology, I believe.

In 2002, the highest-cost group of nonfat dry milk plants was similarly excluded as generally unrepresentative of nonfat dry milk production at market balancing plants, partly because their exceptionally high costs and small size suggested that they were statistical outliers. Since these three plants represent less than 3 percent of U.S. production -- and again, I cite the Dairy Products report for January 2006 that I previously cited -- and just over -- and they also represent just over 3 percent of the production captured in the two surveys, it would be reasonable to exclude them for the same reasons that they were excluded in 2002. Our calculation of the make allowance in Table 1 excludes data regarding this group.

In 2002, the RBCS packaging materials costs for butter were replaced with those from the CDFA study. Again, the 2000 decision is cited. This was based on the existence of a large volume of print butter in the RBCS survey, whereas the CDFA survey included only bulk butter. Since the product price formula is based upon bulk butter prices, the CDFA packaging materials cost was considered more appropriate. Since 44 percent of the butter in the RBCS survey of 2004 costs were prints, this rationale still holds. NMPF's calculation of the make allowance in Table 1 continues to use the butter packaging cost data from the CDFA survey.

In 2002, the appropriate CDFA numbers for "return on investment" and "general and administrative costs" were added to the RBCS numbers. We have done the same in our calculations. And that decision of -- the 2002 decision is again cited.

NMPF believes that any increases in the fixed components of the make allowance should be conservative. It has been asserted by some that yield improvements in manufacturing, based perhaps on such marginal improvements as decreased shrinkage in handling, may partially offset some of the cost increases captured in the survey data. To the extent that there are other uncertainties in the reapplication of the methodology used in 2002, USDA should err on the side of a more conservative increase. We anticipate that a more complete consideration of all elements of the price formulas will be taken up in a future proceeding.

The proposal to recalculate the make allowances using updated 2004 survey costs should be addressed and implemented immediately and on an emergency basis. The methodology of the 2002 decision was well-justified in the course of that proceeding. And I cite it again. Any major deviation from that original approach could well delay the implementation of an interim final decision.

As stated above, Federally regulated plants processing the four benchmark products are at a considerable disadvantage to unregulated plants, and are generally unable to cover their competitive costs. For this reason, an emergency decision is called for the relief of the manufacture of those benchmark products.

Of all components of manufacturing costs, the most volatile by far are energy costs. These can swing violently, while such costs as labor, sewage, laundry and insurance tend to move slowly and consistently.

And I have included in my statement, my printed statement, a graph that demonstrates the large changes in volatility of natural gas and, to a lesser extent, electricity relative to -- compared with my other Producer Price Indexes that are -- that pertain to the dairy industry.

A fixed make allowance, such as the current one, depends upon on estimated energy cost at a single point in time. If the current make allowances for whey and nonfat dry milk were adjusted for increases in electricity and natural gas cost since 1998, they would now be higher than the updated cost as calculated above. On the other hand, if a fixed increase were to be implemented on the basis of the extraordinarily high energy costs incurred in late 2005, for example, the resulting make allowance is likely to be excessive in the near future, as energy prices are expected to regress toward their long-term norms.

A regular adjustment to this highly volatile element of the cost of dairy processing is the best way to maintain equity between producers and processors of the benchmark products.

In the interest of equity and of maintaining each market's capacity for balancing, the Federation urges that the final rule that results from this proceeding include formulas to provide for monthly adjustments of processors' energy costs, based on published Producer Price Indexes. Such indexing would allow specific and regular adjustments -- both up and down -- to reflect changes in plants' costs of natural gas and electricity.

NMPF recommends that the energy index adjustments be calculated from the Producer Price Indexes for Industrial Natural Gas, which is BLS Series WPU0553 with the base of

December 1990, and Industrial Electric Power Distribution, which is BLS Series WPU0543, which has a base of 1982, weighted by the direct costs of electricity and fuels per pound of product, as estimated for 2004 by USDA/RBCS and CDFA. In order to adjust the costs measured for 2004 by CDFA and RBCS, the 2004 annual average of each of these Producer Price Indices would be used as a base. The 2004 annual average PPI was 201.7 for Utility Natural Gas and 147.2 for Industrial Electricity Distribution.

Although a modest one-time adjustment could move the formulas closer to equity under current conditions, a new fixed make allowance could already be out of date when it is implemented. It will unfairly penalize processors when input prices go above the baseline in the revised survey, and unfairly penalize producers when input prices go below the baseline. An energy cost indexing element can and should be added to the formula.

Once the make allowances are updated with the 2004 survey data, we recommend adjusting them each month to account for the often violent rise and fall of energy costs. We recommend that the Electricity and Fuels elements of plant costs be inflated or deflated according to the following formula, as I demonstrate here, which in effect takes the current Producer Price Index, divides it by the baseline Producer Price Index and subtracts by one to get, in effect, the percentage increase and then multiplies it by the relevant cost, both for electricity and for fuels.

The energy costs to be inflated could be averaged from the RBCS survey and the CDFA survey. Or, if CDFA data is not offered at this hearing, although it has been, it could be taken directly from the RBCS survey or whichever survey is determined to be most appropriate by the Department.

The objective of the formula is to adjust the energy components of the cost of processing for each benchmark commodity. Energy is by far the most volatile element of processing cost. Automatic adjustments to energy costs will cause the make allowance to more consistently reflect the cost that it is intended to reflect. The resulting make allowance would be neither too high or too low, as energy costs swing up and down.

Average 2004 electricity and fuels cost from RBCS and CDFA would be used as the base for this adjuster. The following 2004 data were compiled by RBCS and CDFA, and are used to calculate a volume-weighted average of the two sets, which we propose to use as the energy cost adjustment factor in the make allowance formula.

Table 2. Table 2 shows the average

plant costs of electricity and fuels from the two surveys excluding the high-cost powder plant in the CDFA survey. But again, as I said, the attachment Table 3 contains adequate detail to allow the Department to consider alternatives and make their own calculations. Those numbers are available from CDFA exhibits previously presented. Based on CDFA numbers, Table 3 is an accurate representation of those and provides the detail necessary for more thorough consideration. We recommend these numbers as the best use of the available data to establish a baseline set of energy costs.

Producer Price Indices are published by the Bureau of Labor Statistics as a measure of changes in the prices of a large number of inputs to production. The prices for some inputs are measured separately for residential customers, commercial customers and industrial customers. Industrial customers include manufacturing and mining. The Indices are published monthly, in mid-month. All the other months are relative to the base of a hundred in other manufacturing.

This series tracks the average price of natural gas sold by utilities to industrial customers, again defined as manufacturing and mining operations. A note from the economist who works most directly with the Producer Price Index at BLS is attached to my statement and the detail of this note clearly distinguishes the Industrial Natural Gas Index as the one most directly applicable to manufacturers cost of energy.

The same definition for the confusion -- the most likely confusion there is that there is a series -- there is a natural gas series that is not well-identified in the website, the BLS website, which refers to natural gas from the wellhead, and is that not -- that is not relevant to costs of the manufacturer. What is relevant to the cost of manufacturer is this specific series, which is specifically a price index with respect to natural gas sales to industrial customers by the same -- I'll pick up where I left off.

The Producer Price Index for industrial electric power distribution is designated as BLS Series WPU0543. Its base period is 199 -- 1982; that is, the index is set equal to 100 for the annual average of 1982. This series tracks the average price of electricity sold by utilities to industrial customers, defined as manufacturing and mining operations.

Both of these series can be retrieved from the following page on the website of the Bureau of Labor Statistics using their Series ID numbers, and the website is indicated.

And the series ID numbers can be entered into a box on that site in order to call up these series.

In order to adjust the cost measured for 2004 by CDFA and RBCS, the 2004 annual average should be used as a base, as in the formula above and in the attached language. The 2004 annual average PPI was 201.7 for Utility Natural Gas and 147.2 for Industrial Electricity Distribution.

The only consistent series of manufacturing costs over time is for California. This series provides a means of testing that fit proposed energy cost adjustments to the make allowance.

The graph attached here, which should be graph, Figure 2, shows the annual California cost survey results for cheddar cheese and nonfat dry milk, along with make allowances for each, adjusted with our proposed electricity and natural gas adjusters. Although the energy costs don't account for all of the long-term changes in manufacturing costs, they do appear to clearly account for much of the year-to-year variation. And there is a typo there of some type. I would strike "the annual California costs of processing are."

Energy -- especially natural gas -- costs are a large share of the cost of processing nonfat dry milk. Cheese costs in California have been trending downward over 15 years. This long-term trend may or may not be representative of the nation at large. Nevertheless, the proposed make allowance adjustment does reflect much of the year-to-year variation in California cheese processing costs. The graph shows how closely an adjusted make allowance fits the changes in California costs for cheese and nonfat dry milk.

The proposed butter cost adjustment

also correlates with changing costs in California butter plants, but uniquely among these products, non-energy costs have risen considerably more than energy costs, so that it does not show up easily in a simple graph.

California whey costs were not collected before 2003. For this reason, we are unable to directly test the fit over time of our proposed energy index for whey, as we have for butter, nonfat dry milk and cheese. However, whey drying is so similar to nonfat dry milk production that we can reasonably assume, as USDA did in order reform and its 2002 decision, that whey processing costs are closely related to nonfat dry milk processing costs. And we suggest that the evidence for nonfat dry milk also represents evidence for whey.

That's not to suggest that the make allowances should be the same for nonfat dry milk and whey, just that the relevance of energy cost index for nonfat dry milk would bear out the same energy cost indexing for whey is appropriate.

The energy price indexes that we propose to be used are calculated each month by the Bureau of Labor Statistics. The make allowance should be as current as possible by monthly updating. This would provide for smaller month-to-month changes than if adjustments were made quarterly or annually. Just as the milk price formulas are calculated and applied each month as a formula of the dairy product prices, so should an energy cost formula be calculated and applied each month in the revised formulas.

Processing costs from 1998 are not an appropriate basis for calculating make allowances in 2006. However, a single fixed adjustment for all costs will almost certainly be either inadequate to processors or inequitable to producers within months of its implementation. The formulas need to be adjusted not only to reflect more current costs, but also to take into account continuing fluctuations in energy costs. The use of an energy price index in the formula is the best and fairest way to deal with this issue.

Revised make allowances with energy cost indexing would provide specific relief to the Class III and IV plants manufacturing cheddar cheese, nonfat dry milk, butter and whey and squeezed by higher energy costs, then reduce make allowances again when the squeeze is off.

This hearing is being held on an emergency basis to provide relief to manufacturers of the benchmark products whose prices are used to set minimum milk prices, and this relief should be provided as soon as possible. If this requires that an interim final rule be issued without indexing, NMPF would support the issuance of such an interim rule. However, only the application of indexing for energy costs would ultimately ensure that make allowances are fair and equitable.

At this point a sentence was stricken which represents an integral part of National Milk's position but is not allowed based on the ruling issued this morning.

We urge Dairy Programs and the Secretary of Agriculture to target this decision to the emergency at hand by issuing a prompt interim final rule to adjust make allowances with 2004 data -- again, there is a stricken section -- and by implementing energy cost indexing in this proceeding's final rule.

And again, I would indicate for the record that my organization's position extends beyond this testimony and has been curtailed by the motion that was attempted to make -- was accepted this morning.

I then have an appendix with language effecting our proposed changes. It is similarly amended by Your Honor and Mr. Rosenbaum. I will not go over it except to point that Section 1000.50(q)3, the advance butterfat price is calculated independently of the Class III and IV make allowances, and there should be consideration given to the possibility that that is, therefore, not appropriately altered in this hearing.

I also have Table 3 attached to the end, which I described during my testimony as an aside, and the e-mail communication from Ms. Melissa Wolter at BLS, who was the economist who handles Producer Price Index for the commodities that we discussed, including both natural gas and electric power distribution.

I have some additional comments.

Table III contains simple averages across plants for energy costs. They are simple averages of California plants. Although the CDFA provided averages for groups of plans that have different numbers of plants in each group, those numbers of plant, as indicated by Ms. Reed's testimony, are the same numbers of plants as -- are in the same groupings in their general exhibit, that is to say, three low-cost powder plants, four medium-cost powder plants, three high-cost butter plants, four low-cost -- four high-cost butter plants, three low-cost cheese plants and four high-cost cheese plants. And those numbers -- those -- the average of those numbers of plants in each group allows us to weight the averages so that we get a simple average across all plants for an overall average.

National Milk understands that this decision will impact farmers such as those that testified. We do not come to support changes to the Class II and IV make allowances lightly. We sought mitigation of those impacts while supporting a solution to the emergency that prompted this hearing with respect to the manufacturers of benchmark products. That includes the -- our measures to mitigate include to moderate the make increase limited to that supported by the evidence and not go beyond what is supported by the evidence; to index returns to -- index energy costs to return money to producers when it is appropriate; and to define the -- to implement the decision in a way that limited the impact on producers, and -- but that's been disallowed this morning.

We also believe that producers are losing much of the millions that USDA estimates that they would lose under the various scenarios because the -- the producer cooperatives process much of the benchmark products in the U.S., especially commodities, these commodity products. There is a -- I don't know if I can reference it. There is a study by the Rural Business Cooperative Service that indicates the share of each of these products that is produced by cooperatives. That's been published by RBCS and was Charlie Ling. I don't have the exact title for that to make that part of the record or not, but it is appropriate.

Producer cooperatives process much of the benchmark products in the U.S. and producers suffer much of the loss from their plants' inability to break even under the current make allowances. That is to say, there is an offset to the loss of producers from the money that they are already losing as owners of cooperative processing plants.

We would hope, relying on USDA's analysis, that the five-year net impact on the all-milk price, including dividends, could be trimmed down to as little as a penny per hundredweight. Of course, that's not possible, given this morning's decision.

There has been some discussion about the need to consider yields in connection with make allowances. I don't believe that is necessary in gross. There are slight changes, again, based on limited changes in the handling, mostly based upon shrinkage. But the current Federal order yield factors are, at their heart, based on dairy chemistry, which has not changed. It is, in effect -- it's the sort of mass balance analysis that Mr. Yale has asked about repeatedly.

The yields per hundredweight of milk vary because butterfat, protein and other solid content of the milk varies. There has been no change in the yields of the benchmark products, no substantial change in the yield of benchmark products with respect to -- given the component content of a standard hundredweight of milk. The yield formulas that are used now are essentially the same that have been used for quite a long time by manufacturers.

Because we have component pricing in Class III and IV, milk price rises and falls with the yield per hundredweight of milk. That is to say, if there are more components that generate a higher yield, then the price also is higher. If the components are lower, the component contents are lower and the yield will be lower, then the price is also lower.

Regarding the impact -- the relationship between the Class II differentials and make allowances, Class II differentials are 70 cents per hundredweight and are based on the cost of drying and reconstituting Class IV powder and to substitute for Class II milk. Of course, we are here to discuss how those costs have risen. And exactly as much as the record included the make allowances for NDM should increase, there would be some justification that the Class II differential should also increase. It's an identity. The Class II differential should rise by exactly as much as the cost of drying skim milk rises. And that is the effect of maintaining the current -- I'll stop there. The proof of this is the relationship between powder prices and Class II milk would be unchanged if that were the case.

Regarding Class II -- okay, that's fine.

All right, the rest of my comments are excluded, and I'm prepared to answer any questions.

THE JUDGE: Very well. Exhibit 60 as read and supplemented by his oral testimony is now in evidence.

[Whereupon, Exhibit No. 60 was

received in evidence.]

THE JUDGE: Examination of this witness? Mr. Yale.

EXAMINATION

BY MR. YALE:

Q. I'm glad you came back.

A. I don't know if you will be when we are done.

Q. Benjamin F. Yale on behalf of Select Milk Producers and others that we have named in the proceeding. Good morning, Mr. Cryan.

A. Good morning, Mr. Yale.

Q. I want to start kind of almost where you ended. And you make this comment that the yield is a function of dairy chemistry that has not changed. Do you happen to know what the Van Slyke formula is?

A. I do not happen to know.

Q. Do you happen to know what some of the factors are in the Van Slyke formula?

A. I do not. I have discussed this

with manufacturers who know this better than I do. You might have --

Q. So you are not able to discuss the factor of butterfat recovery in the process as part of the yield formula?

A. No. That's the type of handling issue, I think, that would definitely be an issue.

Q. But you make the bold statement that dairy chemistry, since nothing changes --

A. Mr. Yale, if there was something in the decision in 2002 that failed to properly take into account correct equations of dairy chemistry, then that doesn't change the dairy chemistry. It would affect, I guess, the conclusion about what formula should be under the Federal order, but it does not change the dairy chemistry.

Q. But how the plants are able to use and maximize that dairy chemistry to produce cheese is relevant in that yield, right?

A. They are able to use milk to produce products according to basic laws of chemistry, laws of dairy chemistry. If there have been mistakes, if there had been mistakes in the application of that dairy chemistry, that's another matter.

Q. So it is your position that no matter what a plant does with the same test of milk, components of milk, that every plant will generate the same pounds of cheddar cheese?

A. I would say with a given component test, a given volume of milk, there is an asymptotic relationship between efficiency and yield. There is only so much you can get out of a hundred-pound of milk. There is a limit. You cannot go beyond the limit, unlike yield, for example, of milk per cow, which continues to grow because it is based on continued the input or larger volume of feed and water.

And in the case of this yield, we are talking about a specific volume of cheese with a specific content of solids, which can only yield as much cheese as contain the same volume of solids. That's the maximum.

Q. All right. So let me restate it again. Let me ask the question this way.

Is there a range, given the same components of milk, is there a range in which the amount of cheese that can come out of the same component of milk, depending on the method of manufactures?

A. You can be sloppy and you can lose milk, you can lose solids along the way, but you cannot get more -- you cannot get more product. You cannot get more components from your product than you put into the process.

Q. Do you know what the implied yield is under the current Federal formula?

A. Not off the top of my head.

MR. YALE: One moment, Your Honor.

BY MR. YALE:

Q. So I want to make sure that I understand. You are testifying that if a plant receives 3.5 percent butterfat, 3.2 percent protein, or if you want to go true protein you can adjust it, but a fixed percent of protein, that -- and there is no sloppiness, that it will all -- going from plant to plant to plant, that the yield, the number of pounds of cheese that comes from a hundred pounds of that milk will always be the same?

A. No, I'm sorry. You haven't been listening. I said there is an upper limit on the yield that can be derived from a given volume of milk with a specific content of butterfat.

Q. And I asked you --

A. I have said that already, and I'm saying it again, and I'm not going say it again.

Q. All right. So what is the upper limit?

A. I do not know.

Q. Is that upper limit higher than the yield that is implied in the current Federal order program?

A. I do not know.

Q. So then, Dr. Cryan, you have just testified under oath that there can be no change in these yields, that it is mathematical, that it is chemical. And yet, you are saying that there is an upper range, but you don't know what it is, and there is an amount in the Federal order and you don't know what it is.

So how can you make that statement?

A. I think there is a clear concept, and I believe that the USDA staff is smart enough to understand that.

Q. You recognize, don't you, Dr. Cryan, that in fact, there is a higher yield, that there is a higher implied in the make allowance in these products?

MR. VETNE: Your Honor, I would like to interject an objection at this time. The existing Class IV and IV price formula has three major components. One is, what is the selling price of commodity products? Number two, what is a yield for milk used to produce those products? Number three, what is the cost to convert milk to those products?

The only part of those three larger parts of a pricing formula that was noticed for this hearing under consideration is, what is the cost? The yield component is not part of this, and the price component, what is the reference price, is not part of this. Although many of us would like to see a broader look, the hearing is limited to that one issue.

We have probably spent the equivalent of a full day discussing yield, but it is not part of this hearing notice.

THE JUDGE: I tend to agree, Mr. Yale. Let's move on.

MR. YALE: Well, Your Honor, let me go on, because that is a mischaracterization of where we are going to go.

Dr. Cryan has testified that plants cannot pass on their margins. He made that testimony. And I am building the basis to show that they can, in fact, and are passing on those margins in a dynamic market function, and it goes to the heart of their testimony.

THE JUDGE: It is also very difficult to make your case with a witness who is, in other words, testifying in opposition to your position.

MR. YALE: I understand that on cross that's difficult. But it is also capable to establish that a witness who is claiming to be prepared is not prepared to testify to very key issue and to support the broad statements they are making --

THE JUDGE: Let's address the cost issues, and let's leave the yield out of the perspective at this time.

MR. YALE: Well, then, I would like to make a proffer, Your Honor. We entered in an objection at the beginning that the discussion was too narrow; that this issue of yield will, in fact, add 10 to 20 cents to the implied make allowances in these products that these plants never testified about. They come in here and they partially -- including the testimony of Dr. Cryan -- and limit the focus that we are only going look at this piece over here and ignore the other part as if it doesn't exist in an effort to ask this Department to take money away from producers by not giving them the full picture.

And if they are going to take this kind of money from producers, they need to have the full picture. And we believe that we can cross-examine the witness to go to the assumptions of the broad statements that he makes and that just because he -- says its make is implied in the yield as well, and we should have that right to interrogate, and we proffer that that should be part of the record.

THE JUDGE: Your proffer is noted.

BY MR. YALE:

Q. Do you have Exhibit No. 18 in front of you?

A. Describe it for me.

Q. The Charlie Ling study.

A. No, I don't -- I don't believe I do, no.

Yes, I do.

Q. Would you look to page 4.

A. I'm looking at page 4.

Q. All right. These are the make allowances that you are asking the Department to incorporate into the new make allowances under the proposal before the Secretary, is that correct?

A. No, these are some of -- these are costs from RBCS that are one element of the recommended calculation of the weighted average cost to be included in the make allowance.

Q. And what are the other elements?

A. The cost numbers from the California Department of Food and Agriculture as well as some additional adjustments.

Q. And those adjustments that you make are what?

A. They are the same adjustments -- with a minor exception, they are all the same adjustment as the Department made in 2002.

Q. Now, are these make allowances for the production of commodity cheddar cheese under the formula that is used in the current Class III or IV formulas?

A. I beg your pardon.

Q. Are these make allowances reflective of a plant that produces commodity cheddar cheese -- let's just refer to the cheese -- commodity cheddar cheese under the formula that is part of the Class III formula?

A. Which make allowances?

Q. The ones here on Table 4 or page 4 of this --

A. In Exhibit 18?

Q. Yes.

A. That's what we are here to decide.

Q. Okay. Now, these make allowances were derived based upon what yield?

A. They were based upon the operation of milk plants who are subject to the same laws of physics and chemistry as the rest of country.

Q. And on page 4, it indicates under the 40-pound block that that was a 10.7 yield, does it not?

A. I see, yes, it does. It says that. It doesn't indicate what the component test of the milk is.

Q. Do you know what the component tests were?

A. I do not. I would point out that the CDFA studies make a point of indicating component tests of the milk that the study -- whose production the study describes --

Q. And that is --

A. -- which allows a better analysis. And I would also indicate, I would also suggest that if there are ways that the make allowance could be adjusted to take into account any yield issues you have got, you would have to present testimony and make those -- make that argument. I can't offer -- I can't provide your argument for you.

Q. Dr. Cryan, I would never ask you to make my argument for me. The point that I want to point out is --

A. I feel the same way.

Q. The point that I want to bring out here is that you are testifying on behalf of reducing producer prices, and you are not utilizing the full formula.

You would recognize, would you not, that the yield is a factor on the applicability of the make allowance and that there should be an adjustment for the make allowance in these as well as the volumes of milk in those various orders, is that correct, or various studies?

A. Would you repeat the question.

Q. Yes. Let's break it down into parts.

You would agree that there are different yields that are shown up on these studies. Page 4 shows two yields, the California study shows another yield, does it not?

A. Those are different yields per

hundredweight of milk.

Q. That's right.

A. Milk varies in its component test.

Q. I understand that. And the ability -- but we also -- the yield is also a function of the plant efficiencies, is it not?

A. That's what this study intended to look at, a range of plants of varying efficiencies.

Q. All right. And these efficiencies show a yield rate higher than that implied in the Federal order program, do they not?

A. I don't know. If they do, they -- the Federal order program yield rates are based on a formula to calculate a value for milk of 3.5 percent butterfat and 2.9 percent protein, but the typical component test of producer milk is higher than that.

Q. You testified that you are concerned about the impact on producer prices. Have you computed what the impact is on producer prices?

A. I inferred -- I interpolated to some degree from the USDA analysis. I mean, I am necessarily, on short notice, trusting that the USDA did their -- the full, good job in producing that analysis. I am unhappy that the impacts would be larger than we originally hoped that they would be, but that's what I used.

Q. You saw the exhibit that was prepared by the Market Administrators that used the scenarios provided by -- used by Dr. McDowell. Did National Milk run the same types of scenarios order by order based upon its proposal, either with or without the energy adjustments?

A. No, we did not.

Q. Would you agree that with the energy adjustments, that the rate -- the effective impact on per hundredweight is greater than that of the highest scenario under the USDA analysis?

A. I'm sorry. Repeat the question, please.

Q. Would you agree, though, based upon the differences in the make allowances that you are proposing from the scenarios, that the impact on a per hundredweight on the blend prices would be higher than the highest USDA scenario?

A. I do not believe that that would be the case over the long term. I believe it would be the case if we looked, for example, at 2005 or December of 2005 or November 2005, when energy costs had been exceptionally high. However, I believe that over the -- I did calculate that over the past five years, we expect that impact would be lower. And for the future five years, we certainly hope it would be lower because we expect energy costs to go down substantially. They are extremely high right now, and we -- that's a -- we do not believe that's a long-term average.

Q. Do you recall what the amount under the exhibit prepared by USDA or the Market Administrators, the impact on the blend average, blend price, was based upon scenario No. 3?

A. The USDA --

Q. Yes.

A. The study summarized in the hearing notice?

Q. No, the study -- the information put on by John Rourke.

A. I have not looked at that in detail. It is not a dynamic study, doesn't take into account market response to the change, and it overstates the impact. It is what economists call a naive model.

Q. So you're saying -- you were here when Dr. McDowell testified and was cross-examined, right?

A. I was.

Q. And he agreed that, in the first months, that the impact stated by those would probably be every bit of what was stated there, right?

A. That it would approximate that.

Q. It would approximate that.

A. In the -- of course, in the up years of his model, the impacts are quite a bit lower than the averages that he is presenting.

Q. All right. Let's talk about the first months. National Milk's proposal is approximately 50 cents a hundredweight.

A. Our proposal, as it's been amended by Mr. Rosenbaum and the judge.

Q. Is 50 cents a hundredweight, right?

A. And we would represent that that is not our full proposal. It is what we have been limited to.

Q. But you haven't withdrawn your proposal in total, either.

A. We are primarily interested in maintaining a record for the indexing concept. And we recognize the need to provide some relief to Class III and Class IV manufacturers of benchmark products, specifically.

Q. So you would support the adoption only of the index and leave the rest of it alone?

A. At present, our position is as it has been presented.

Q. All right.

Now, you indicated -- first of all, the membership of National Milk is comprised of what?

A. Dairy farmer cooperatives.

Q. Do you have any individual dairy farmers that are members of National Milk?

A. Not with respect to development of

our position for this proceeding. Not with respect to our representation of dairy farmers to Federal order policy. We do operate the Cooperatives Working Together Program, which has individual members who are represented with respect to the operation of that particular program.

Q. You indicate that in time that the impact of this proposal will narrow. Is that your testimony?

A. That is the evidence put on the record by the USDA and Dr. McDowell, and we understand that to be a reasonable analysis.

MR. YALE: One moment, please, Your Honor.

BY MR. YALE:

Q. Do you have Exhibit 18 in front of you?

A. I still do.

Q. And on Scenario 3, what is the first year impact on the all-milk price computed by

Dr. McDowell?

A. Exhibit 18 is Charlie Ling's study.

Q. Oh, I'm sorry.

A. I have the hearing notice in front of me. I do not have the appendix.

MR. YALE: Bear with me one second, Judge.

THE JUDGE: No. 27, Mr. Yale.

MR. RASTGOUFARD: If the --

THE JUDGE: Mr. Vetne, do you want to interject something at this point?

MR. VETNE: Yes, but I want to make sure that Ben Yale is listening, and he is not at the moment.

MR. YALE: Go ahead.

MR. VETNE: I was going to object that if the question is what is already in the record, I don't think we need a redundant statement of what is in the record. The question was, what does exhibit so and so say. We don't need to do that. We tend to do that, but it's getting late.

MR. YALE: I'm not asking him to -- I'm setting him up for some further questions based upon his analysis.

MS. DESKINS: Exhibit 2 is the appendix.

THE JUDGE: There is 2, and there is 27.

MS. DESKINS: 27 is a --

THE JUDGE: Dr. McDowell.

MS. DESKINS: -- statement.

THE JUDGE: And 28, I believe, is the explanation of the methodology.

MR. ROWER: Right.

BY MR. YALE:

Q. Looking at page 3 of Exhibit 2 --

A. Which I do not have.

Q. You do not have Exhibit 2? I'm sorry, it would be page 4.

MR. YALE: Do we have the exhibits available? Thank you.

BY MR. YALE:

Q. Look at page 4 of the Exhibit 2.

A. [Complying.]

Q. U.S. producer revenue projected by Dr. McDowell, first year was a $318 million loss, right?

A. Yes. In applying this change to all four classes of milk, the loss is $318 million, according to Dr. McDowell's analysis.

Q. Right. And in each of these years, there is a loss, right?

THE JUDGE: The document speaks for itself, Mr. Yale.

THE WITNESS: Although I do not believe he took into account impacts on future dividends with respect to operating losses of cooperative-owned milk plants. If I am wrong on that, someone can correct that.

BY MR. YALE:

Q. Let me ask you this, does National

Milk take the position that this $318 million loss is appropriate to impose upon producer income?

A. I think it is a very large loss. I think it should be about half of that.

Q. So it is National Milk's position that producer income should drop in the first year $159 million?

A. It is our position -- our position is as we intended to deliver it at this hearing.

I should state -- I would like to state for the record that we will continue to explore options to pursue that position; that our position is as we intended to present it. Our position is not entirely or fully represented in the hearing record, so it is not -- it is not necessarily relevant to -- I can't answer that we feel that it these impacts are appropriate.

Q. You earlier mentioned the CWT

program. What is the CWT program?

A. CWT is Cooperatives Working Together.

Q. How does it function?

A. Farmers contribute 5 cents per hundredweight of their -- actually, I'm not sure how this is relevant.

Q. You mentioned CWT. I would like to get an explanation into the record of what CWT is.

A. CWT is a program in which 75 -- nearly 75 percent of the milk produced in the country, both as individual members and represented through their cooperatives, contribute to a fund managed by National Milk as a private entity that -- that 5 cents per hundredweight of their milk marketings, and that money is used to retire whole herds and to assist in the export of dairy products in order to reduce the available domestic supply of milk and milk products to increase the price to producers.

Q. Has National Milk done an estimate of what the economic impact was to producers by that program?

A. We believe that the nickel return is about 50 or 60 cents per hundred to all producers, not just --

Q. Right.

A. It is not proportionate. So 75 percent contribute a nickel and a hundred percent get about 50 or 60 cents.

Q. In developing the program, CW -- or the position in this hearing, has there been any conversation on the negative impact that this has towards the effects of the CWT program?

A. I think that's an internal matter.

Q. You indicate you represent cooperatives.

A. Right.

Q. National Milk does not represent any

proprietary cheese plants or manufacturing plants, is that correct?

A. That's correct.

Q. What percentage of the cheese is produced in the United States by cooperative plants?

A. Again, I would have to refer to a study I do not have, and I will defer to the authorities here as to whether or not the -- it is possible to enter into the record Charlie Ling's regular study of the operations of dairy marketing cooperatives that details those numbers. I don't know what they are exactly, but I believe they would be helpful in updating economic impact analysis on --

Q. But there is a significant portion of the milk used in manufacturing that is acquired by proprietary plants?

A. Beg your pardon?

Q. There is a significant portion of

milk acquired by manufacturing plants that are operated by proprietary plants?

A. Yes, right. And there is a significant volume of milk that's sold to proprietary plants who do not make benchmark products, and there is a very large volume of milk that is sold to Class I and II handlers who would similarly benefit from the proposal and --

Q. I want to talk about the manufacturing plants.

A. That's fine.

Q. Is it National Milk's position that these proprietary plants that are not making benchmark products should have the benefit of reduced cost for producer milk?

A. I would have gone over that testimony that was stricken. It is not practical to exclude -- it is only practical to limit the application of make allowances to entire classes of milk. It is not practical to apply -- to limit the application of these make allowance changes to manufacturers of individual products. Something like that might be ideal, but that's not possible. It is especially not possible as of this morning.

Q. If you could, you testified that you want to combine the two surveys, the CDFA survey and the survey done by Charlie Ling and RBCS, is that correct?

A. We recommend following the same procedure that USDA followed in order to expedite the -- in 2002 in order to expedite the proceeding.

Q. But you would recognize, would you not, that the RBCS does not include any proprietary plants?

A. I recognize that.

Q. And it does not include any of the newer, modern, efficient plants that are owned or owned in part by cooperatives?

A. The California study includes large plants.

Q. But you are proposing to exclude them from some of the calculations, right?

A. I am proposing to -- the only thing I'm proposing to exclude are several small, high-cost powder plants. So I'm not proposing to exclude any large, efficient plants from the study. I expect that the USDA, following the same methodology as before, will find an appropriate balance between large, efficient plants and smaller, less-efficient plants.

Q. The California study looked at Monterey Jack as well as cheddar. RBCS doesn't consider Monterey Jack as part of the process?

A. If you say so.

Q. I mean, that's what -- and the fact that it uses a different cheese, does that have any impact on --

A. I would have to defer to Ms. Reed's testimony. But as I recall it, she indicated that the costs for Monterey Jack and cheddar cheese are so comparable as to be identical in terms of the study.

Q. And the California plant is more than a survey, it is almost a census, isn't it, of all of the milk that goes into the --

A. It is nearly a census.

Q. Right. And you would agree, as a trained economist, that there is a difference between a census and a survey?

A. And I would also agree that there is a value to having whatever information is available properly weighted, and I believe this process is the best way to do that.

Q. But how do you weight the U.S. study to account for larger, efficient, proprietary plants that are not included in the formula?

A. Well, they are accounted for in the CDFA study. We are talking about prices as they apply to Federal orders. CDFA plants are an appropriate proxy for the large, efficient plants in the rest of United States that have not been accounted for.

Q. But you are not giving them the same weight in the study as would be in existence within the United States, right?

A. I'm giving them the same weight on the basis of their volume. For some commodities, their weight is larger. I would say it is appropriate and, again, I would generally defer to the decision of the Department on November 7th, 2002, and indicate that that decision was well justified; the procedures were well-established and well-thought out and that they -- that clear justification will help expedite the promulgation of an interim final rule.

Q. And you want an interim final rule in order to get an early decision?

A. Yes.

Q. And to have the impact of a negative price upon producers hit as early as possible, is that correct?

A. To allow manufacturers of benchmark products, including cooperative manufacturers, to continue to operate to provide an outlet to producers for their milk. I believe that the Howard McDowell study is very good, but the one thing that it does not take into account is the negative impact on producer milk of the bankruptcy of processing plants.

Q. Does it take into account the bankruptcy of producers?

A. Mr. McDowell's study?

Q. Yes.

A. I believe I would say implicitly it would, as bankruptcy of producers is one part of this. However, I would point out that none of this represents an absolute year-to-year decrease in milk demand or outlets for milk supplies. We have an annual increase in milk supplies throughout the model. It is only a matter of how quickly they rise. It is not cutting producer production, it is changing the rate of growth.

Q. It is shifting the location of production, is it not?

A. I can't speak to that.

Q. Under the California study, the plants in California have to purchase market-grade milk at these minimum prices, is that right?

A. I believe so, but I can't say. You should ask someone who knows.

Q. But yet you are proposing to combine the two studies and you haven't done a check to see how that system works and how those numberings were derived?

A. Regardless of the regulatory machine, plants are in competition and will pursue efficiency as best they can. And costs of processing are affected by competitive forces, just the same as they are in the Federal order. It is unnecessary to go into that detail.

Q. The California program included the plant cost to produce 640 blocks, and the RBCS does not include that. Do you have any knowledge about the efficiencies of 640 plants that --

A. Repeat the question.

Q. The California program, do you recall whether the California program included 640-block cheddar?

A. I don't recall.

Q. Do you know what 640-block cheddar is?

A. Yes, it is an alternative bulk product.

Q. Is its production more efficient or less efficient than 40-pound block?

A. I don't know. Again, I defer to the decision of November 7, 2002, with regard to justification for the methodologies of combining the two surveys.

Q. Whether it is right or wrong, you are going to defer to that?

A. From what I have seen, it's a reasonable approach. And to the extent that there are details that may or may not been have considered, that I may or may not have considered, I would certainly sit here for the rest of day and listen to testimony from anybody you present to explain the differences and why I may have been wrong. But I have not yet heard testimony to indicate that there is any reason not to adopt the same methodology.

Q. Turning to your issue on the energy adjustment, you have heard testimony here, in fact, I think, even on the dried whey, that there are alternative methods to dry products, particularly through the use of RO, that uses less energy. Have you heard that testimony?

A. I have heard some of it, yes.

Q. Would it not be -- should it not be the policy of the Department to encourage less energy-intensive processes rather than fully pay for the higher energy processes?

A. I believe that competitive market forces will drive that transition and over time a future processing survey will reflect those lower costs.

Q. Is there a cap on your energy adjustment?

A. No, there is not. Do you care to propose one?

Q. Are you still -- I mean, you are not proposing a change in terms of a floor on the dried whey, the other solids computation, or the -- as you know, we can have a negative over solids factor on the --

A. Yes, I don't believe that's within the scope of the hearing as it was narrowly defined.

Q. And with the increases in the proposed make allowances that you have for the other solids, the potential of negative other solids factors in the Class III price, the risk of that increases, does it not?

A. Now that you mention it, I suppose it does. So perhaps it is in the scope of the hearing, but I have no position on that. We have no position on that at the moment.

MR. YALE: I have no other questions. Thank you, Your Honor.

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

EXAMINATION

BY MR. VETNE:

Q. Dr. Cryan, thank you for your testimony.

A. You are welcome. Good morning.

Q. Good morning.
The bottom line of the manufacturing allowance recommendations of NMPF are found on pages 14 and 15 of your testimony which contains revised order language?
A. Yes.
Q. And the bottom line of Proposal 1, as presented by Agri-Mark, is contained in Table 4 of Agri-Mark's proposal. Do you have Bob Wellington's testimony handy?
A. Do you know the number?
MR. ROWER: 29.
MR. VETNE: 29.
THE WITNESS: I have it.
BY MR. VETNE:
Q. I would like you to have in front of you Exhibit 29, the Wellington testimony, open to Table 4, and your own statement, pages 14 and 15, available.
A. I'm sorry, Exhibit 29?
Q. Bob Wellington is Exhibit 29.

A. I have something else as Exhibit 29.

Q. The rest of us have Wellington as Exhibit 29.

A. Yes, now I have it.

Thanks, Bob.

Q. You have the Wellington testimony, Table 4, in front of you?

A. I do.

Q. And you have your own testimony open to pages 14 and 15?

A. I do.

Q. All right. In Table 4 of the Wellington testimony, under the column labeled, Cheese, work your way down to near the bottom of the page in bold numbers, 2004 Average Costs $.1794.

A. Yes.

Q. The equivalent -- and that's a cheese make allowance. The equivalent allowance is found on the bottom of page 14, under Protein Price in your testimony?

A. That is right.
Q. That's Subsection (n)(2)(i), is that correct?
A. I accept that. I think what you're getting at is cheese and butter, we have arrived at the identical make allowances.
Q. With some rounding?
A. Yes.
Q. And further continuing down the cheese column in Table 4, the Wellington testimony, there is an adjustment for 2004 to 2005 energy costs for a new fixed make allowance. That is something that you have not incorporated in your proposal for a fixed allowance?
A. No.
Q. And you have heard witnesses in support of Proposal No. 1 favoring both a 2004 to 2005 adjustment in the fixed allowance as well as indexing as they anticipated you would propose and did

propose?
A. Right.
Q. So you propose a two-step process, one to get to 2004 average costs and from that point, index. And the other witnesses have proposed what I'll call a three-step process: get to 2004 energy costs, adjust for 2004 to 2005, and thereafter index?
A. Uh-huh.
Q. Is that a fair characterization of the difference?
A. Yes, I would say that's a fair characterization.
Q. But you wouldn't want the indexing component to delay a decision, you want -- you would like the Department to do it, but you would not like it to delay the decision?
A. We would support your desire to expedite the hearing, get the first round out of the way as quickly as possibly. We support the principal proponent's desire,

your clients desire to move the hearing along quickly or to get relief as quickly as possible.

Q. And you anticipate me. You mentioned that the NMPF butter allowance which appears in about a third of the way down, near the top of the page on page 14 of your statement, butter allowance is 15.1 cents?

A. Right.

Q. And Bob Wellington calculated 15.15 cents. So you round it down?

A. Exactly the same issue with -- the same difference between us on butter and cheese, difference in our stated positions. And again, I would state for the record that, again, that our position is not entirely represented by testimony for the record, but go ahead.

Q. But with respect to nonfat dry milk, which is on the middle of page 14 in your proposal, nonfat solids price, etc., less a manufacturing cost allowance equal to 16.5 cents, therein there is a significant difference with the Proposal No. 1 as advocated by Bob Wellington of 18.67 cents.

Is it true that that difference is derived from whether -- from your inclusion --

A. Exclusion.

Q. Well, your inclusion of the large, most-efficient manufacturing plants in California and Bob Wellington's exclusion?

A. I -- that is right. Right, your client excluded both the high- and the low-cost and included only the middle-class groups.

Q. Only the middle-class groups, and your proposal would -- or your calculation would include the very largest of the California plants, not just the medium plants?

A. My calculation did include that. In that case, it followed the methodology for 2002. Your methodology is -- intrinsically seems reasonable as well.

Q. Would you agree that the medium plants in the California survey are probably more representative of the nonfat dry milk operations in the Federal milk order system?

A. I don't know that. I would have to leave that up to the Department to determine how best to define an overall average that is representative of the Federal order clients generally.

Q. Are you aware that the very large California plants are operating at much closer to capacity year-round than Federal order balancing plants?

A. I don't have that information with me.

Q. You don't know whether they do or not?

A. I do not.

Q. If it is true that the California plants operate at much greater year-round efficiency, would not inclusion of those plants in the survey price tend to undermine the -- a small function of the Federal make allowance for powder as described in the 2002 decision and described more recently in the decision for the Northeast, would tend to undermine that function of capturing some, but not all of the balancing costs?

A. I would say that it is unfortunate that all balancing costs have been forced -- apparently been forced by implication on the make allowance, especially since it is only the manufacturers of those products and co-ops who balance the markets who pay that cost. But I would accept that what you are saying is a valid argument to make with respect to this proceeding. However -- well, I'll stop there.

Q. Okay. You indicated that you do not know the portion of manufactured product produced by cooperatives versus proprietors, but that RBCS produces a periodic publication that does describe that?

A. That is right.

Q. Do you know whether that publication is Internet available?

A. It is available on the Internet. It is a publication who -- I believe Charlie Ling, who was one of the government witnesses, is the author of that publication. It is done periodically. I don't believe it is done every year. I believe the last one contains data for 2002 or something along those lines. By it is an indication of the magnitude of cooperatives' participation in the production of those products.

Q. Although you do not have current details on the proportion of co-op versus proprietor manufacturing operation, do you --

are you familiar with the direction of ownership within the manufacturing group? And by that, I mean whether proportionally more plants or more capacity is being operated by co-ops versus proprietors?

A. It is my impression that it is moving towards cooperatives and entities who are willing to take it on because of the other requirements of dairy producers.

As stated, those plants are necessary to -- they have to operate for the sake of producers having an outlet. And if proprietary plants can't make money, then the co-ops end up buying them to take the milk.

I would say my recollection of the last RBCS study -- and again, I would defer to the actual study -- nonfat dry milk production is -- something like 60 percent of it is undertaken by producer cooperatives and something like 40 percent of cheddar cheese production. I believe those numbers are about right.

I don't have a good recollection of the other products, the dry whey or butter --

Q. And those products --

A. -- but I believe butter is a relatively high percent as well.

Q. Total production of those products would be reflected in that publication called, Dairy Products?

A. Total production would be reflected in that that publication, and cooperative share as of the most recent study of the market would be in that publication and in Dr. Ling's publication. And I'm sure it is on the Internet.

Q. In response to a question from Mr. Yale, you made the observation that the formula employed by USDA for deriving a price to Van Slyke -- modified Van Slyke was at a 3.5 cent fat and 2.9 cent protein and that did not represent the component test of milk.

Do you recall that question and answer?

A. I indicated that the formula is established for the prices of milk at 3.5 percent butterfat, 2.9 percent protein. There have been some changes.

At one point, the -- at one point, the yield formulas were based on a more -- they were based on dairy counts. I don't -- sitting right here, I don't -- I wouldn't want to get into more detail.

Q. The witness for CDFA testified that the component content of cheese vats which are reported are greater than the component content of raw producer milk for a number of reasons. Do you have any familiarity with -- outside of California, whether the component content for similar regions, whether it's concentrated or cream, is greater than the component content than average --

THE JUDGE: Pull up the mike, Mr. Vetne, please.

THE WITNESS: Please restate the question.

BY MR. VETNE:

Q. Do you have any information or knowledge of whether, in the Federal order manufacturing sector, the milk that comes into the vat is more condensed in its component content than average incoming producer milk?

A. I believe it has become standard practice to fortify the vat with skim condensed milk and nonfat dry milk and other components, depending on the identity of the cheese that is being produced.

Q. All right.

A. But I don't manufacture cheese, so I only know what I hear.

Q. And that kind of deficiency, that kind of yield increase, should be reflected in survey make costs because survey make costs are per pound of finished product?

A. Right. They are not per hundredweight of material in the vat or per plant, they are per pound of milk.

MR. VETNE: Just one minute.

Thank you. That's all I have for the moment.

THE JUDGE: Other questions of this witness?

MR. SCHAD: Mr. Schad.

EXAMINATION

BY MR. SCHAD:

Q. Dennis Schad, Land O'Lakes.

You don't buy or sell cream, do you? Small joke. Sorry.

A. I get it.

Q. Thank you.

Can I take you to page 2 of your statement, the last full sentence on that page?

A. Are you referring to my statement or to the amended statement?

Q. In both cases, I believe it is the same.
A. Okay.
Q. I'll read that to you.
"Increases in other costs have been more gradual and have been partially offset by increased productivity in the manufacturing process."
Has there been any evidence in this hearing which you can point to to back up that statement?
A. In this hearing?
Q. Yes, on the record.
A. What is on the record -- one thing that's on the record is the graph I have with various producer pricing indexes. I tried to find all the ones that would be relevant to the dairy industry.
That is to say, I did not leave any out that I thought were for dairy cost indexes, dairy processing costs, and that

includes PPIs for dairy industry machinery, paper boxes and containers, shipping sacks, multiwall bags, specialty cleaning and sanitation products, refined sugar and byproducts as well as raw milk.

The BLS series like these for each of those is in a footnote at the bottom of page 8, and I certainly -- if there is a missing -- I included everything I could find.

You can see that the energy costs are more volatile than the raw milk costs. They are obviously not as large a share of the processors' cost but they are, on their own scale, larger. All the other costs move in -- all the other costs except electricity, raw milk and natural gas move more or less on a straight line. Again, if you want to look at those numbers in more detail, they are referenced in the footnote at the bottom of that page.

Whether there are any other -- let's

see. You are asking about evidence as to whether costs -- okay.

Q. I'm talking about the cost of productivity. And if you are finished --

A. No, I'm not. I'm regrouping.

There is another table -- let me think about this.

Well, Figure 2 is related to some analysis I did where I thought, at least with respect to California --

THE JUDGE: Dr. Cryan, if you would take your hand away from your mouth so we can get your testimony a little more clearly.

THE WITNESS: When you look at California numbers for cheese, that cost, for example, the energy costs seem to account for all the up and down swings. When you correct for energy costs, they -- it just relatively -- relatively smooth downward, downward line.

Most of the costs -- as far as I could tell, most of the costs were gradual.

And I expect if someone were to look at the California data going back for 10 years, detailed numbers, they would not -- labor and processing costs probably reflect most of the variation from year to year, and processing costs, that the rest, I believe, are more gradual.

Q. Okay. I would submit that another way of looking that, as the record has ample evidence, is to look at a cost per pound for the different products. The pound would -- pounds produced by the plant would call in the productivity of the plant and the cost, obviously.

So if you looked at Dr. Ling's survey, for instance, if you look at the exhibits that would take the 1999 cost per pound per category and the 2004, would you expect to see an increase in a cost per pound for -- against most of that category?

A. Would I expect to see an increased

cost of processing per pound of product?

Q. No, the cost of -- well, for instance, if you had in front of you the 1999 survey for wages and other benefits for powder, you would see that it was 4.5 cents per pound of powder.

A. Yes.

Q. If you looked at the most recent, you would see that number to be 6.8 cents per pound. So to assert that the productivity wiped out the impact of increased costs -- well, would you assert that productivity over the five years wiped out the impact of increased cost against all categories?

A. No, not at all. In fact, it is appropriate to say, as I did, that the 1998 costs are generally out of date and it is time to update that. And I think the energy cost indexing is a partial solution. In a perfect world, we would know what some reasonable cost is every year and we would apply it appropriately. We are doing the best we can.

But the volatile energy prices, specifically, are so much more volatile than other costs that it is appropriate to apply an adjustment for those and not necessarily to the others for the purposes of simplification.

Q. I think we are in agreement. And another --

A. So we certainly are not -- our position is not that we should stick with the '98 cost index, the indexed energy from that. I think we are agreeing that an update is called for.

Q. Yes, I agree, and I was afraid that the implication from your statement could made by the opponents that that's what you were saying. But that's not what you are saying at all?

A. No. When I say gradual, I mean

whereas energy costs may rise by a hundred percent one year and then drop all the way back down the next year, that most of the rest of the costs show a relatively straight line. Even though they are -- they certainly are significant increases, they move in a relatively straight line. They don't have wild variations. You know, people don't make -- most people don't make twice as much one year and nothing the next. It's a -- so it is much more regular and much more regular increases in cost.

Q. And you would be in favor of regular updating across all costs for make allowances?

A. We don't have a position on that, but we certainly -- we expect to have a position one way or the other when we have what we expect will be another hearing on the success or not of the methodology being developed -- I'm sorry, let me strike that.

Strike that.

We are interested in looking at -- we will look at that going to the future hearing on formulas. We understand that there will be another hearing, and we look forward to developing a position in that case.

Q. Following up on Mr. Vetne's questions about the difference in the manufacturing allowance for nonfat dry milk in your statement and also in the proposal of Agri-Mark, the previous -- in previous testimony here, someone recommended that the Department look at the final decision of the last hearing, where they used criteria of -- in their weighting selection between the RBCS and CDFA group or subgroups based on like size, like costs and a recognition of balancing in the RBCS numbers. Would you agree that the Department should use the same determinant to determine the weighting for the RBCS and the CDFA survey?

A. Yes.
Q. Thank you.
THE JUDGE: Other questions?
Very well. It's right at the noon hour. Let's take our --
MR. ROWER: We have some questions here, Your Honor.
THE JUDGE: Very well.
MR. SCHAEFER: Would you just as soon break and come back?
THE JUDGE: I guess that will depends on how many questions you have got.
MR. SCHAEFER: Just a couple.
THE JUDGE: Let's have them now.

EXAMINATION

BY MR. SCHAEFER:
Q. Henry Schaefer, USDA.
Dr. Cryan, in your testimony you had the two formulas for adjusting the -- by the energy costs, and you have got Industrial Electric PPI Current. And what current there

are you referring?

A. The most current available. I recognize that generally will mean it is a month or two behind, but it is better than being six years behind.

Q. And that should be -- you feel that's a sufficient update at that point?

A. In every case, we do the best we can with what we have got.

Q. And have you -- we have a tendency to look at our pricing in somewhat of a vacuum with regards to Federal orders, and over the last 5 to 10 years we have seen a fairly significant increase in trading on the Chicago exchanges for milk futures. Will this monthly index adversely impact or, on the other hand, positively impact the ability of futures to hedge or forward-contract or risk manage their product sales?

A. Well, it wouldn't change the ability to hedge Class III milk because it settles on

Class III milk. It would create some basis variability for those who are using Class III as a proxy for cheese. And I suppose that would be -- you would be talking probably about an expected range -- maybe an expected basis range of variation of maybe 30 or 50 cents. Off the top of my, I would think something like that like for a hundredweight of milk.

I don't think it would eliminate Class III as a useful basis for hedging cheese. It might create an incentive for separate cheese futures. I'm not sure. It does somewhat complicate things, but as you know, futures market generally are very complicated already. Most other commodities don't have the kind of zero risk basis -- zero basis risk that folks that price under Federal orders do. It is very unusual to have a futures contract like the Class III price that is cash settled on a price that is exactly what people have contracted on unless people choose to contract on the basis of -- of the future --

Q. Going back to your --

A. Is that too rambling? Can I restate that?

Q. No, I think I got what you intended.

Going back to your formulas, I did notice that on page 9, where you first give us your formulas that I referred to with the industrial electric PPI current divided by the industrial electric PPI 2004 minus one, and then I noticed, in your order language further on, I believe on page 14 and 15 which we talked about earlier, the formula is somewhat different. Any reason why you decided to put different formulas in those two places and what impact that might have?

A. It's a good question. It is the same -- it is basically the same equation -- it is the same identify expressed in two different ways.

In the first one, the equation is expressed in the way that can stand all by itself, it's easiest to understand the -- you know, one over the other minus one as a proxy for -- as a representation of the percentage increase and then say -- and that percentage increase multiplied by the base energy cost.

In the order language, because of the linear -- the linear flow of order language, the simplest way to draft the language was to actually to incorporate -- incorporate this, which is to say we take the current -- the current index and subtract the baseline index and then divide it by the baseline index. That also gives you a percentage increase. It is an alternative method for calculating the percentage increase. And then we take that increase and apply it to the specific energy cost.

And again, it is just really a

reorganization of the same equation in order to conform to the linear nature of the order language.

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

THE JUDGE: Mr. Rower.

EXAMINATION

BY MR. ROWER:

Q. Jack Rower, AMS Dairy Programs. Good afternoon, Roger.

A. Good afternoon, Jack. It is afternoon.

Q. I just have two very brief questions.

In your statement, you had mentioned that you support the return on investment from the previous decision on return. And in California's work, they select Moody BAA rate as a return on investment. Can you tell me why that is a rate that you or anybody else would support versus some other rate of return?

A. I would have to defer to the 2002 decision. I did not give specific consideration to the appropriate rate of return on investment.

Q. Okay.

Similarly, the general administrative expense item seems to apply or have been derived from California. Does it seem reasonable that California expenses, general administrative and otherwise, apply uniformly across the United States?

A. I guess it comes down to a general philosophical question on that -- everybody shuddered when they heard that -- as whether we ignore it or use the best information we have got. And given the need to use some information to account for what is clearly a cost that is faced by dairy product processors, it is better to use the information we have got.

Ultimately, again, I have to defer to the 2002 decision as the source of that and as the basis for that and as a justification for that. But I would say that philosophically, you need to use something if you are going to attempt to capture the full cost, and I have not seen an alternative series presented.

Q. That was my next question. Okay. Thank you. I'm done.

THE JUDGE: Mr. Beshore.

MR. BESHORE: I would just like to make the request that the Association of Dairy Cooperatives in the Northeast be able to present Mr. Schad as its witness with its position immediately after Dr. Cryan. It was developed hand in glove with them and goes right with National Milk's position. So I would like to be able to put him on immediately after lunch.

THE JUDGE: The only problem I have with that is that we do anticipate having a producer who is going to be here right after lunch.

MR. BESHORE: I have no problem with that, but the next industry witness, if you will.

THE JUDGE: Very well.

THE WITNESS: Am I done, Your Honor?

THE JUDGE: It looks like you may step down. Thank you.

[Whereupon, the hearing recessed at 12:08 p.m. and reconvened at 1:30 p.m.]

JANUARY 27 - DAY 4 - AFTERNOON SESSION.

THE JUDGE: We are back in session.

Mr. Wellington.

MR. WELLINGTON: Yes, I want to present a witness we have from Agri-Mark, Mr. Eric Ooms.

THE JUDGE: Very well.

Whereupon,

ERIC OOMS,

having been first sworn by the judge, was examined and testified under oath as follows.

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

THE WITNESS: My name is Eric Ooms. E-R-I-C, O-O-M-S.

THE JUDGE: Very well.

EXAMINATION

BY MR. WELLINGTON:

Q. Can you give us some background about your farm and your family?

A. Sure. First of all, I would like to start by saying that, due to my close proximity to the airport in Albany, I was able to milk this morning before coming. I'm probably the only person in the room who milked cows this morning and plans to do so tomorrow morning as well.

My father, two brothers and I are partners in a dairy farm in Kinderhook in Columbia, New York.

As I mentioned, it's about 25 miles south of Albany and about a hundred miles north of Manhattan. This morning we were milking 343 cows, which may sound like a lot, but when you consider four partners choosing to work together, when you factor in milking and dry cows, that's about 90 cows per family. So we have tried to capitalize on the economies of scale on our farm.

We have been in business, in the dairy business, in the United States since 1952. If we go to when my parents immigrated from the Netherlands and our family history shows that we were dairy farmers back into the 16th century, at least. We have been members of the Agri-Mark and its predecessor cooperatives since 1956.

And actually, the reason why we became Agri-Mark members was because our neighbor drove the truck that went to Springfield, and that's why we became members of the co-op. It was really nothing more than that. Our family has accumulated a great deal of equity in our cooperative, and at this point we have over $160,000 of equity in our cooperative.

This issue has been on the radar screen as far as our family is concerned for nearly a year. We've had prominent discussions at our local and regional meetings for at least the past year. And as having attended our Agri-Mark annual meeting in April, I do remember Bob Wellington, at the first day of the annual meeting, talk about the issue at some length in his presentation.

I can also say that we have had several check letters. Twice a month we get a milk check, and we get a letter with that milk check.

And I always look at the back first because that's usually the price forecasts, which I think is the first one for -- entered into the record for August 2nd has the price forecast. And then we read the rest of the letter, and my father copies this check letter for myself and my brothers. It's one of the few things that we make copies of for everyone so that we all are aware. It's easy to read and generally has good, up-to-date information.

In addition, at our most previous regional meeting in November, our chairman of our cooperative, Carl Peterson; our vice-chairman, Neil Ray; and Bob Stoddard, who is our member services director, had a substantial discussion about the issue at the meeting. And at the close of all the days, we had an opportunity for discussion twice over, and probably the biggest amount of discussion was about the milk truck cleanliness in our area and what could be done about it. If this a controversial issue, we would have been talking about it.

In talking to my fellow members, we didn't like the concept, but we recognized it had to be done.

As far as for our farm, we have seen the impacts of what not adjusting the make allowance has done. Since July, we have had a 15-cent reduction in our producer PPD to cover some of the costs of the problem, and we are expecting to pay 30 cents a hundredweight this year to cover the cost of the problem.

As far as other cooperatives and how they have been informing their members, I talked with two friends of mine over the past 24 hours. One is a member of Upstate Farms, very involved in the agricultural community, and he said 90 percent of the farmers that he's talked to, of course, nobody likes the concept of having to increase the make allowance. However, if we do not have a processing sector, that's even worse.

And that's somebody from Upstate Farms in western New York. The other gentleman, I talked to this morning, and his cooperative, Allied Cooperative in northern New York, doesn't even own any plants, but they have been notifying their members the importance of this and the need to do it. And they have firsthand knowledge of why this is important and why a vibrant processing sector is important, because they have seen the plant closings that have happened in their area.

Which brings me to the point of -- I saw a chart recently, I'm sure somebody brought it up previously here -- the alarming number of Northeast plants that have closed in the past two years is very frightening, and the amount of milk that's being processed by co-ops has increased exponentially.

Kraft is basically saying they have -- I don't know if they have officially said it, but it looks like they are pulling out of Northeast and it's in no small part due to issues like this.

I know for a fact on our farm our costs were increased 10 percent with increased energy prices last year. There is no doubt in my mind it's hitting every sector. And if there hasn't been an adjustment for processors when they are dealing -- working under different rules than we are, it's a big problem for them as well.

Again, once again, we don't necessarily get an increase in our milk checks for the energy issues we are facing, but my family and our co-op members who own plants are currently shouldering the load for all the farms to make sure that plants and markets remain open.

And I will say that I'm very proud that my co-op is one of the few organizations that stepped up and tried to keep plants open. And most recently, the Chateaugay plant, the Cabot cheese plant in Chateaugay, New York, was threatening to go out of business. It was an opportunity for our co-op to step in and do what we could to keep the milk in that plant.

And I also say this. I feel that many dairy farmers have taken the -- taken our market for granted. And I realize -- I'm also a -- I'm primarily involved in Farm Bureau, and I'm a county Farm Bureau president. We have a lot of fruit and vegetable growers in our area, and those fruit and vegetable growers, there's nothing that they don't grow that they don't have to find a home for that product, whereas dairy -- growing up, I might have said it myself. I mean, hopefully I'm a little smarter than that now, but a lot of people's attitude, a lot of dairy farmers' attitude is, I put the milk in the tank and somebody comes, picks it up. That's pretty much the -- and I'm not saying that every dairy farmer is that way, but a lot of dairy farmers take for granted the amount of marketing that goes into our product. We have been forced to do that because we have a perishable product, but it is also a huge advantage for us as dairy farmers that we have cooperatives that take care of our marketing for our milk.

And I would also state that a bigger factor in farm prices, a bigger factor than the make allowance and so forth, is the rise in milk production in the southwest and western part of the country.

And just lastly, my brothers and I generally meet every day to talk about issues facing our farm. And probably, you know, periodically, once or twice a week we'll talk about -- it's not really planned, but we have kind of impromptu discussions about the future of our industry. And over the past -- and it hasn't been in the past 24 hours since I was asked to come here, but over the past two months we have been talking about this issue.

And regardless of what impact of -- whether it be 5 cents or 20 cents or 50 cents, in the coming year -- and again, we are already seeing a 30-cent impact on our farm, at our age we need to look toward the future, and we are more dependent on a vibrant and competitive processing sector in our region of the country.

So if these issues aren't addressed -- I'm sure some of the plants that have gone out of business have been due to just changes in their structure and their businesses. But there is no doubt that some of them have gone out because of the competitive issues, and we hope that you would address these issues here.

MR. WELLINGTON: Thank you, Eric.

Mr. Ooms has a document that --

THE JUDGE: It's actually two documents, two separate letters.

MR. WELLINGTON: Two separate letters, okay. So if I could mark them as exhibits.

THE JUDGE: Exhibit 62.

[Whereupon Exhibit 62 was marked for

identification by the judge.]

BY MR. WELLINGTON:

Q. Were these check letters that were received by your farm?

A. Yes.

Q. Yes? Thank you.

A couple just quick questions. You mentioned a term, PPD. Would that be the Producer Price Differential under the Federal order?

A. That is correct.

Q. Were you and other members informed that the impact of this change in the Federal order could initially impact your blend price by upward of 30 or 40 cents?

A. Yes.

Q. And how did you respond to that and how did the other members respond?

A. Well, we are already seeing that impact already. And the theory is, and I have heard that USDA has the theory as well, that initially it will have that impact, perhaps, but in the long run it will come back. So, of course, we don't like it. Nobody ever likes it when they have an extra bill, but it's reality and we'll deal with it.

Q. Are there other things that affect your price in addition to an action like this, such as supply and demand conditions?

A. Oh, absolutely. It used to be we thought about the weather conditions in the east. We're in eastern New York. We think about the weather in western New York and what that might do to milk prices. Now it's kind of, you know, what is the weather doing in California or out in the west.

And I know -- I had a discussion a couple weeks ago with someone about how the reason you have a lot of dairy historically in New York and Pennsylvania and Vermont and Minnesota and Wisconsin is because of our topography of land and our water resources and all those other issues. But due to technology, you have got farms in the western part of the country that may have Federally subsidized water for their irrigation for their land or whether it be the newer management technologies, not to mention a lot of Latino labor sources, more so than we have in our area. Those factors impact us or a far greater scale.

And I'm not begrudging them their ability to do that. It's a good place to do business, and people want to do that, and more power to them. But that's been a bigger factor for us than anything else.

Q. Are you involved with Agri-Mark's policy-setting in regard to legislation and co-op support?

A. Yes.

Q. Can you explain a little bit about your role in that?

A. I have been a member for three to four years of our ALEC group, which is our legislation and education committee. And we have regular conference calls to discuss pertinent issues before Congress. I know you mentioned this issue on the calls. There really wasn't much for us to do at that time.

But generally speaking, when there is an issue before Congress we have kind of our own little phone trees. And if there is a congressman or woman that needs to be talked to, we get our points across and hopefully influence policy that way.

Q. Thank you.

One of the key issues here is producer farm income. And there was a program out there that was in effect and it just expired a few months, but now it may be back into effect. I think it may have some value to talk about that.

Are you familiar with the Milk Income

Loss program and did you or other Agri-Mark members play a role in that program?

A. Yes, absolutely. I mean, the milk program was initially kind of a compromise deal resulting from the sunset of the dairy compact. And with the number of senators being supportive of the compact, this was a way to kind of bring the Midwest and Northeast together.

This past -- when they put the MILC program into effect, in the farm bill they did only a five-year -- sunsets two years before the farm bill. So this past -- I believe it sunsetted October 31st, if I'm not mistaken.

Q. Perhaps September 30th?

A. September 30th. We were getting the payment, so it really didn't make big difference at that, the point safety net. But we -- we knew we would have a shot at getting it through budget reconciliation.

And we got a call from Bob Gray, who represents our cooperatives on Capitol Hill, or I got a call, specifically asking -- when they were going through the budget reconciliation process, there was a senator, Senator Bingaman from New Mexico, was threatening a point of order to have this MILC stricken from the reconciliation bill. And there were a number of Democrats that were looking to sink the reconciliation bill, so there was some fear that they would stick together on that, sink the bill, and we'd lose our MILC.

So I immediately called our two New York senators, and I didn't actually get a hold of Mrs. Clinton's office. I simply left a message. But I did talk with our Senator Schumer, or his staff, and they were already highly aware of the situation and had been working on the issue and had been lining up votes that were specifically inclined to keep the MILC program in the package.

So that was part of the vote, because we knew that our -- at least we knew Senator Schumer would be actively involved in trying to keep it in that despite the partisan issues.

Q. You mentioned the cap that the MILC program had.

A. Yes.

Q. Is there a cap under that program?

A. Yes.

Q. What is that?

A. It's for the first 2.4 million pounds of milk that a farm produces.

Q. Now, when you are talking to legislators about the benefits, do you tell them what percentage of Agri-Mark members fully go under that or get full payment?

A. Yes. I believe it is about 80 percent or more than 80 percent. It is probably that much of the whole Northeast, not just Agri-Mark members but, I mean, it is a huge majority.

Q. So in Agri-Mark membership, if 80 percent of the farmers are making 2.4 million pounds of milk or less, does that imply anything about their farm income? Do you have any experience with someone who is making that volume of milk about how much their income would be?

A. Last year we shipped about 8 million pounds of milk, and we grossed a little over a million. So we are talking about, I'm thinking, 350,000 pounds of milk per farm.

Q. $350,000?

A. Yes, $350,000

Q. So if there was a definition of a small business of 750,000, probably these farms would fall into that group as well?

A. Clearly.

Q. And so, if we are talking about over 80 percent of Agri-Mark membership, do you ever talk with people about how many members that is of Agri-Mark?

A. Did I ever talk about --

Q. Yes, about the number of farms involved in Agri-Mark that would fall into that --

A. Yes, I always make it more general about the Northeast as a whole. I mean, I would say 80 percent of Agri-Mark members, but the Northeast as a whole, I think Agri-Mark is an effective sign or effective symbol of the rest of the industry in the Northeast.

Q. So if Agri-Mark has 1,300 members -- that was put in the record a while ago -- over 80 percent, there are over a thousand? Would that be a fair --

A. Yes, sure.

Q. Over a thousand of our members would fall under that basis? Thank you.

Okay. Anything else you want to add?

A. I would just reiterate that we need to have a vibrant, strong processing sector that's competitive. I mean, we can't have one co-op or one processor control the industry. And if the make allowance, the not adjusting for -- for the energy costs that everybody's seeing is going to put in jeopardy the competitiveness of our markets.

MR. WELLINGTON: Thank you.

The witness is available.

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

EXAMINATION

BY MR. YALE:

Q. Good afternoon. Ben Yale on behalf of Select Milk, Continental Dairy Products and the others that we have named.

You indicate that your members are willing to absorb costs in order to maintain manufacture markets for your milk. Is that what I understand?

A. That would probably be accurate.
Q. Now, do you understand that the proposal, as it is right now, would have the impact of reducing the -- initially the blend price, at least in the front months, by as much 50 cents a hundredweight? Do you understand that?
A. Yes, I understand initially.
Q. Yes, and that's on milk that's going to bottlers will also be paying that. Do you understand that?
A. Uh-huh.
Q. And ice cream?
A. [The witness nodded.]
Q. And as a producer, you are in support of reducing what processors have to pay you for milk?
A. No. I'm in support of a processing sector that can be profitable, and USDA's figures indicated that that price will come down. That's the best knowledge that I have.

I'm not an economist, so that's the best I can tell you.

Q. Does the viability of the processor sector depend also upon having production available to supply that processor?

A. Absolutely.

Q. And how do you keep producers in business? Do you do that by reducing their prices or raising their prices?

A. Clearly, you do it by raising their prices. However, we don't have the -- it's just a -- nobody likes this, but I think it's a fact of life that we have to deal with.

Q. Let me give you a hypothetical from a producer standpoint. Let's say that your co-op comes to you and says, we need some processing capacity in our market because we're moving milk great distances and we don't have enough capacity. And to do that we are going to ask you to pay, in your case, let's say 30 cents a hundredweight to accumulate capital so that we can build a processing plant in our market to absorb our milk.

And based on your testimony, you would see that as a positive stand, that that's just a type of future-minded position a producer needs to take, right?

A. Yes.

Q. So let's say that the producers do that and they negotiate a price based upon current Federal order formulas. And then they hardly get the plant built, and producers in another part of the country come and say, we want to reduce all milk prices, including yours, 50 cents a hundredweight so that we can keep plants in our market.

A. Initially.

Q. Initially. And how would you feel about that?

A. That's, I guess, a negative.

Q. And you can understand, then, why

producers in that region would be opposed to dropping these prices, wouldn't you?
A. Yes. Everybody has a different reason for seeing what they see. I mean, hypothetically, you can say a lot of things.
Q. So what you speak of is a situation that you are experiencing in the northeast, right?
A. Absolutely.
Q. You are not speaking on behalf of any producers in the southeast or the southwest or the west, right?
A. No, I don't have a great deal of interaction with them.
Q. Now, New York State, in recent years it hasn't been quite that big, but there for a number of years, was losing a significant amount of milk, was it not, milk production?
A. I don't know the numbers, so I don't know how you define significant. We somewhat stabilized the past two or three years. When

I say stabilized, I mean, you know, give or take 1 or 2 percent. That doesn't mean farm numbers haven't decreased.

But at the same time, you also have families like mine where we've chosen -- I have one brother who milks 75 cows on his own because he didn't want to stay in a family situation. And families aren't always a barrel of monkeys, but --

Q. Maybe they are a barrel of monkeys and that's why --

A. Yes, maybe they are but, I mean, we made a decision to do that. But we could theoretically be -- well, we wouldn't be four because my father is 73 now, so he wouldn't go off on his own. But we could be three separate operations, because that's part of -- and it's not the whole thing, but that's part of what's happened.

That's why I don't like to get into the large versus small debate because all that does is put us against each other and make us less effective.

Q. You testified, and I think one way or another or maybe it was in the newsletter, the suggestion that -- I guess it was in the newsletter, the suggestion that the make allowances was causing California to grow and New York to shorten. Do you have any knowledge of that?

A. No, I don't think -- I didn't testify to make allowance. I was testifying that I theorized, my own theory, that technology, Federally subsidized irrigated water, the labor supply was probably a bigger factor.

Could the fact that California, in a state order, can adjust their make allowance be a factor? Certainly. But is it a big factor? Probably not, not as big as the other three.

Q. Do you -- you say you try to stay on top of the issues. Do you ever monitor the prices that producers receive in other parts of the country?

A. Not a -- I check twice a week what the Chicago Mercantile does. As far as the rest of the country, I see it in blurbs, but I -- you know, regularly, the Northeast is higher because we have a higher Class I utilization, just like the Southeast is higher yet.

Q. You indicated that you are taking a 30-cent-per-hundredweight reblend. I think that was your --

A. That is correct.

Q. Does that show up -- they show a gross payment or a gross pay rate and then they subtract that off? Is that how it shows up on your check?

A. I believe so, but we are just -- we were getting a 15 percent reduction in our PPD, which was shown clearly on our check. I haven't seen the first check for this year yet, for this year's milk.

Q. Your PPD that you receive, how does that compare to the PPD that -- the statistical one that's issued by the Order 1? Do you compare that to see how your PPD compares to the --

A. Not regularly, but when I have seen it in the past -- I haven't checked this year, but in the past when I've looked, when they first came up with the PPD it seemed to track fairly closely.

Q. Do you get more or less than that number?

A. Again, fairly closely. I don't get -- maybe I should, but I don't get -- like you have farmers who will ship to a different cooperative or a different processor if they can get 15 cents more. But then they find out that they are paying 30 cents more for trucking, so what was the gain? So I don't generally sweat it when it's within a dime.

And again, I haven't looked recently, but when I do look when it first came in to try to get -- and again, I don't understand milk pricing. I mean, I think I get some of the basic concepts, but it seemed to be tracking fairly closely.

Q. You said you talked to other producers. Have you had any formal producer votes in support of this provision?

A. No, because we didn't think it was a big deal. We thought it would be a done deal. And actually, the discussion that we had about milk pricing was opposing any legislation that would allow California, or not -- well, it was specifically California, but those people or those areas with state orders the ability to get protections that they could have if they joined the Federal order. That was -- because that was a potential issue at the end of last session.

There was certainly no negative votes

and certainly no positive votes. It was kind of something that we kind of got to happen, so it hasn't been a, you know --

Q. You are talking about the Nunes bill?

A. Yes.

Q. Maybe we have some areas that we agree on, but we won't go there today.

I don't have any other questions. Thank you very much for coming.

A. Thank you.

THE JUDGE: Other questions? Ms. Deskins.

EXAMINATION

BY MS. DESKINS:

Q. Good afternoon. I'm Sharlene Deskins with the USDA Office of General Counsel.

I just want to understand. You haven't been here for all the testimony, but there has been some where people have said that this could cost farmers anywhere from 20 cents to 50 cents per hundredweight?

A. [The witness nodded.]
Q. You have to say audibly for the --
A. Yes.
Q. You understand that, that it could cost anywhere from 20 to 50 cents a hundredweight of the make --
A. Yes.
THE JUDGE: That was Mr. Yale's question.
THE WITNESS: Yes, I understand that, and I understand that we are already paying 30 cents. It's not 20 to 50 on top of the 30, so we are already in that range. And everybody says initially. So I'm going to put faith in the people that have generally been pretty honest with me that it's just initially and that it will fix some of our issues.
BY MS. DESKINS:
Q. What kind of impact do you think this will have on your business?

A. At this point, it is not going to have -- I mean, we're looking at probably a dollar less a hundredweight for milk this year. That's a big impact on our business. But fortunately, 2004 was a record high year, and last year was a decent year. So we are pretty well positioned this year. As far as 2007 and beyond, I can't comment on that, but I don't think we'd comment on the weather for 2007, either.

So we feel, in our business, that we are in a strong position for a downturn. And basically, there is always things that change in the marketplace that impact our prices, and you have to -- what I can see in just observing for the past 15 years of milk prices, we have five-year cycles, and there's all kind of factors that play into it. And we view this as just another factor, and that's another factor we have to deal with.

Q. Thank you.

THE JUDGE: Other questions? Mr. Wellington.

EXAMINATION

BY MR. WELLINGTON:

Q. Just a couple quick follow-up. Eric, if we don't correct this problem and this 30-cent deduction continues and, in fact, because of energy and other factors it may get higher, do you think that will have an impact on your operation?

A. At some point it will.

Q. Do you think that other members may consider leaving Agri-Mark or any co-op that has manufacturing plants where they don't have to incur this loss?

A. I'm sure there will be, but that only exacerbates the problem.

Q. Can you elaborate on that? How does it exacerbate the problem?

A. At some point -- we have our $160,000 in Agri-Mark, and I believe there's over $40 million that members have invested. At some point we lose that base of equity as members pull out, and we need that equity to keep our plans going, you know, to borrow for inventory or for what have you. So if we lost too many, it would negatively impact the equity standing and a bank is not going to give you money if you don't have equity to back it up.

Q. Do you think that if the three cheese plants that's operated by Agri-Mark and the butter-powder plant, if that were to close, would that have an impact on other farmers that aren't even Agri-Mark members in the Northeast?

A. Oh, absolutely. I mean, everybody ships milk into the Springfield plant.

Q. So do you think that would be a negative or a positive impact on those farmers?

A. It's clearly a negative impact, and

they may not realize it. Like I said, the fruit and vegetable people are far more aware of this than we are.

Q. Thank you.

THE JUDGE: Other questions?

Very well. Thank you, Mr. Ooms, for coming, and you may step down.

MR. VETNE: Is Exhibit 62 received?

THE JUDGE: He's identified it, and it will be admitted at this time.

[Whereupon, Exhibit No. 62 was received in evidence.]

THE JUDGE: Ms. Deskins, are you ready for Mr. McDowell?

MS. DESKINS: Yes.

MR. RASTGOUFARD: Babak Rastgoufard, USDA. I would like to recall Dr. Howard McDowell.

I would like to have marked what I believe is Exhibit 63.

THE JUDGE: That is correct.

[Whereupon, Exhibit No. 63 was marked for identification by the judge.]

THE JUDGE: Dr. McDowell, you are still under oath.

Whereupon,

DR. HOWARD McDOWELL,

having been previously sworn by the judge, was examined and testified under oath as follows.

MR. RASTGOUFARD: Mr. McDowell also has a statement which I believe he is prepared to read at this time.

STATEMENT FOR THE RECORD OF HOWARD MCDOWELL

THE WITNESS: It has been determined by the economic analysis staff that the preliminary analysis tables contain errors. The first error pertains to the baseline numbers found in the first column of Table 3 in the hearing announcement and in the last column of Appendix Table 1. The reported average baseline numbers mistakenly included a sixth year, 2004-2005. The impacts reported in the scenario columns are correct.

The second error pertains to the variable U.S. marketings. The variable label, U.S. Marketings, is actually U.S. Class Use, the quantity of milk and net imports of ingredients used in each class and in total. Baseline forecasts of annual net imports of ingredients are 290 million pounds each year of the 2005-6 through 2009-10 period.

The total of U.S. class use was mistakenly picked up as U.S. marketings in the calculation of U.S. producer revenue, which is defined as U.S. marketings times the all-milk price. Because the error is constant for each year in the baseline and the scenarios, the impacts for each scenario are not affected by the error.

The economic analysis staff has prepared revised tables. The revised Table 3 in the hearing announcement includes:

1. Properly labeled and footnoted U.S. Class Use.

2. The correct U.S. marketings and U.S. producer revenue numbers; and

3. The correct five-year average baseline numbers.

The revised Appendix Table A-1 includes the correct five-year average numbers.

Appendix Tables A-2, A-3 and A-4 containing the scenario differences from the baseline are unchanged.

At the request of Mr. Miltner, information on milk cows and milk per cow is provided in Appendix Table 5. Baseline values and changes by scenario are provided for milk per cow and milk production. Farm use in U.S. marketings are provided as well.

Finally, in the hearing announcement there are several explicit references to either average baseline number or to a percentage change calculated from a baseline number. An errata sheet has been prepared to correct errors. We request that these tables and error sheet be entered as an exhibit into the hearing record. We will post the corrected tables and the corrected text on the Dairy Programs website. We regret that the mistakes were not caught in earlier reviews, but we point out that the scenario impacts have not changed. We regret any misunderstanding that we may have caused.

I'll answer questions.

MR. RASTGOUFARD: Just so the record is clear, the one exhibit that's been marked as Exhibit 63 actually contains revised tables and an errata sheet and then also the additional information that was requested by Mr. Miltner. So it is both for the correction and some additional information, and we would like to have it entered into the record as Exhibit 63.

THE JUDGE: Exhibit 63 is admitted.

[Whereupon, Exhibit No. 63 was received in evidence.]

THE JUDGE: Mr. Miltner.

EXAMINATION

BY MR. MILTNER:

Q. Dr. McDowell, thank you for preparing the information on the cows and production for us.

Just so we can understand the information that's on there -- I'm sorry, I should introduce myself. Ryan Miltner for Continental and Select.

If we could look at Table A-5 for a moment, are the numbers on this chart prepared in the same way as the numbers that were prepared on previous charts in that for each of the fiscal years listed? These are the changes for that particular 12-month period?

A. That is correct.

Q. So under Scenario 1, milk cows, in the first fiscal year the model anticipates or predicts a loss of 3,000 cows nationwide and then an additional 4,000 cows in the following fiscal year and so forth?

A. That is correct.

Q. And they are averaged in the final column?

A. That is correct.

Q. Do you know if the model would predict similar losses in the number of cows going forward after fiscal year 2010?

A. At some point -- I don't know exactly how far out, but at some point the losses would attenuate towards nothing. And the reason why is that at some point there is enough supply response that you get back an equilibrium again. So you approach the baseline as that takes place.

Q. Am I correct, in reading these

numbers, at least as it appears that the rate of cows lost in the national herd is accelerating through fiscal year 2010?

A. Looks like it.

Q. Thank you.

THE JUDGE: Other questions of Dr. McDowell? Ms. Deskins.

EXAMINATION

BY MS. DESKINS:

Q. Dr. McDowell, the one that you prepared for Mr. Miltner, is that Table A-5?

A. Correct.

Q. Thank you.

THE JUDGE: Further questions? Ms. Deskins, further questions?

MS. DESKINS: No.

THE JUDGE: Further questions?

Dr. McDowell, in your testimony here today, are you testifying either for or against the proposal that is before us?

THE WITNESS: No, I'm not.

THE JUDGE: This is just responding to the requests that have been made of you and in your normal duties?

THE WITNESS: That is correct.

THE JUDGE: Very well.

THE WITNESS: Again, this preliminary analysis was done with the idea of illustrating potential effects with scenarios that are intended to be illustrative?

THE JUDGE: Very well. Other questions?

Thank you, Dr. McDowell, you may be excused.

Excuse me. Mr. Rosenbaum?

MR. ROSENBAUM: May we have one moment?

EXAMINATION

BY MR. ROSENBAUM:

Q. Steve Rosenbaum with the National Cheese Institute.

To follow up on how this works, take

the year 2009/2010. I'm looking at Table A-5. You have lost 15,000 -- take Scenario 2 as an example. You have lost 10,000 more cows than you otherwise would have projected for 2009/2010, correct?

A. Correct.

Q. That's not 10,000 more cows above what you had lost the previous year, is it?

A. This is against the baseline. This is -- you are looking at 2009 and 2010 changes from the baseline on Section 2, Scenario 2.

Q. Just as an example?

A. Right. That minus 10 there is against the baseline that year.

Q. Right, but it is not -- okay, it is minus 10 compared to what it would have been under the baseline scenario?

A. That is correct. It is not related back to the year before.

Q. That's what I wanted to clarify.

A. Right.

Q. These numbers don't relate back to the year before. What they relate back to is to the baseline?

A. Against the baseline for each year.

Q. So that it is not that you are losing 10,000 more cows in addition to the cows you had lost in 2009/2009. Rather, it is that you have 10,000 fewer cows than you would otherwise if you -- you would have in 2009 --

A. I don't think you said that how I would have said it.

Q. Okay. That's what I'm trying to make sure I understand.

MEMBER OF THE AUDIENCE: Why don't you say what the number is?

THE WITNESS: Well, let me -- we have a baseline that we are working against.

MR. ROSENBAUM: Right.

THE WITNESS: And the baseline is -- in terms of the number of cows is going right across the top. That's the USDA baseline.

MR. ROSENBAUM: Right.

THE WITNESS: What our changes are are changes from the baseline for each year, okay? So the minus 10 relates to the baseline figure of 8,676.

Notice, however, that clearly, in the baseline, there is a reduction from the year before, okay? So that's going on all the time, but our analysis is run against the baseline. So each year there is a reduction, it relates to the corresponding year in the baseline.

BY MR. ROSENBAUM:

Q. And so, just to follow up on that, your baseline projection -- which doesn't reflect the proposal under consideration, correct?

A. That is correct.

Q. -- already predicts, for example, a loss between the 2008-2009 year and the

2009-2010 year, a loss of, if I can do the math in my head, 74,000 cows. Is that right?

A. That looks about right.

Q. Okay. All right. That's all I have.

A. There are reductions every year.

THE JUDGE: Mr. Beshore.

EXAMINATION

BY MR. BESHORE:

Q. Dr. McDowell, do you know how the class prices for I and II were calculated that you assumed in these model projections?

A. Yes. They were calculated in the same way that they are calculated every month with one exception. When you are working with an annual model, it is different to have an advanced price series, okay? So we -- we just base it right off the Class III and the Class IV prices as an annual average.

Q. So it doesn't have in it the advance price factors that are in the formulas, as in Exhibit 16 printed off the web page? I think that's what you said.

A. No, I didn't say that. The advanced formula, the factors are identical to the other formulas with the exception that you are using an advanced average of prices in order to come up with the advanced price. This is -- that's on the month-to-month basis.

Clearly, we don't have the last two weeks of prices involved in this model. This is an annual model. So we use the same formulas, just like the formulas are the same in practice, only we have to do it on an annual basis. It is an annual average.

Q. So was the Class I price for 2005 based on the Class III and IV price of 2005?

A. Correct.

Q. On a current basis? Same 12 months -- same 12 months of Class III and IV prices --

A. Correct.

Q. -- gave you the Class I price for the same 12 months?

A. Correct.

Q. Which is not the way it works in the Federal order system because they are on advanced basis and lag basis. They are not in synch, correct?

A. I understand they are off by two weeks. Across an annual average there is very little different in that with regard to looking at something on a baseline.

Q. Do you think the Class I price for January is only two weeks off from the Class III and IV price for January in terms of the product prices that they are based on?

A. Class III and IV prices are calculated after the fact. The advanced are calculated the two weeks, month before. So if you want to look at it that way, what do you think the difference is? What do you think the difference is on an annual basis?

I ask you. There is no way --

Q. Well, I'm not testifying, Dr. McDowell.

A. Well, I'll put it as a hypothetical. It is very clear that if you have got an annual average, that you can't account for two-week intervals within that annual average.

Q. I'm just asking you how it was calculated.

A. Well, I'm telling you, but I'm also positing the rhetorical question that if you are working with an annual average to begin with, there is no way that you can account for two-week intervals within that annual average.

Q. I think what you are telling me is your model doesn't have the capability for replicating the Federal order relationship of class prices in the way that it operates?

A. I think that we can replicate the

kind of changes that take place with respect to changes in the formulas such as make allowances, and I think we can represent that with very good accuracy on an annual basis.

Q. Did you determine what scenarios and what price changes to put in the analysis here?

A. Not by myself, no, sir. We had discussions about it in Dairy Programs, and as I testified the other day, not having Mr. Ling's work to go from, we decided that we would use the changes that California was showing for the past 10 years.

And then, as we looked into that, we realized that the change in the cheese manufacturing costs was so small that we decided that we would have three scenarios dealing with larger cheese costs, manufacturing costs than were shown on the California, and we did that for illustrative purposes.

And similarly, we didn't have anything to base changes in the dried whey on, so we arbitrarily, as I testified before the other day, chose 10 percent to show what the illustrative -- for illustrative purposes.

Q. Okay. Thank you.

A. You are welcome.

THE JUDGE: Other question?

Thank you, Dr. McDowell. You may now step down.

MR. Beshore, you wanted to put Mr. Schad back on?

MR. BESHORE: Yes, I do.

THE JUDGE: This will be 64.

[Whereupon, Exhibit No. 64 was marked for identification by the judge.]

THE JUDGE: Mr. Schad. You are still under oath.

Whereupon,

DENNIS SCHAD,

having been previously sworn by the judge, was examined and testified under oath as follows.

EXAMINATION

BY MR. BESHORE:

Q. Mr. Schad, we have marked -- Judge Davenport has marked as Exhibit 64 a statement identified as, Testimony of Dennis Schad for the Association of Dairy Cooperatives in the Northeast.

Before you present that statement, could you -- since it is a statement for the Association, could you explain just briefly how this association of cooperatives comes to a position to take in a hearing such as this?

A. First off, I'll give an amended thumbnail description of what the Association of Dairy Cooperatives in the Northeast is. It's an organization of dairy cooperatives which will be listed in a moment. They probably came together during February reform to find joint positions. We have an economics, an economist group which is the designated economics person from each of the cooperatives. We try to hammer out positions on Federal order issues. I don't think that we have ever gone on any issue than a Federal order issue.

We will then come to a consensus position about issues, and we'll send that consensus position up to a group of CEOs or their designates from the -- I guess there's eight cooperatives -- from the eight cooperatives, and the positions then reflect a consensus position of the eight cooperatives.

Q. And is that how this position was arrived at for this hearing --

A. Yes.

Q. -- representing Exhibit 64?

Would you present the testimony, please?

A. Sure.

MR. ROSENBAUM: Excuse me, Your Honor, before Mr. Schad starts, I have had a chance to glance at the testimony, and it appears, on the bottom of page 4 and continuing on for the entirety of the rest of page 5, except for the very last sentence, to go to the issue that was the subject of Your Honor's ruling this morning.

And so, I would ask that, consistent with what Your Honor has already ruled, that that not be admitted in evidence. I recognize the document will travel with the record, but clearly, this is the very same issue that we have already resolved.

MR. BESHORE: Your Honor --

THE JUDGE: You may respond.

MR. BESHORE: We understand the ruling that has been made. This is a statement of position of the association. There have been all kinds of position statements made by witnesses in response to questions from Mr. Rosenbaum now and many other persons on matters, yield factors among others, that are not "subject to the actions of this hearing." Those positions are in the record.

The position of this association, which was deliberated at length prior to this hearing with the understanding of what may be available, should be allowed to be stated for the record.

MR. ROSENBAUM: As I say, Your Honor, I think -- well, I don't think I need to add anything.

THE JUDGE: I'm sorry. Are you withdrawing your objection?

MR. ROSENBAUM: No, no, I am objecting. I was saying I didn't think I needed necessarily to respond to anything, any additional points that Mr. Beshore had made. No, I am moving to strike the paragraph that starts with the, "While it is urgent," at the bottom of page 4 and continuing on through the words, "should not be changed," on page 5. I will not -- for the exact same reasons that we have already discussed at great length.

THE JUDGE: Mr. Vetne.

MR. VETNE: When this came up as a motion in response, I took a neutral position. Agri-Mark is also a member of ADCNE, and I don't think the -- although it comes in the record regardless. There is no need to strike what represents a statement of position that does not constitute a separate proposal, which I don't think the witness is making. The proposal has been ruled upon, but the views of the association as a collective of the cooperatives of the Northeast are relevant and should be received, just as we have received a day and a half of cross-examination on yield factors which were not noticed.

THE JUDGE: Mr. Yale.

MR. YALE: Just standing in support of the objection, we believe that it should be stricken because it is a play to the Department to consider that in making the decision. And our concern is even more so now that there is no rule --

THE JUDGE: Rather than delay the hearing much longer, though, let's note the objection. It's going to be in the record, anyway, and the Secretary can use it as a statement of position as opposed to evidence and a furthering of a proposal.

THE WITNESS: Before I read, Your Honor, that means I read that paragraph as well?

THE JUDGE: Yes, sir.

STATEMENT FOR THE RECORD OF DENNIS SCHAD

THE WITNESS: Thank you.

This statement is given on behalf of

the Association of Dairy Cooperatives in the Northeast (ADCNE). The ADCNE cooperatives represent in aggregate more than 65 percent of the Order 1 pool. Following is a brief description of their operations in Order 1.

Agri-Mark, Inc., headquartered in Methuen, Massachusetts, has approximately 1,300 members located in the six New England states and New York. It markets about 2.5 billion pounds of milk annually. Agri-Mark owns and operates four manufacturing plants including cheese plants in Middlebury, Vermont, Cabot, Vermont, and Chateaugay, New York; and a butter and powder plant in West Springfield, Massachusetts.

Dairylea Cooperative, Inc., headquartered in Syracuse, New York, represents 2,400 dairy farmers, most of whom are pool producers under the Northeast Order.

Dairy Farmers of America, Inc., (DFA) is a national cooperative of more than 13,000 farms. The DFA Northeast Area Council represents 2,200 dairy farmers, with most being Order 1 pool producers. DFA owns two Order 1 area powder plants at Reading and Middlebury Center, Pennsylvania, under the name of Deitrich's Milk Products, LLC -- I believe that's a misspelling -- and is an owner-member of O-AT-KA.

Land O'Lakes, Inc., is a cooperative with a national membership base. In the Northeast, Land O'Lakes has over 2,000 members who are pooled on Order 1. LOL owns and operates an Order 1 pooled butter/powder plant located in Carlisle, Pennsylvania.

Maryland and Virginia Milk Producers Cooperative Association, Incorporated, is a cooperative headquartered in Reston, Virginia, with approximately 1,400 producers in 11 states in the east and southeast. It owns and operates an Order 1 pool plant at Laurel, Maryland, which has a butter and powder manufacturing capacity; and it also owns and operates an Order 5 pool manufacturing plant at Strasburg, Virginia. Maryland and Virginia also owns and operates Class I plants in Virginia and North Carolina.

O-AT-KA Milk Products Cooperative, Inc., is a federated cooperative owned by Upstate, DFA and Niagara Milk Producers of Niagara Falls, New York. O-AT-KA owns and operates the manufacturing plant at Batavia, New York.

St. Albans Cooperative Creamery, Inc., is a Capper-Volstead cooperative with 600 members headquartered in St. Albans, Vermont. It owns and operates an Order 1 supply plant which includes facilities receiving, separating, condensing and drying milk.

Upstate Farms Cooperative, Inc., is headquartered in Buffalo, New York, and has about 300 member dairy producers the majority of whom are pooled in Order 1. Upstate owns and operates a pool distributing plant at Rochester and is a member-owner of the O-AT-KA butter/powder plant in Batavia, New York.

The ADCNE cooperatives are an important part of the Order 1 market, which is the largest Federal order representing more than 20 percent of the milk in the Federal order system. Order 1 is the largest Class I market in the Federal order system, with nearly 24 percent (23.8 percent) of producer milk used in Class I in the Federal order system in 2004 and 2005, nearly 900 million pounds per month on average. Its Class I utilization was 47 percent in 2004 and 45 percent in 2005. It is also the largest Class II marketing in the system with 20 percent Class II utilization and 4.8 billion pounds of Class II use in 2005. The

Class III and IV manufacturing uses, the remaining 35 percent of the milk in the order, are essential to balance Order 1's massive Class I and Class II marketplace. Order 1 is home to the largest regional concentration of butter/powder balancing plants in the system. These plants, owned and operated by ADCNE cooperatives, give Order 1 the largest Class IV utilization in the Federal order system, 2.9 billion pounds of producer milk in 2005. By contrast, the region's Class III industry, with a greater proportion of proprietary ownership, has been declining, with plants closing as Mr. Wellington and others have detailed. From peak usage of 7.8 billion pounds in 2002, 2005 use for cheese was 5.4 billion pounds. The viability of these Class III and IV uses is a critical component for the northeast cooperatives and the northeast dairy industry.

ADCNE supports the positions of the National Milk Producers Federation on the proposals in this hearing. ADCNE has reviewed the hearing proposals independently with particular reference to the marketing conditions in the Northeast and believes that the consensus positions advanced by the National Milk Producers Federation represent constructive, positive positions on the issues which are in the best interests of the dairy farmers of the Northeast. We offer the following additional testimony in support of the National Milk Producers Federation position so ably articulated by Dr. Ryan.

Make allowances: ADCNE supports the National Milk Producers Federation's testimony with respect to the urgent need to update manufacturing allowances for Class III and IV products. We believe that the Department should follow the procedure used to adopt the current make allowances. Both the RBCS-Ling data and the State of California data should be utilized. The RBCS data and CDFA data have been reinforced by the additional testimony from individual plant operators. Weighted average data from California manufacturing operations as well as plants in the Federal order system should be used. In an end product pricing system, make allowances must be reasonable and adequate, but should not unduly depress producer revenues.

Emergency action: The make allowances must be updated at the earliest possible time, on an emergency and expedited basis, through an interim final rule.

Energy costs/fuel adjuster: All milk marketers and plant operators, in particular, are acutely aware of the cost burdens of energy cost increases. It is important that these volatile input costs be accounted for in the Class III and IV make allowances. The

National Milk Producers Federation recommendation for a monthly adjuster is the most equitable solution, allowing for prompt input of cost increases and decreases in the make allowances and resulting class prices. The index should use the 2004 cost embedded in the RBCS and CDFA data as a base to be adjusted from that level by the mechanism elaborated by Dr. Cryan.

Class I and Class II prices: While it is urgent to adjust the Class III and IV make allowances, and prices, it is not necessary, and would be positively detrimental to allow the changes to impact Class I and Class II prices. The Order 1 market illustrates well the issue: 35 percent of the utilization is in Classes III and IV and requires emergency price adjustments. However, 65 percent of utilization is in Classes I and II. These uses do not operate on pre-set make allowances; and the prices charged for the finished products are not reflected back in the minimum class prices. The Class I and II competitive marketplace allows processors the opportunity to pass through to consumers increases in their costs of operation. There is no reason that producers should suffer price reductions on these classes of utilization. It would mean, in Order 1, that producers would suffer price production on two pounds of production for every pound requiring the make allowance adjustment. The status quo should be preserved for Class I and II prices by simply retaining the current order language and formulae for advance Class I and II pricing factors. These prices are calculated independently of Class III and IV prices and should not be changed.

Thank you for the opportunity to present the views of ADCNE cooperatives.

BY MR. BESHORE:

Q. Now, Dennis, you have presented what you have indicated is the consensus views of cooperatives. It is correct that some individual cooperatives have particular different views on some of the -- some issues?

A. This statement is the consensus position of the organization's members, and all members may or may not agree with each provision of the National Milk Producers' position.

MR. BESHORE: Thank you. I move for the position of Exhibit 64.

THE JUDGE: Exhibit 64 is admitted.

[Whereupon, Exhibit No. 64 was received in evidence.]

THE JUDGE: Mr. Yale.

EXAMINATION

BY MR. YALE:

Q. Ben Yale for Select and Continental Dairy Products.

MR. Schad, do you buy or sell any cream?

A. As a member of ADCNE or as Land O'Lakes?

Q. In either capacity.

A. Yes.

Q. And do you that on a multiple of the CME better price?

A. I do, sir.

Q. And what difference does that make to this hearing?

A. Not sure yet, thank you.

THE JUDGE: Is there serious cross?

MR. YALE: It's late in the day and late in the week.

BY MR. YALE:

Q. I notice, in your testimony here, a great deal on the need in the Northeast. And there is also testimony by many of the members of your group who have testified regarding the fact that balancing costs are a factor that ought to be considered in deciding -- of setting make allowances and stuff for manufacturing plants.

My question is this. Would your group support the Department issuing a decision in favor of making adjustments in the Northeast order on the grounds that it addresses the balancing plant issues of the Northeast order and not make changes to other Federal orders in prices unless those orders specifically requested that?

A. No.

Q. Now, I know over the years that Land O'Lakes has been a strong proponent of the Federal order system. Is that right?

A. Yes, sir.

Q. If the decision of the Department were to proceed as some have suggested at this hearing or whatever decision may be done that would cause the group to seriously consider and possibly even vote against the order to the point that one or more orders may be terminated as a result of this proceeding, would that change your position regarding whether it ought to be the Northeast or other regions?

A. No. Those decisions would be made independently by the farmers in those marketing orders.

Q. So as I understand it, is that in the orders that do not support it, that it would be they would have the choice of either accepting a huge reduction in their pay or have no Federal order because there is a need -- potentially a need in the Northeast for its manufacturing plants?

A. I would think that there is -- all dairy farmers, whenever they have the referendum put in front of them, have the opportunity to choose from minimum -- Federally regulated minimum class prices and Federal order.

Q. I have no other questions.

THE JUDGE: Other questions of this witness?

Mr. Rastgoufard.

EXAMINATION

BY MR. RASTGOUFARD:

Q. Babak Rastgoufard, USDA Office of General Counsel.

I understand the statement was prepared with other considerations in mind, but I just want to clarify something, and this is on page 4 of your statement.

I understand you are in support of Proposal 1, Agri-Mark's proposal. Yet, at the bottom when you state, on the second-to-last line, "It would be positively detrimental to allow the changes to impact Class I and Class II prices," reading that I kind of have the impression that you are saying, on the one hand, we support the proposal but, on the other hand, it would be detrimental to implement the proposal. And I didn't know if there was any duplicity there and, if so, maybe you --

A. I think first -- the first confusion, I think, is that this is in support of National Milk Producers Federation and it's not solely Agri-Mark's proposal.

And the second is that that statement talks about the effect of make allowances to changes in Class I and Class II prices -- changes of make allowances to Class III and IV to Class I prices.

Does that straighten up your --

Q. I think --

A. -- your question of that sentence?

Q. Just --

THE JUDGE: I think we are getting into an area that we are trying to stay away from.

MR. RASTGOUFARD: No, no, I just wanted to recognize --

THE JUDGE: Well, I'm saying that if you are going to pursue this line of questioning, I'm going to cut you off.

BY MR. RASTGOUFARD:

Q. Okay. Now I just have one unrelated question. The other National Milk producers proposed, also --

THE JUDGE: Excuse me, counsel. We are not going to talk about National Milk's proposal.

MR. RASTGOUFARD: They mentioned that that was part of the proposal, and I just wanted to make sure that that was --

THE WITNESS: This testimony is also in support of National Milk Producers index proposal.

MR. RASTGOUFARD: Thank you.

THE WITNESS: And also in support of National Milk Producers' call for an expedited decision in updating the make allowances based on the RBCS and CDFA numbers.

MR. RASTGOUFARD: Thank you. I appreciate you clearing up my confusion.

THE JUDGE: Other questions? Mr. Wellington.

EXAMINATION

BY MR. WELLINGTON:

Q Bob Wellington, Agri-Mark. Just one question.

Dr. Cryan, the proposal that Dr. Cryan had from National Milk differed slightly in regard to how the nonfat dry milk price was calculated. But were you in the room when Dr. Cryan said both the National Milk way they are proposing and the Agri-Mark way they're proposing is a reasonable way of approaching it?

A. Yes, and ADCNE would support --

Q. You agree that either way would work?

A. Right. And I would expect that the individual cooperatives of ADCNE have testified that we probably put in brief their -- their preference.

Q. Thank you.

THE JUDGE: Other questions?

EXAMINATION

BY MS. DESKINS:

Q. Sharlene Deskins, USDA Office of General Counsel.

Mr. Schad, since you are testifying on behalf of the Association of Dairy Cooperatives of the Northeast, you testified that they believe emergency action is necessary in this situation?

A. That is correct.

Q. Could you tell us, on behalf of that group, what they believe the emergency situation is how doing this on an expedited basis will help to relieve the situation?

A. As the testimony points out, that the cooperatives are basically the only owners of Class IV operations in the Northeast. We are the largest concentration of Class IV in Federal Order 1. Timely updating of the make allowances to current costs would help the bottom lines of those cooperatives as they are currently -- as they are currently running their operations.

Q. I mean, could you elaborate? Are all of these cooperatives experiencing a loss because the make allowance hasn't been updated? I'm trying to get idea of what they think the emergency is.

A. I know that Agri-Mark has testified that they are losing money at their plant. Land O'Lakes testified yesterday that they are losing money at the Carlisle plant. O-AT-KA testified to the level of changes in their profitability numbers if the Agri-Mark proposal was adopted. I don't have numbers on St. Albans or Maryland and Virginia to elaborate any further.

Q. Since you are speaking for them in

general, are they also experiencing these losses at these other ones you have testified to?

A. I don't know whether they are experiencing operational losses, but I think the testimony of Dr. Ling testifies to the cost disparities. I don't know whether their accounting is such that they are declaring a loss. I just don't know the answer to that.

Q. Thank you.

A. Thank you.

THE JUDGE: Other questions?

Very well, Mr. Schad. You may step down.

It is about not quite quarter of 3:00. In other words, gentlemen, what is your pleasure with respect to the next order of witnesses? Are we going to go to Dr. Yonkers and Ms. Taylor, or are we going to take Mr. Hollon?

MR. BESHORE: I think Mr. Hollon has

got some time constraints.

MR. ROSENBAUM: That's fine.

THE JUDGE: Mr. Beshore, do you want to go ahead and take our afternoon break at this time so that we don't interrupt him?

MR. BESHORE: That would be fine.

THE JUDGE: How long is his testimony, I guess?

MR. BESHORE: A couple of handwritten pages.

THE JUDGE: Well, I think we can probably get that in before 3:00, then.

Whereupon,

ELVIN HOLLON,

having been first sworn by the judge, was examined and testified under oath as follows.

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

THE WITNESS: My name is Elvin, E-L-V-I-N, Hollon, H-O-L-L-O-N.

STATEMENT FOR THE RECORD OF ELVIN HOLLON

THE WITNESS: I am making this statement on behalf of Dairylea Cooperative and Dairy Farmers of America Cooperative.

We support the position that the change in make allowances which have been proposed and supported for reasonable cause are not warranted in the case of Class I and Class II pricing formulas. Margins for Class I and Class II products are not constrained in the same manner by the product price formulas as described here by Class III and Class IV manufacturers.

MR. ROSENBAUM: Excuse me.

THE WITNESS: Do you want to read it? I'll give it to you to read it to save time.

MR. ROSENBAUM: No, I -- Your Honor, he is obviously getting -- as I heard him, he is getting into the issue that was the subject of Your Honor's ruling this morning. And this is, once again, that can be stated without it constituting evidence or a proposal, and that's how you handled the matter when Mr. Schad took the stand. If that's what this is, then I just --

THE JUDGE: Let's denominate it as such if that's the case.

MR. BESHORE: Well, Mr. Hollon hasn't finished presenting his statement yet. He's been interrupted.

THE JUDGE: Well we also don't have the ability, in other words, to pre-review it or see if it is objectionable. So, in other words, Mr. Rosenbaum's objection is timely at this point if it is going to get into that direction.

MR. BESHORE: Your Honor, I don't know what the rest of the statement is, okay. He has been interrupted in a preamble. There is no requirement that his handwritten statement --

THE JUDGE: That's true.

MR. BESHORE: -- be presented to Mr. Rosenbaum before he testifies.

THE WITNESS: I'm more than willing to let Mr. Rosenbaum glance through it. I don't think he will object. It is fine by me.

MR. ROSENBAUM: I would be happy to look at it, Your Honor. I had understood him to start to talk about whether or not -- what should be done with Class I and II pricing, which is the very issue that was the subject of our --

THE JUDGE: Earlier --

THE WITNESS: How about if you hold your objection until I finish, then we can stop, and if you want to make an objection at that time, we'll treat it as if you had read it beforehand. Is that fair?

MR. ROSENBAUM: Well, Your Honor, obviously, normally one objects before material is accepted.

THE JUDGE: This, of course, is not a trial.

MR. ROSENBAUM: I appreciate that, Your Honor. I'll proceed as Your Honor sees fit.

THE JUDGE: Well, if it's just a statement of policy, then we can accept it at that. The Secretary, in other words, is certainly free to reject that as he sees fit.

Proceed.

THE WITNESS: Margins for Class I and Class II products are not constrained in the same manner by the product price formulas as described here by many Class III and Class IV manufacturers.

We feel that producer revenue should be maintained inasmuch reasonably possible in view of any make allowance changes. It is unfair in our view to reduce the producer income by unwarranted changes in the Class I, Class II prices.

We came to this hearing with a position predicated on the positions outlined in the original National Milk proposal. Since the Department has now ruled that dairy farmers cannot defend a no-change position with regard to application of the make allowance changes in Class I and II prices --

THE JUDGE: Mr. Hollon, that's not exactly my ruling.

THE WITNESS: Okay. Correct me.

THE JUDGE: My ruling was that what was presented was beyond the scope of the notice and, as such, in other words, it was not at issue in this hearing.

THE WITNESS: Okay.

THE JUDGE: Mr. Vetne.

MR. VETNE: I hesitate to get in the middle of this, but I can empathize with Mr. Hollon.

THE JUDGE: I empathize with Mr.

Hollon, too, and I appreciate the fact that, obviously, this is an issue which is very difficult. It's very complex. It has many, many, many -- a penny one way or another makes a big difference to a lot of individual farmers.

And above all, I really was very torn about, in other words, stopping the expansion of the issue into what might have been a very profitable discussion. However, I feel constrained that I must follow what the parameters and scope of the notice were.

MR. VETNE: As I perceive the oncoming testimony -- and I haven't heard it, but as I perceive it, Mr. Hollon is about to express the view of DFA on the proposal at issue as constrained by Your Honor's ruling in view of that constrain, that's all.

THE JUDGE: What I understood him to say was not exactly what my ruling was. In other words, he was indicating that, in other words, that debate was stifled, and it was not stifled, it was indicated that it was beyond the scope of the notice for this hearing.

THE WITNESS: Fair enough.

THE JUDGE: All right. Let's proceed.

THE WITNESS: So we now do not support the changes as proposed in Proposal 1.

We will evaluate the options available to us on this issue of the application of changes in the Class IV and IV make allowance and communicate them to USDA promptly. However, in the event that the Secretary does find for the Agri-Mark proposal as noticed, we urge the inclusion of an energy-adjusting index, whose construction and operation was outlined both by the National Milk Producers Federation witness and the Agri-Mark witness, be included in the decision at the same time. This is the only way to reasonably ensure that producer income is treated in the same fair manner as for Class III and Class IV dairy product manufacturers with regard to energy costs. That is, when energy costs change, the portion of the make allowances as attributed to energy also change.

Finally, I would like to enter into the record additional details for the DFA Lovington, New Mexico plant. This information is for 2004 and is the information that was compiled and submitted to Dr. Ling in his survey and reported as such. This information clearly shows the costs of the DFA Lovington plant for 2004 are within the ranges outlined by Dr. Ling's statement for all cheeses. And I have 41 one-page copies to make available to anyone who wants them, and I would like to have them entered.

THE JUDGE: Very well. It will be marked as Exhibit 65.

[Whereupon, Exhibit No. 65 was marked for identification by the judge.]

THE WITNESS: That concludes my prepared statement.

THE JUDGE: Examination of this witness?

MR. Hollon, it looks like you get a pass.

THE WITNESS: Time for a break.

THE JUDGE: Yes, sir. Let's take our 15-minute break and let's be back at 3:15.

[Whereupon, Exhibit No. 65 was received in evidence.]

[Whereupon, the hearing recessed at 2:57 p.m. and reconvened at 3:15 p.m.]

THE JUDGE: We are back on the record. Mr. Rosenbaum.

MR. ROSENBAUM: Your Honor, the next witness is Ms. Sue Taylor, who has prepared a statement that's been marked as Exhibit 66.

[Whereupon, No. 66 was marked for identification by the judge.]

Whereupon,

SUE TAYLOR,

having been first sworn by the judge, was examined and testified under oath as follows.

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

THE WITNESS: My name is Sue Taylor. Last name is T-A-Y-L-O-R.

THE JUDGE: Counsel.

MR. ROSENBAUM: Please proceed with your statement.

STATEMENT FOR THE RECORD OF SUE TAYLOR

THE WITNESS: I am Sue Taylor, Vice President of Dairy Policy and Procurement for Leprino Foods Company, headquartered in Denver, Colorado. Our business address is 1830 West 38th Avenue, Denver, Colorado

80211. Leprino operates nine plants in the United States, manufacturing mozzarella cheese and whey products domestically and marketing our products both domestically and internationally. Six of the nine plants that Leprino operates in the United States receive milk pooled in the Federal Milk Marketing Orders. We produce sweet whey in our plants located in Waverly, New York, and Allendale, Michigan. The six plants that receive milk pooled in the Federal orders will be directly impacted by the outcome of this hearing. Therefore, Leprino has a strong interest in the decision by USDA as a result of this hearing.

In my role as Vice President of the Dairy Policy and Procurement at Leprino Foods, I am responsible for developing the company's policy positions and advocating those positions in appropriate forums, such as today's hearing. Additionally, I am responsible for market analysis and forecasting, and raw milk procurement among other things. I have represented the company at all Federal order and California order hearings that have related to cheese milk pricing over the last 11 years.

In addition to my current responsibilities at Leprino, I chair the Legislative and Economic Policy Committee for National Cheese Institute and chair the Producer Relations Committee for the Dairy Institute of California. Both committees formulate the respective organizations' positions as they relate to milk pricing policy.

My professional responsibilities have focused on dairy markets and policies since 1989, when I joined Sorrento Cheese as a dairy economist/production analyst. From 1992 through 1994, I was a principal in a dairy economics and management consulting business, Dairy Management Concepts, which provided consulting services to a broad spectrum of dairy companies, most of whom operated plants. I have been at Leprino leading the dairy policy and procurement efforts since January 1995. My educational background includes both Bachelor and Master's degrees from Cornell University in agricultural education with a heavy emphasis on agricultural economics.

Position.

My testimony is in support of adoption of Proposal No. 1 on an emergency basis. This proposal updates the make allowances in the current formula using an approach that is generally consistent with the decision from the May 2000 Class III/IV hearing that defined the formulas that are operative today.

Although there are several other aspects of the Class III/IV formula that we believe warrant review and correction, the urgent need for relief supercedes our interest in reviewing these other items at this time. We have anxiously awaited the completion of the cost study commissioned by AMS for the purposes of updating the Class III/IV formulas and had planned to seek a comprehensive hearing to consider the make allowance and other formula factors upon the data release. We continue to support the call of such a hearing in the future. However, given the delay in the completion of the AMS-commissioned study and the urgent need for relief, we believe that it is critical to move forward with an update of the make allowances in the milk price formulas on an emergency basis at this time.

The need for relief for cheesemakers is urgent. Costs have increased significantly from the base period of 1997-1999 that was used to establish the current make allowances. The fixed relationship between finished product prices and the Class III and IV formula milk prices limits the marketplace's ability to adjust for these changes. To the extent that some manufacturers have successfully implemented energy surcharges, those surcharges are being captured in the price surveys and flow through to the milk price.

The margin problem resulting from the understated Class III make allowances is not isolated to manufacturers of cheddar that is eligible for National Agricultural Statistics Service reporting. The vast majority of cheese produced in the United States would be considered commodity cheese. I would place American cheese, mozzarella, brick and Muenster in that category. Data from the NASS publication "Dairy Products" indicates that these cheeses comprised 75 percent of total U.S. natural cheese production in 2004.

These cheese are all priced relative to the CME and the milk used to produce these cheeses is priced as Class III under the Federal Milk Marketing Order system. Market forces drive the net economics of these cheeses to equilibrate with cheddar over time. This is because much of the equipment required to produce these cheeses is interchangeable. Several plants have gained the capability of producing both cheddar and mozzarella in recent years. Land O'Lakes' joint venture mozzarella plants in both Lake Norden, South Dakota and Tulare, California have added the capability of producing cheddar within the last year. It is illogical to believe that this additional capital investment was motivated by a desire to achieve lower margins. Regardless of the motivation, with dual capacity, milk can easily be shifted to the higher margin product. As that additional production seeks a market, downward pressure is applied to the pricing of the product with greater margins and the margins equilibrate.

Estimating manufacturing margins on non-cheddar varieties of cheeses by using prices that distributors are charging for 1,000 to 5,000 pound mixed lots to their customers is wholly inappropriate. The distributor level prices quoted typically on page 3 of "Dairy Market News" that have been used in this hearing to suggest that non-cheddar manufacturers enjoy very large margins are not reflective of prices received by mozzarella manufacturers. These prices are received at a different level in the marketing chain and reflect many other factors beyond the price paid to the manufacturer for the cheese. I am aware that mozzarella sold into the food service and food manufacturing segments by manufacturers is very competitively priced at a slight premium or discount to the CME. I am not aware of any energy surcharges being charged to address increased costs of manufacturing by mozzarella manufacturers for mozzarella being sold. Although I cannot comment on the pricing of branded product to grocery chains, mozzarella sold to converters who market cheese into the retail segment is similarly priced.

The increased costs reflected in the cost studies are not regional issues. The combined cost studies and the individual company data submitted for the record at this hearing cover a broad geography. Energy, health care and packaging costs have all risen substantially since the late 1990s throughout the country. The health of the manufacturing sector and maintenance of adequate willing plant capacity for orderly marketing of milk is contingent upon timely relief in the form of updated make allowances as a result of this proceeding. Manufacturing Allowance Update.

We support the use of the combined California Department of Food and Agriculture and Rural Business Cooperative Service survey results as a benchmark for setting the make allowances as a result of this hearing.

The CDFA cost studies are completed by a staff of accountants whose primary responsibility is collecting and analyzing cost information. The resulting cost studies are based on audited data compiled according to a consistent methodology. CDFA's cost studies have been fine-tuned through many years of data collection and use to support policy decision-making. Although the methodology used in the CDFA studies results in the most accurate cost studies currently available, these costs are representative of California plants only and, therefore, may not be representative of the broader geography regulated under the Federal Milk Marketing Orders.

To establish a benchmark for costs in the broader geography outside California, the RBCS survey should be used. Although the RBCS survey is narrow in its composition (in other words, cooperative plants only) and was intended only as a benchmarking study, it does provide important information regarding trends in costs. The RBCS survey was used in establishing the current make allowances and it should continue to be used until such time as a more comprehensive study can be completed.

Bob Yonkers of IDFA will testify to the mechanics of the specific adjustments made to both the CDFA study and the RBCS survey results to develop the weighted average cost, inclusive of a marketing adjustment, ROI, G&A, and energy update to 2005. We support his testimony and I will not retread that water. However, I would like to further elaborate on the approach to the whey cost studies.

Both the RBCS and CDFA dry whey cost studies have been criticized by other witnesses at this hearing. I, too, am critical of the RBCS study, but believe the CDFA cost study is sound.

Several characteristics of the RBCS dry whey cost study cause concern. First, the participating plants are much larger on average than typical sweet whey plants. The average whey plant included in the RBCS survey is more than double the size of the average whey plant as characterized by the "Dairy Products 2004 Summary," published in April 2005 and available on USDA's website. The following table summarizes that data and shows that the average U.S. whey plant size in 2004 produced 25.6 million pounds, less than half the 59.5 million pounds average volume per plant in the RBCS survey. The average plant size fall within a reasonably tight range across the regions, spanning from a low of 24 million pounds of whey to a high of 28 million pounds whey. Economies of scale are very important on whey because of the significant capital costs associated with whey processing. The significantly larger plant size in the RBCS study is likely contributing to a lowering of the survey results below the levels achievable by many sweet whey plants.

The second area of concern regarding the RBCS dry whey cost study is the omission of certain relevant costs in the reporting by the participating cooperatives. The Northwest Dairy Association witness indicated that his company omitted the costs associated with condensing whey in other plants and transporting the condensed to their drying facility. Most of the plants in the whey survey did receive outside condensed whey and none of them incorporated transportation costs incurred in order to accumulate the large quantities of whey that allowed their plants to run more efficiently and at a larger capacity than they otherwise would. These omissions result in a serious understatement of actual whey processing costs.

In contrast, the CDFA cost study was completed under the same rigorous process as the CDFA cost studies for cheddar, nonfat and butter. CDFA has conducted the whey cost survey two consecutive years. The data from the first survey was thoroughly reviewed during the February 1st and 2nd, 2005, Class 2, 3, 4a and 4b hearing.

The CDFA hearing Panel Report concluded that:

"After reviewing the information, the Panel believes the Department's cost studies on dry skim whey are accurate, reliable, and consistent with the parameters of the Cornell study."

Ultimately, the panel recommended that the whey factor be eliminated from the Class 4b pricing formula. The decision to retain a whey factor and set the make allowance at $.20 was made at levels above the Dairy Marketing Branch within CDFA. The decision to set the make allowance at a level below the cost study was not recommended by the Hearing Panel and should not be taken as a sign that the CDFA data is invalid. The entire Hearing Panel report can be found at the CDFA website, and I have provided the reference location.

The CDFA whey cost study submitted for the record in this hearing covers three plants with average output of 31 million pounds, consistent with the average whey plant sizes nationally.

Leprino supports the increase in the whey make allowance to $.2215 as proposed by Agri-Mark and supported by IDFA. In the absence of an RBCS whey cost that reflects fully the costs to achieve the capacity utilization reflected in the study and more representative plant sizes, I endorse the general approach advocated by Agri-Mark and IDFA to determine the whey cost by adding the incremental cost of drying whey to the nonfat dry milk cost. I have reviewed the update submitted by Scott Burleson of West Farm Foods of the Venkat analysis from the 2000 hearing and agree with his conclusions.

Consistency with Changes in Leprino Costs.

The proposed whey make allowance of $.2215 is consistent with the cost that would be determined by adding the change in Leprino's sweet whey processing cost since the survey period that was used to establish the current whey make allowances. The current formula make allowance of 15.9 cents was based upon the average costs of drying whey determined by a study commissioned by National Cheese Institute. The study primarily relied on data from 1998 and 1999. We produce sweet whey in Waverly, New York and Allendale, Michigan and participated in that study. Since 1999, our costs have increased by 5.4 cents per pound sweet whey in these two plants. When added to the 15.9 cent make allowance (the average NCI survey whey cost from the time), the new make allowance would be $.213, just slightly less than that proposed by Agri-Mark.

In Conclusion.

Setting regulated manufacturing prices above the manufacturing value of that milk results in disorderly marketing by encouraging additional milk production that the market does not have a ready outlet for, while decreasing demand for that milk from processors. Clearly, costs have increased significantly since the existing make allowances in the manufacturing classes were set and it is necessary to update the make allowances consistent with those changes. The magnitude of the issue warrants an expedited decision and we urge the Department to adopt the Agri-Mark proposal to adopt make allowances reflective of 2004 cost data updated for changes in 2005 energy costs.

Thank you.

MR. ROSENBAUM: Your Honor, at this point I would move Exhibit 66 in evidence.

THE JUDGE: 66 will be so admitted.

[Whereupon, Exhibit No. 66 was received in evidence.]

MR. ROSENBAUM: And Ms. Taylor is available for cross-examination.

THE JUDGE: Mr. Yale.

EXAMINATION

BY MR. YALE:

Q. Benjamin F. Yale on behalf of Select, Continental and the others named.

You have identified the number of plants that operate, you say six or nine plants, in the United States. Can you provide -- and I'm not looking for a -- but a range of average or the average size of production that is produced at those plants?

A. I do not have that number off the top of my head, but we are -- our plants average larger than the average mozzarella plants or cheese plants within the U.S.

Q. There are some -- there was some plants listed in the CDFA cheese plants. Have you seen that table and the size of those plants?

A. Are you referring to the cost study?

Q. The cost study for cheese.

A. I'm familiar with that cost study.

Q. And the size of the plants that are part of the cheese study?

A. I'm generally familiar with that.
Q. I guess my question was, would they -- bear with me one second.
Do you have Exhibit 23 by any chance?
A. It would appear that I do not.
Thank you.
Q. On the -- they have three plants that they categorize in the low-cost group.
A. And what page are we looking at?
Q. It's not page, but it's a cheese processing cost. It's a 12-month period, and they show 628 million pounds produced by three plants, which would be approximately 200 plus million pounds per year per plant. Would that be about right on an average?
A. Yes.
Q. Would the Leprino plants tend to fall in that size group, in general? I'm not asking for a specific number, but in general would they tend to be in that range or higher?

A. Generally, yes.

Q. And are the -- okay, thank you.

Are you suggesting that the cost to produce mozzarella is comparable to the cost to produce cheddar?

A. No, I'm suggesting that the margins that are achievable in mozzarella are generally comparable to the margins achievable in cheddar.

Q. Now, in addition to traditional mozzarella, Leprino produces other cheeses, sometimes called pizza cheese, and other types of things, is that correct?

A. We produce mozzarella, some of which is marketing under another fanciful name. The majority of the mozzarella that we sell has been shredded and maybe combined with cheddar or some other cheese varieties according to our customers' pizza-topping desires. And so, yes, it's sold under a different fanciful name.

Q. But is your mozzarella the typical pasta balata?

A. It is pasta balata.

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

THE JUDGE: Other questions of Ms. Taylor? Mr. Vetne.

EXAMINATION

BY MR. VETNE:

Q. Ms. Taylor, you have a sweet whey processing plant in Allendale, Michigan?

A. Yes.

Q. Correct? And that's your only whey processing facility in Michigan?

A. Correct.

Q. But you operate two plants in Michigan, one in Remus and one in Allendale, correct?

A. Correct.

Q. Does the Remus plant, as you have heard some other plants do, condense and ship its whey to Allendale as its solution to whey disposition?

A. Yes, it does. The Remus plant is a small string cheese plant. It doesn't justify the capital investment in whey processing.

Q. And you have three plants in California?

A. Yes.

Q. Do you operate three separate whey plants in California?

A. We do.

Q. And each plant takes care of its own whey?

A. That is correct.

Q. And those plants are all fairly large mozzarella plants?

A. One larger than the other two. Two, I would characterize as more moderate size.

Q. So when you responded to questions about the relative size of Leprino's whey plants, you were referring to each of the three plants or just one?

A. Actually, I interpreted Mr. Yale's question about plant size as being broadly across all nine of our plants. Our whey plants are more characteristic of the size that you see in the USDA data.

Q. RBCS data, you mean?

A. The NASS data.

Q. Oh, the NASS data, where you report certain volume of whey and then number of plants producing it?

A. Actually, let me consult my reference just momentarily.

I should amend that. Our plant size is somewhere between the RBCS and the NASS numbers.

Q. Thank you.

THE JUDGE: Other questions? Mr. Beshore.

EXAMINATION

BY MR. BESHORE:

Q. Marvin Beshore. I have just one question. There's been testimony about, you know, hauling whey from one plant to another plant for disposal. You commented on that a little. I'm not sure I understand how -- how do you think the whey -- the manner for accounting for that transaction should be done?

In other words, you add volume in one plant.

Are you saying the transportation cost should be added to the cost of production at the receiving plant, or is it a cost of whey at the plant and shipping it or --

A. If we are looking at the cost at the receiving plant, then it needs to reflect all the costs that contribute to the volume that is going through that, including the condensing cost of that whey prior to leaving the shipping plant, any of the other logistical costs, including transportation and assembly.

Q. So the total volume produced at that point should be distributed over costs that include the condensing from the shipping plant?

A. That is correct, because if it was a self-contained plant, it would be incurring all those costs.

Q. All right.

THE JUDGE: Other questions?

Thank you, Ms. Taylor.

[Whereupon, Exhibit No. 67 was marked for identification by the judge.] Whereupon,

DR. ROBERT D. YONKERS

having been first sworn by the judge, was examined and testified under oath as follows.

THE JUDGE: Tell us your name and spell your last name for the hearing reporter.

THE WITNESS: My name is Robert Yonkers, Y-O-N-K-E-R-S.

EXAMINATION

BY MR. ROSENBAUM:

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

A. Yes, I do.

Q. Which has been marked as Exhibit 67?

A. Yes, that is correct.

Q. Could you please proceed to read that.

STATEMENT FOR THE RECORD OF ROBERT YONKERS

A. This testimony is submitted on behalf of The National Cheese Institute, or NCI, a trade association representing manufacturers, marketers, distributors, and suppliers of cheese. NCI's approximately 70 member companies manufacture and/or market more than 80 percent of the cheese consumed in the United States.

As buyers and processors of milk, NCI

members have a critical interest in this hearing. Most of the milk bought and handled by NCI members is regulated under the Federal milk marketing orders, or FMMO, promulgated pursuant to the Agricultural Marketing Agreement Act of 1937, the AMAA.

I am Dr. Robert D. Yonkers, Chief Economist and Director of Policy Analysis at the International Dairy Foods Association, or IDFA, the umbrella organization that encompasses NCI. I have had held that position since June 1998. I hold a Ph.D. in agricultural economics from Texas A&M University (1989); a Master's degree in dairy science from Texas A&M in 1981; and a Bachelor of Science degree in dairy production from Kansas State University (1979). I have been a member of the American Agricultural Economics Association since 1984.

Prior to taking my current position

at IDFA, I was a tenured faculty member in the Department of Agricultural Economics and Rural Sociology at The Pennsylvania State University, where I was employed for nine years. At Penn State, I conducted research on the impacts of changing marketing conditions, alternative public policies and emerging technologies on the dairy industry. In addition, I had statewide responsibilities to develop and deliver extension materials and programs on topics related to dairy marketing and policy. I have written and spoken extensively on economic issues related to the dairy industry, and I have prepared and delivered expert witness testimony to state legislators and to Congress.

These hearings were called to consider whether any changes should be made to the Class III and Class IV make allowances currently contained in all FMMOs. NCI fully supports Proposal 1 as proposed by Agri-Mark and contained in the Notice of Hearing. For the reasons I am about to explain:

1. USDA should update the make allowances used in all FMMO minimum class price formulas using the methodology used to establish the current make allowances, but with the most recently available industry cost data from both the California Department of Food and Agriculture and USDA's Rural Business Cooperative Service. Since the most recent data from these two sources covers industry cost data from 2004, these costs should be updated for the dramatic increases in energy costs between 2004 and 2005 using indices from the U.S. Bureau of Labor Statistic, or BLS, for industrial electricity and industrial natural gas.

2. The make allowance for cheese should be set no lower than 18.1 cents per pound.

3. The make allowance for dry whey

should be set no lower than 22.2 cents per pound.

4. The make allowance for butter should be set no lower than 15.4 cents per pound.

5. The make allowance for nonfat dry milk should be set no lower than 19.7 cents per pound.

6. The Department should omit a recommended decision and issue and implement a final decision and rule on as expedited a basis as soon as is reasonably possible.

I. The Critical Importance of Make Allowances In a Pricing System Based Upon Product Price Formulas.

Before addressing the specific make allowances that should be adopted, it is instructive to review the critical role they play under the current Federal milk pricing system.

Prior to January 1, 2000, the minimum

class prices for milk regulated by FMMOs were established based on the actual competitive market prices paid for unregulated Grade B milk in the Upper Midwest. The Basic Formula Price, or BFP, under FMMOs based on the Minnesota-Wisconsin price series, a survey of the prices paid for Grade B milk in the second preceding month, updated by the changes in the weighted average of the wholesale prices for cheese, butter and nonfat dry milk between the second prior month and the immediately preceding month.

While the minimum class prices moved up or down with changes in wholesale dairy product prices, the underlying market conditions for unregulated milk in the Upper Midwest were the driving force in the level of FMMO minimum class prices. Those competitive pay prices could, and often did, change in response to industry manufacturing costs. Thus, the milk order pricing system could adjust automatically to changes in manufacturing cost, without any need to amend the terms of the FMMO themselves.

Since January 1, 2000, however the Federal milk order system has adopted a new approach, which utilizes the price of finished products to determine the minimum milk prices that must be paid to farmers through a mechanism commonly referred to as a "product price formula." Oversimplifying slightly, a product price formula sets the minimum prices that farmers must be paid for their milk as the price handlers receive for their finished product (such as cheese or butter) minus the cost the handlers incur in turning farm milk into those finished products (commonly referred to as the "make allowance").

In general terms, a make allowance is the difference between wholesale sales value of a manufactured dairy product and the cost to purchase the raw milk necessary for that product's production. This make allowance is used for many economic purposes, for example, to pay for the use of the capital necessary to build and maintain the plant, to cover the nonmilk costs relating to obtaining raw milk, to pay for marketing the processed dairy product, to pay wages to employees of the manufacturing plant, to pay utility companies for the water, electricity and natural gas used to manufacture the dairy product, to buy ingredients other than raw milk, and to long cover a wide variety of other expenses such as plant maintenance, equipment, and insurance.

A hypothetical, but realistic example may help explain the concept of make allowances in product price formulas. Assume the example where the wholesale price of cheese is $1.40 per pound and the total cost of manufacturing and marketing that cheese is

17 cents per pound of cheese. A manufacturing plant facing these assumed economic factors would be payable to pay up to $1.23, which is $1.40 minus 17 cents, for the raw milk needed to manufacture each pound of cheese.

What if this hypothetical plant is regulated under a Federal order? If the make allowance specified in the regulated minimum price is 17 cents, this example plant can pay all the costs associated with manufacturing and marketing cheese after paying the regulated minimum milk price to the milk producers supplying the raw milk.

If, on the other hand, the make allowance specified in the regulations were 15 cents, the plant would be required to pay a minimum price of $1.25, which is $1.40 minus 15 cents, to milk producers supplying milk. In this scenario, the plant would still receive the wholesale cheese price of

$1.40, but after being required to pay the minimum milk price of $1.25, would only have 15 cents left to cover the total cost of turning that milk into cheese. But with the actual total costs of manufacturing and marketing cheese of 17 cents, the plant would be unable to pay for one or more factors of manufacturing and marketing. Obviously the plant could not continue to operate like this for any extended period of time.

It is easy to see through this simple but accurate example the critical needs for a make allowance that covers the total cost of turning raw milk into a finished dairy product. Without an adequate level of make allowance, a manufacturing plant could not continue to operate, as it would have insufficient funds available to pay the vital costs necessary for operating the plant.

The extreme case would be if a manufacturing plant were required to pay the entire sales value of a dairy product to the supplier of the raw milk used for that product. In this extreme case, there would be no funds left to cover any of the costs associated with manufacturing and marketing the dairy product. The plant would be forced to cease operations, and a viable market for raw milk would no longer exist. But even if the manufacturing plant were committed to hang on to some of the sales value, it will not be able to cover the costs fully unless it is entitled to hang on to enough money to pay for all of its costs

Furthermore, if the manufacturing plant is not, in our example, getting enough money to cover its costs, it cannot simply raise the prices for its finished product or lower the amount it is paying for its milk. In an unregulated market, that might be possible. The manufacturer would do one of two things. It would either raise the wholesale price of its products, or find a less costly source of raw milk.

But, of course, we know that under the Federal order system the handler cannot reduce what it is paying its farmers below the minimum regulated price. This option is non-starter.

What is equally important to recognize is that the handler cannot escape from its conundrum by raising its finished product prices, either. We can see why this is so by returning to our example. Recall that the handler is selling cheese for $1.40, the make allowance is 15 cents, and the minimum price of milk is, therefore, $1.25. The handler is losing 2 cents for every pound of cheese it makes because its true costs of manufacturing is 17 cents, but it only has 15 cents left over after it pays for its milk.

So why can't the handler simply raise its price to $1.42? The problem lies in the

Federal order minimum price formula. As previously noted, the minimum price is the price of the finished product minus the make allowance. In our example, before any finished product price increase, the minimum milk price was $1.40 minus 15 cents equals $1.25. After the finished produce price increase, the minimum milk price is $1.42 minus 15 cents equals $1.27. Thus, all of the money derived from the increase in the finished product price has gone directly to the farmer in the form of a higher, legally mandated, minimum milk price. None of the money derived from the finished product price increase has gone to the handler. After paying the now higher minimum milk price, the handler only has 15 cents left over, precisely the same amount as before it raised its finished product prices.

The same effect will result no matter how much or, for that matter, how little the handler attempts to raise its finished product prices. You can plug any price increase you want into the equation. The result is always the same because the pricing formula works as a ratchet. All of the finished product price increase gets passed on to the farmer in the form of a higher minimum milk price. None of it is available to the handler to make up for the shortfall between the make allowance and the handler's true cost of manufacturing. Any steps it might take would be as futile as a dog chasing its own tail.

The example I have been using has focused upon cheese and its make allowance, but the same principles apply equally to all of the make allowances contained in the pricing formulas.

The only rational conclusion is simple and straightforward: too low a make allowance leads to reduced manufacturing capacity and reduced outlets for producer milk. FMMOs must be amended when their make allowances no longer reflect the real costs of making manufactured dairy products.

As was similarly observed by Ed Jesse and Brian W. Gould in their recent paper, "Federal Order Product Price Formulas and Cheesemaker Margins: A Closer Look," Marketing and Policy Briefing Paper No. 90, October 2005:

"Fixed margins can be a serious problem if they consistently yield subpar returns and cause disinvestment in cheesemaking. Farmers and cheesemakers are partners -- both must be profitable over the long run to sustain a healthy dairy industry."

USDA itself recognized this principle in adopting the current make allowances, and I quote.

"The make allowances incorporated in

the component price formulas under the Federal milk orders should cover the costs of most of the processing plants that receive milk pooled under the orders. In part, this approach is necessary because pooled handlers must be able to compete with processors whose milk receipts are not priced in regulated markets. The principal reason for this approach, however, is to assure that the market is cleared of reserve milk supplies."

That's November 7th, 2002, 67 Federal Register, page 67915.

NCI believes that there are flaws in the current pricing system going beyond the make allowances. But given that this hearing is limited to make allowance, I will confine my testimony today to the ways in which the current make allowances need to be amended.

II. The Current Make Allowances Are Outdated and Causing Substantial Harm to the Dairy Industry.

The make allowances currently used throughout the FMMO system for cheese, dry whey, butter and nonfat dry milk were established following a hearing in May 2000. At that time industry cost data were available for the years 1997 through 1999 depending on the dairy product, and this formed the basis of testimony by a number of industry participants.

In a decision based on that hearing, USDA fixed the make allowances for cheese, butter and nonfat dry milk by using data from two sources presented at the hearing. The first source was based on actual plant cost audits conducted by the California Department of Food and Agriculture, or CDFA, based on the period January 1997 through April 1999. The second source was a summary of a survey of dairy cooperative manufacturing plant costs conducted by USDA's Rural Business Cooperative Service, or RBCS, based on the period 1998 through 1999. The method adopted by USDA was to weight these two data sources by the volume of cheese, butter and nonfat dry milk represented by each data source. At that time, the CDFA weighted average cost for all cheese plants in the survey was used by USDA. For butter, CDFA reported costs for two groups, the high-cost and low-cost groups. Based on average volume processed and indications of plant capacity utilization, USDA concluded that only the high-cost group was comparable to the butter cost data from RBCS, and therefore used the weighted average of the CDFA high-cost butter group only. For nonfat powder, CDFA reported costs for high, medium and low cost groups; again, the USDA concluded that it was most appropriate to use the weighted average of only the medium and low cost groups based on comparing both average plant volumes and capacity utilization to the RBCS data.

Finally, neither of these two data sources included industry cost data for dry whey in 2000.

Actual manufacturing and related costs have risen significantly in the six years since. However, as discussed in Section 1, FMMO regulations strictly prevent manufacturers from in any way recovering any portion of those higher costs through higher sales prices or any other means.

Neither Congress nor USDA intended to threaten the economic viability of the U.S. dairy industry by forcing manufacturers to lose money on every pound of cheese or other product produced, or potentially injure dairy producers by eliminating this important outlet for farm milk. However, the current system of FMMO regulated price formulas fixes the difference between the value manufacturers obtain in the marketplace for their products and the minimum price they must pay for the milk used to make those products based on the industry costs as they existed at or before the May 2000 hearing at which the make allowances were established. Without any mechanism to adjust the make allowances in response to changes in industry costs, manufacturers are trapped into either losing money on every pound of product produced or stopping production entirely.

There is, therefore, an overwhelming and imperative need for immediate relief from the highly injurious fixed relationship between output prices and minimum regulated milk prices that do not reflect current industry costs. NCI accordingly supports updating the make allowances used in all FMMO minimum class price formulas using methodology used to establish the current make allowances, but with the most recent available industry cost data from both the CDFA and RBCS as updated by energy indices from the BLS.

The most data provided by CDFA were first published in November 2005, and in an update for nonfat powder only was issued earlier this month. These data are presented in Table 1. Note that unlike data available from CDFA in May of 2000, CDFA now does provide data on dry whey costs.

Due to the time necessary to conduct audits under the CDFA system, manufacturing cost data is already 11 to 23 months old at the time of publication. Therefore, even the data published in December 2005 represents the data period January 2004 through December 2004.

The second source of industry manufacturing cost data used by USDA as a result of May 2000 hearing was the RBCS, the results of which were presented during that hearing by Dr. Charles Ling. Dr. Ling has conducted a new survey of cooperative dairy manufacturing plants and has already testified at this hearing regarding the results of this new survey. As with the CDFA data, the RBCS data now includes data on dry whey cost, and I have included those in Table 2.

USDA established the current make allowances based on the average of the RBCS and CDFA (selected groups by product) data, weighted by the volume of production represented by each data source. However, NCI notes that unlike the data available for the May 2000 hearing, the most recent CDFA data for different cost groups more closely match the most recent RBCS data. For butter, USDA should use the weighted average of all the butter plants in the CDFA data, which includes the both the high- and low-cost groups, rather than only the high-cost group used to calculate the current make allowance. In addition, the RBCS butter cost should be adjusted due to the fact that most of the butter in the RBCS survey was processed into one pound prints, while the CDFA data was adjusted for bulk butter only. This should be done by subtracting the RBCS butter packaging costs and adding the CDFA packaging costs to the RBCS data for butter only. For nonfat dry milk, USDA should use the average for the medium-cost group only, rather than the weighted average of the low- and medium-cost groups used to calculate the current make allowance.

For cheese, USDA should use the weighted average of all the cost groups in the CDFA data, just as USDA concluded following the May 2000 hearing; in addition, since the CDFA is all adjusted to a 40-pound block basis, USDA should use only the RBCS data on cheese plants with 40-pound blocks, rather than the average for all cheese plants as used by USDA to calculate the current make allowances.

The RBCS data is for in-plant costs only, and USDA concluded from the May 2000 hearing that an adjustment should be made to this data by adding the CDFA data for both general and administrative costs and return on investment. USDA should make the same adjustments in updating the make allowances. In addition, USDA also concluded following the May 2000 hearing to add a marketing cost of .15 cents to the weighted average of the RBCS and CDFA data, since neither cost data included marketing costs. Again, USDA should include this adjustment when updating the make allowances.

The CDFA and RBCS data now available represents industry costs from the calendar year 2004. These reported costs ignore the significant increase in energy costs between 2004 and 2005. Therefore, USDA should include in the make allowances an adjustment for the increase in these energy costs. The Bureau of Labor Statistics' price indices indicate that industrial electricity prices increased 6 percent and industrial natural gas prices increased 23.8 percent between 2004 and 2005. The RBCS data provides cost breakdowns for electricity and total fuel costs. USDA should apply these cost increases to the reported cost data for these two cost categories in updating the make allowances.

In May 2000, neither the CDFA nor RBCS reported data for the cost to manufacture dry whey.

CDFA has reported skim whey powder data for the past two years. The weighted average cost exceeded 26.7 cents per pound of skim whey powder produced in both years. After being first published last year, the California state milk regulation authorities decided to adopt a skim whey powder make allowance of only 20 cents, more than 6.7

cents per pound below the reported industry cost.

The RBCS is reporting whey cost data publicly for the first time at this hearing, and reported separate cost data for plants which only condense whey from those which dry whey. The dry whey costs for the January 2006 RBCS data reported above in Table 2 indicate such costs are more than 3.5 cents per pound less than that for nonfat dry milk. This is inconsistent with testimony at both the May 2000 hearing and at this hearing, which establish that the costs for dry whey exceed the costs for nonfat dry milk. In addition, the dry whey costs reported by CDFA are more than 11 cents per pound of product processed higher, or 70.8 percent higher.

Therefore, USDA should calculate the current dry whey make allowance by adjusting the nonfat dry milk make allowance for the incremental costs associated with drying whey. As testified by others at this hearing, USDA should add 2.5 cents per pound of product to the nonfat dry milk make allowance to determine the dry whey make allowance.

USDA should therefore amend the FMMO regulations to reflect the make allowances set forth in Table 3, which are for butter, 15.4 cents per pound; for nonfat dry milk, 19.7 cents per pound; for cheese, 18.2 cents per pound; and for whey, 22.2 cents per pound. III.

USDA Should Render a Final Decision Promptly Without First Publishing a Recommended Decision.

USDA is authorized to omit recommended decision when the facts dictate a need for prompt action. The Administrative Procedure Act authorizes the omission of a recommended decision in a case in which the agency finds on the record that due and timely execution of its function imperatively and unavoidably so requires. And I listed the citation.

The Department's rules are to the same effect. And I have also listed that citation.

The tremendous gap between the current make allowances and actual manufacturing costs cries out for prompt resolution. The Secretary is tasked under the AMAA with maintaining orderly marketing conditions and with setting milk prices that reflect economic conditions that affect market supply and demand for milk and its products. These obligations cannot be fulfilled so long as the current outdated make allowances remain in place.

The due and timely execution of the Secretary's function accordingly mandates that the Department issue a final decision without first issuing a recommended decision.

Alternatively, the Department should issue and implement a tentative final decision and interim final rule allowing for comments to be filed prior to the issuance of a final decision and final rule. This was the practice employed in the implementation of the current make allowances as discussed. And I have got the citation in the Federal Register.

MR. ROSENBAUM: Thank you.

Your Honor, at this point I would like to move Exhibit 67 into evidence.

THE JUDGE: It will be admitted.

[Whereupon, Exhibit No. 67 was received in evidence.]

MR. ROSENBAUM: Dr. Yonkers is available for cross-examination.

THE JUDGE: Mr. Yale.

EXAMINATION

BY MR. YALE:

Q. Ben Yale, Yale Law Office, on behalf

of Continental Dairy Products, Select Milk, Dairy Producers of New Mexico, Zia Milk Producers and Lone Star Milk Producers.

Good afternoon, Bob.

A. Almost evening, isn't it, Ben?

Q. Almost evening. And maybe it will be evening.

In your testimony, you say you're speaking on behalf of the 70 member companies that manufacture and market more than 80 percent of the cheese consumed in the United States?

A. That is correct.

Q. Do you know what the volume of milk that they purchase is?

A. No, I do not.

Q. Do you know what the approximate volume of cheese that they produce would be in pounds?

A. Produce or produce and market?

Q. Produce, manufacture and/or market.

A. Because some of our members market cheese but don't produce cheese. In other words, they buy cheese and manufacture it into another product, and no, I don't have the breakout for that.

Q. Do you know how much cheese is produced in the United States annually?

A. Over 8 billion. I don't.

Q. So 80 percent would be 6 to 7 billion pounds that you --

A. I'll buy that. I should say that was over 8 billion pounds of natural cheese. Of course, there is processed cheese that's less than a full component of natural cheese.

Q. And roughly, that would translate into 60, 70 billion pounds of milk?

A. Ten to one. That's a reasonable rule of thumb, yes.

Q. And a reduction based upon the estimated change in the make allowances as proposed by Agri-Mark and the others is approximately 50 cents per hundredweight change in the Class III formula. If you use the same component prices, commodity prices, that it yields approximately 50 cent less than the current formula does?

A. Yes. If all we are changing are the make allowances as proposed by Agri-Mark and NCI.

Q. Right.

A. Yes.

Q. So for the numbers you are representing, that would be several hundred million dollars a year?

A. You could do that math and, yes, I would agree with that.

Q. Are there any -- you don't have any testimony in here regarding -- you talked about disorderly marketing, and it's one of those buzz words I hear at every hearing. Do you have a definition of disorderly marketing?

A. I don't believe anyone has ever had a definition for disorderly marketing that's been accepted by everyone else. As I refer to it here, the disorderly marketing that would result would be closure of plants, manufacturing plants, and therefore reduced outlets for milk, farm milk.

Q. And is there evidence that there is a reduction in manufacturing capacity for milk in the United States since 2000?

A. I know of no data source that tracks capacity for manufacturing cheese. I know previous testimony by members of NCI have indicated that plants have closed, particularly in some regions of the country. So looking at it on a national basis doesn't address needs for regional capacity.

Q. There might be some regional issues but not on a national basis?

A. I'm not saying that there's not. I don't know. I have never seen any data source that looks at capacity utilization.

Q. What about production of cheese in the United States? Has it been the same, gone down or gone up in the last five years?

A. Thankfully, consumers seem to be demanding more, so we are producing more cheese every year.

Q. Does that also include that there is more domestic production of cheese to meet that demand?

A. Yes, there has been an increase in the production of cheese on average over the last, I think close to 20 years.

Q. Are you aware of whether there's been additional new plants being built in the last five years in the country to produce cheese?

A. I read the same trade press you do and, yes, I'm aware that there have been new plants that have gone online in the last five years. Also, those some trade press carry stories of plants that have been closed during the last five years, also, but no indication of what the relative capacity of those plants is.

Q. You indicate that you served and have been involved in this -- in one way professionally for approximately 15, 16 years? Is that about right?

A. And prior to joining Penn State University, I was a staff economist in the Agricultural and Food Policy Center at Texas A&M for about six years, so longer than that.

Q. And in that same trade press, you saw the opening and closing of cheese plants that occurred long before order reform, right?

A. Absolutely.

Q. In fact, there were periods prior to order reform when there would be seemingly major closings in Wisconsin and New York of cheese plants and other parts of the country, is that right?

A. My recollection of, certainly, the

period of the late '80s and most of the '90s was that the Upper Midwest had a chronic situation of not enough milk and too much plant capacity. So, yes, there were some closings, but it wasn't related so much to anything other than just the inability to attract milk.

Q. Which is also an important factor that the Secretary has to consider, to make sure there is a sufficient price to provide a sufficient supply of milk, right?

A. For the fluid market under the AMA and under Federal orders, only for the fluid market. That's my understanding.

Q. Did you do any analysis to determine or has anybody reported to you whether any of your NCI members are at a net operating loss position under the current regulation?

A. We don't collect data on the profitability of NCI members.

Q. So the answer is you don't have any

such data?

A. No, I don't.

Q. Do you know at a macrolevel the thing of actual plants closing or plants going out of business would be more indicative of whether there are insufficient margins rather than breaking it down to a very discrete description of cost accounting, is it not, that --

A. Could you repeat the question.

Q. Sure. Let me rephrase it.

The determination of the profitability and viability of a plant is that -- is ultimately at the bottom line after the all the income and all the expenses and so on and so forth are considered, right?

A. For each plant, that is correct.

Q. Right. And although cost accounting has an aspect to it that assists in managing and understanding if or where they can make profit and how they need to change, one does not measure the profitability of a plant based upon just simply the cost accounting of -- to produce, does it?

A. If by cost accounting, you mean taking into account all of the revenues and all of the costs, I don't know how else you would measure the profitability of --

Q. Well, cost accounting in terms of individual units, being able to sit down and identify the actual costs that went into the individual units produced at the plant.

A. But that's just dividing the total revenue and total cost by the volume that runs through the plant. Maybe I'm not getting your question.

Q. No, I think you're getting the question because, really, what it comes down to is that to really understand the full impact of any margin or ability to transfer sales into the marketplace or the yields or any of these things, that really the thing to do is to look at the net profit of the plant. You take the gross sales, you subtract out the cost of goods, and what is left is the margin, gross margin. And if your cost to make that -- if there is sufficient there to cover the rest of cost, you have a profit, and if it's not you have a loss, right?

A. I think what you just laid out is exactly what I go through at the very first hour of a two-day course I teach for members of IDFA before I introduce the concept of product price formulas, because that is exactly the root of a product price formula, is you take a revenue and you subtract out a cost of turning a raw product into a finished product, and what is left is what is available to pay for the factors of production that are already accounting for in the cost --

Q. Right.

A. That's exactly what I go through.

Q. But in the real world -- we are talking here on individual items, production of whey or production of nonfat dry milk. But in the real world, in a given plant, there are generally more than one product that's being produced, right?

A. There are some plants that are highly specialized for one product, but I would imagine that many plants have the ability to -- if they aren't producing multiple products, they have the ability that they could produce multiple products.

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

A. It's been a long time since I have had physical relations to chemistry like that.

Q. Have you seen determining mass balance in terms of financial accounting for plants?

A. Seen it, yes, but not familiar with the concepts. I'm not an accountant by trade.

Q. A couple statements you made here I wanted to address. At the top of page 7, you said, "We know that under the Federal order system a handler cannot reduce what it is paying its farmers below the minimum regulated price."

Isn't it true, Dr. Yonkers, that manufacturing plants can choose to participate in the Federal order or not? That that's a choice that they can make?

A. That's correct.

Q. In fact, I think we had a witness testify building a new plant in Texas, and they are deciding whether to be part of it or not part of it, right?

A. I heard that testimony.

Q. And if they are not part of it, they don't have to pay the minimum price, do they?

A. They don't have to, but they may not get any milk if they are unable to pay competitive prices.

Q. Right.

A. And the majority of my members who are located outside of the state of California, where there is Federal opportunities to be part of a Federal milk marketing order system, choose to be regulated because that provides them additional revenues from Class I and II to attract the milk necessary to their plants. Without that, they would be unable to do that.

Q. Which is the case that they -- they take the risk of the minimum pricing system that you are now discussing that needs fixed, but in return for that they get additional money to attract milk to their plant, right?

A. That's how I understand the Federal order system.

Q. So they have a choice in that, an economic choice that if the system is forcing them into a loss position, that they can make another financial choice in terms of how they procure their milk or what they paid for it, right?

A. Can you ask that question again, Ben?

Q. Sure.

A. I'm really not sure I followed you.

Q. Take the plant, for example, we had the one that was discussed the other day, and I just speak this hypothetically. I have no specific knowledge. But let's say you and I are going to build a plant in an area such as north Texas. And I have the choice to be part of the regulated system or I have an unregulated price and stay out of the regulated system. That's a decision that I get to make or we get to make as part of that process, right?

A. I understand that.

Q. If I choose to be in the regulated system, then I have to choose to play by those rules, right? There's rules that --

A. Certainly.

Q. Right.

A. Well, the Market Administrator will make sure that you play by those rules.

Q. Right. They make sure. We would hope that they would, and they do. But participating and following those rules has a cost, right? It generally has some cost associated with it?

A. There are shipping requirements.

Q. Right.

A. There are the other performance requirements under the order, sure.

Q. And the minimum pricing requirements?

A. Well, you don't -- I mean, there is not a choice, though.

Q. Right.

A. You have to follow the minimum

pricing, but your economic decision to participate in the pool or not is based on your ability to attract milk with or without it. It's not a decision that you make that you're going to lose -- well, I want to lose money on my cheese manufacturing operations, and therefore I'm going to join the order. If you don't, you don't have milk in our plant. I had several members who testified about the competitive nature of procuring milk.

Q. And they have all testified that irrespective of what the margins are, that they are paying this higher price and then some.

A. Well, not all of them testified to because some of them weren't asked any question.

Q. Right.

A. But there were some that said that they had to do that to attract a supply of milk. And if they are not covering all their costs, economics tell us that in the short run you choose not to cover fixed factored of production and only cover your variable costs -- and you can do that for a short period of time, because the minute your costs go above the make allowance, you don't decide to stop procuring milk and go out of business. There are other things you do in the short run which could last a year, could last two years, could last longer, depending on the reserves and your commitment to your market. But it's common, accepted economics that in the short run you cover your variable costs. But you can't do that forever if you are not covering your fixed cost of production.

Q. In this hearing the focus has been primarily on the issue of the margins. The reality is that in the real world in a plant, that you come to bottom line in profit, that they also have opportunities of the sales end to see if they can't acquire additional money from sales through the marketing, added value and other negotiations, right?

A. You can, usually incurring costs in both of those things --

Q. Right.

A. -- adding that value and incurring that marketing, but sure, you can do that

Q. And the decision is, we incurred a cost but we make more income as a result thereof? Isn't that --

A. You make more gross income.

Q. Right.

A. You have to evaluate whether those additional costs are on your bottom line.

Q. And plants have that option. They even have that option today, right?

A. Well, plants always have that option. The problem is that if there were those opportunities and everyone started doing it, you would increase the supply of that type of product, value-added product, and the price would fall in the marketplace. So that opportunity does not last forever if one product has a relatively higher profitability than another product to a plant.

Q. But in terms of coming down to the net profitability or plant viability in a market, it's more than just the margin cost. It also includes your ability to manage, your ability to come up with product and product mixes that can be profitable?

A. Absolutely. The costs that have been introduced by CDFA and the Rural Business Cooperative Service are average costs, which mean by definition, half the plants are above that and half the plants are below that.

Q. Now, if you take -- following up on that, if you take a situation where you begin to include more of the plants that are profitable under those margins that are allowed by the order as opposed to those --

the plants that their margin costs exceed that, aren't you also going to create a sense of disorderly marketing in the sense that you will now allow some plants to have such profits that they can expand and move and do things for the market that can still put the smaller ones out of business?

A. They can also use that -- since they were talking about minimum Federal order prices, they can also use that to procure the milk to do those things you are talking about, and that's absolutely correct. I don't know of any way to solve that if you are going to use averages for prices, averages for make allowances, averages for yield, unless you're prepared to do a product price formula for every plant in the country.

Q. Or unless you are willing to let the market make those decisions?

A. I think my members are ready to sit down and talk about having a much more freer market oriented. I think that's why we have always advocated that minimum pricing should be the focus, not average pricing the marketplace for Federal milk marketing order regulation.

Q. Maybe that's a discussion that needs to be made, but for another day, and I have no other questions.

THE JUDGE: Mr. Vetne.

EXAMINATION

BY MR. VETNE:

Q. To follow up on that last colloquy, when we were in Washington in the year 2000 --

A. Alexandria?

Q. Oh, Alexandria.

A. Yes.

Q. -- discussing this same issue, NCI advocated larger make allowances than were eventually adopted, correct?

A. Well, I know they adopted our make

allowance for dry whey. I believe we did advocate for a larger cheese manufacturing make allowance than was adopted. I don't remember what we did for butter and powder, generally.

Q. Do you recall expressing the economic theory that there is little risk to having an allowance that is too high but a lot of risk in having an allowance that is too small?

A. What I remember expressing was that there is greater risk in economic sense in setting a make allowance that's too low rather than setting a make allowance that's too high because we are talking about minimum pricing, and that if you set one too low, as I stated in my examples in this testimony, there is no way to recover that. If the make allowances are set too high, in other words, if they are set higher than a manufacturing plant's actual costs and there is increased profits there, that because of the nature of minimum pricing, those will be very often used competitively in the marketplace to attract more milk to the more profitable plants, so therefore they are returned in over-order premiums.

Q. Would it be correct to paraphrase what you just said like this, that marketplace factors respond better when the allowance is larger than when the allowance is smaller if the marketplace is permitted to work?

A. No, I think the marketplace will work just fine if they are set too low because plants will go out of business, and that's what happens in the marketplace. You know, your initial question was about risk, and I wasn't referring to risk. I was just saying that, from an economic sense, there is less risk to set a higher rather than a lower make allowance.

Q. If the make allowance is large

enough, plants can respond to, for example, changes in energy, without suffering those same risks? I'm suggesting that there is more market maneuverability with an allowance that is larger than an allowance that is smaller?

A. I haven't heard the term market maneuverability, but I think what you're getting at is --

Q. You'll see it again. It's going to be in all --

A. -- there is more room for future cost increases, no matter what they happen to be, they are more flexible in terms of being able to address that without going to a hearing because the market has more opportunity to handle that without going to a hearing.

Q. In fact, I think they alluded to that's the way the market works --

A. Yes.

Q. -- during the MW -- you know, from

the era prior to 2000?

A. Yes.

Q. And the product price formula approach that was adopted in 2000 was adopted as kind of a proxy to the MW because there wasn't enough unregulated Grade B milk left to confidently measure the competitive value of milk?

A. Well, you know, I don't want to own up to any responsibility, but I was on -- at that time a faculty member of Penn State, and I was on a committee, one of the committee USDA asked to look at various things. And I happened to be on the BFP study committee, and it was less about the lack of volume of Grade B milk than it was about the lack of plants or firms running those plants that were accepting that milk in the Minnesota-Wisconsin area.

Q. So you would rephrase it to be that the remaining volume of Grade A milk being

purchased by two plants would not be
representative anymore --
A. Grade B milk.
Q. -- Grade B milk would not be
representative anymore of the competitive
value of --
A. There were concerns about how
competitive that price was at that time.
Q. In your testimony, you endorse the
addition of 2.5 cents per pound of make to
the nonfat make to achieve an equivalent whey
make allowance?
A. That is correct.
Q. It is your intention, nevertheless,
that the Department should look for -- to
apply the best available data to achieve --
available and objective data to achieve a
reasonable margin that covers the cost of an
average plan, correct?
A. At least cover the cost of an average
plan.

Q. At least cover the cost. And you heard the testimony of Mr. Burleson from West Farms that the difference in cost between powder and butter was 2.9 cents rather than 2.5 cents?

A. Actually, I was not in the room, but I did see his testimony and I saw he referred to that, yes. And I would have no objection to substituting that, based on his testimony, for my 2.5.

Q. Okay. And CDFA, going further along that extreme, find an 11.3 cents difference between the cost of NFDM and whey?

A. And I alluded to that in my testimony as evidence that -- or I guess it was between the RBCS and CDFA but, yes, there is a significant difference between the cost that's been testified to for drying whey versus nonfat dry milk.

Q. You said you wouldn't object to 2.9, if the Department found that more persuasive, to be the difference between the two manufacturing processes?

A. I have been here four days, I'm very agreeable.

Q. Or 3.1 or 5.0. All right. Thank you.

THE JUDGE: Other questions? Mr. Wellington.

EXAMINATION

BY MR. WELLINGTON:

Q. Bob Wellington, Agri-Mark.

Just one question, Dr. Yonkers. Mr. Yale said that the real sign of lack of plant profitability is plant closing in the marketplace, a really true indicator. Isn't that a lot like writing on your gravestone, I told you I was sick? Aren't we really -- I mean, once you close a plant, it doesn't come back, does it?

A. Yes, there is no outlet for milk. I mean, it is not only the profitability of the plant that's being indicative of that, it's a sign of disorderly marketing in that region that they weren't able to cover the costs of that plant.

Q. To follow that analogy, aren't you here today and others here today, including myself, to say that our plants are sick and we need some remedy?

A. Not only some remedy, we are looking for the exact or nearly the exact methodology with some selection of different cost groups and the addition of an energy adjuster from 2004 to 2005. We are not asking for anything different than USDA has already concluded was necessary in the market.

Q. Thank you.

THE JUDGE: Other question. Ms. Deskins. Mr. Rower.

EXAMINATION

BY MR. ROWER:

Q. Jack Rower.

Bob, in looking at your statement, the marketing cost factor that you had built in is the same as the one you recommended in 2002?

A. I had no other marketing cost data to go by. In the 2000 hearing, there were some other costs testified to by a few companies. I went back and looked at the record. But I decided to go with what USDA concluded was the appropriate marketing cost at that time rather than try to change that, also.

Q. With respect to return on investment, do you continue to believe that the CDFA, California Department of Food and Agriculture, Moody's BAA is a reasonable rate return?

A. Since neither the CDFA data that I saw published or the RBCS data had what the capital investment was, I don't know how you would apply a different rate to the capital that's there.

Q. I'm just trying to get someone to tell me how do you select an appropriate rate other than --

A. Yes, and I'm not --

Q. -- simply pulling it out of the air.

A. You do have to pull one out of the air, and I decided to use what USDA concluded as appropriate last time, which was what CDFA decided to use. And I didn't even look if CDFA had changed what they were using, but in order to pick a different rate, you would have to know what the capital investments were, weighted average on those plants. So -- and that was not reported in either the RBCS or CDFA data that I saw.

Q. Thank you. That's all I have.

EXAMINATION

BY MS. DESKINS:

Q. Dr. Yonkers, I just want to understand what your proposal is. Are you proposing that there be -- are you supporting the index proposal for make allowance that other people have discussed during the hearing?

A. Which index? As I view it, there are two index proposals that have really --

Q. Okay.

A. One is to take the 2004 data and update it with 2005. NCI has agreed that we are fully supportive of that. The other concept that's been advocated is for indexing in the future. And the only proposal I saw was for doing monthly indexing.

NCI members have discussed the concept of an ongoing way of adjusting make allowances, not strictly for energy costs but for other factors, also. We don't have a policy position at this time on a specific way to do that. I would note that it is our position that this hearing's focus was on updating the existing make allowances, and we would like to see that done in as quick a manner as possible because of the dire need some of my members testified to about their cost increases. And if considering an ongoing energy adjuster is going to take longer, we would rather that be conducted in a additional hearing to consider other factors my members would like addressed in the formulas that would initiate after this process is completed, after we get to final rule that's implemented.

Q. I think I understand.

You also have in here that you want some floors on certain parts of the make allowance. You have specific amounts in here such as to dry whey?

A. Floors?

Q. Well, you have that the make allowance of cheese should be set no lower that 18.1 cents per pound?

A. As a result of this hearing. But if USDA were to decide to adopt some ongoing adjuster afterwards, that would be a different matter. I'm talking about updating the current make allowances as an immediate result of this hearing.

Q. Okay. But if there is indexing, then would these floors that you put in here still apply?

A. Well, I don't apply them as floors. I'm just saying as a result of this hearing, when it is implemented, I'm suggesting that those make allowances should be no longer than the ones that I have testified to.

Q. I think I understand you. Thank you.

THE JUDGE: Other questions?

Thank you, Dr. Yonkers.

Other witnesses? Mr. Vetne?

MR. VETNE: Your Honor, I have been keeping track of things that have been referred to and things that have been officially noticed, and I want to make -- just to make sure that are able to refer to some requests for official notice.

We previously noticed Federal milk order market statistics and the Dairy Market Statistics Annual and dairy plants approved for grading and the Energy Department short-term outlook. Here are the things that have been referred to but have not been officially noticed, which I requested -- of which I requested official notice. NASS Milk Production Disposition and Income Annual, as published in -- annually in 2000 through 2005, so that would be data for 1999 through 2004. That's published each year.

NASS Dairy Product Annual, 2000 through 2004 data, which would be releases released in 2001 through 2005. And periodic publications of Economic Research Service, USDA, Livestock Dairy and Poultry Outlook Reports -- obviously, only for the dairy part of that report -- released during 2005 up through January 2006.

And finally, Mr. Cryan, for which I'm grateful, included --

THE JUDGE: Dr. Cryan.

MR. VETNE: Dr. Cryan, yes, included on page 7 and 8 in Footnote 1 of his testimony, reference to the Bureau of Labor Statistics specific items that are commonly employed in dairy product manufacturing and --

THE JUDGE: Talking about the specific energy tables for industrial natural gas and industrial electricity?

MR. VETNE: Electricity, sugar and byproducts, cleaning, packaging, that kind of thing.

THE JUDGE: Okay.

MR. VETNE: The table on page -- the figure on page 8. But there is a list of the BLS product codes or line items in Footnote 1.

THE JUDGE: That's fine.

MR. VETNE: I would like to have each of those officially noticed so that we may examine them and be able to refer to them and incorporate them.

THE JUDGE: That's fine.

MR. VETNE: Thank you.

THE JUDGE: Mr. Miltner.

MR. MILTNER: Your Honor, I have three other items we'd like to have official notice taken, one of which I think we may have referred to already, the Federal Milk Marketing Order Annual Statistic Summaries. The website is www.ams.usda.gov/dwfmos/mib/fmoms.htm.

[Whereupon, there was a discussion off the record.]

MR. MILTNER: Monthly costs of milk production compiled by ERS. The website is www.ers.usda.gov/data/costsandreturns/testpick.htm# milkproduction.

MR. VETNE: Your Honor, John Vetne

for Agri-Mark. I would object to that particular publication. Although it is relevant, perhaps, to broader issues, it is not relevant here to this issue. I don't question the data for what it is used and how it is presented, but we would need a lot more information connecting --

THE JUDGE: Let's take notice of it, and if it is something that is relevant to the issues before us, it may be used. If it's not, then obviously, it's not relevant.

MR. MILTNER: Thank you, Your Honor.

Finally, the pricing factors and component prices kept by the AMS. The website is www.ams.usda.gov/dwfmos/mib/nass_fedord_prc.hdm.

And specifically, what we are looking at are the NASS dairy producer price averages, the Class I and Class II advance prices and pricing factors, and the Class II, III and IV milk and component prices.

THE JUDGE: Very well.

MR. MILTNER: Thank you, Your Honor.

THE JUDGE: Other requests?

MR. RASTGOUFARD: Babak Rastgoufard, USDA Office of General Counsel. I have a few more requests as well. The first request is actually on the same website that was referred to by Mr. Miltner, that's the ERS website. I can give you the full citation again. That's www.ers.usda.gov/data/costandreturns/testpick .htm# milkproduction. Also on that website is a publication entitled, "U.S. Regional Costs and Return Data."

Also, like, I think it was -- Mr. Vetne, I think, had moved for two NASS annual reports? Two NASS reports?

THE JUDGE: That is correct.

MR. RASTGOUFARD: Those are the reports -- those are the Dairy Product Annual

Reports and then the Milk Production Annual Report. Those same two titles are also issued on a monthly basis for those same periods, I guess 2000 through current. I wanted to move for judicial notice of the monthly reports in addition to the annual reports.

THE JUDGE: Very well.

MR. VETNE: The monthly reports subsequent to the last annual report?

MR. RASTGOUFARD: Yes.

MR. VETNE: That's fine.

MR. RASTGOUFARD: We would also like to have judicial notice taken of the California Department of Food and Agriculture Audit and Cost Procedures Manual for Dairy Manufacturing Plants. This is the procedures manual dated revised 2001 that is used by the CDFA in producing their numbers or their studies.

And then another CDFA publication,

and that would the 2004 Annual Statistics by the California Department of Food and Agriculture.

THE JUDGE: Are those readily available?

MR. RASTGOUFARD: My understanding is that this is on the website, this has recently been put on the website?

MR. ROWER: No, that one is not on their website. That one has to be acquired.

MR. RASTGOUFARD: One second, Your Honor.

It may not be on their website, but it is published by a state government, specifically the California Department of Food and Agriculture, Dairy Marketing Branch. I can give the full address and telephone number and website that appears on the cover sheet of this document.

THE JUDGE: As long as it is available, that's fine. I just don't want to have something that's an internal document that nobody can get to.

MR. RASTGOUFARD: My understanding is that it is generally available.

THE JUDGE: Very well.

MR. RASTGOUFARD: As well as the 2004 annual statistics by the CDFA.

And then, lastly, this in fact was something that was referenced in Dr. Yonkers' testimony, I think, and the testimony of a few others as well, and that is the Marketing and Policy Briefing Paper that was put out by Ed Jesse and Brian W. Gould, "Federal Order Product Price Formulas and Cheesemaker Margins: A Closer Look." And it may have been --

THE JUDGE: Wasn't that attached as an exhibit?

MR. RASTGOUFARD: It was marked as Exhibit 57. My understanding is it was never entered into the record, it was marked.

MEMBER OF THE AUDIENCE: It was objected to.

THE JUDGE: Very well.

MR. YALE: We objected without, you know, cross, although it could be used as the evidence used by that -- to the point it supported that witness's testimony. But beyond that, we don't believe it should be appropriate, and that was the rule.

MR. RASTGOUFARD: We are just asking for official notice. We are not asking that it be entered as an exhibit or anything like that.

THE JUDGE: Well, it was attached as part of the thing, and it was given a limited admissibility, so I think that's already been covered.

MR. RASTGOUFARD: Thank you.

THE JUDGE: Other requests?

MR. VETNE: Not another request of official notice, but I have a request of the government. The CDFA statistics were on the website, but the auditing book is not. Although it's an official publication, it is not published on the website. So I wonder if USDA would be willing to provide a copy to those who might require it. It is also a long document to be produced, but I can get it on the USDA website, I don't know if that's possible, either way.

MS. DESKINS: I don't know that we put it on our website, but I think we can try to give you a copy.

MR. VETNE: That would be fine, and anybody that might want it. Thank you.

MS. DESKINS: Your Honor, as for what was marked as Exhibit 57, we are asking that official notice be taken of it. That's a different standard than admission of an exhibit.

MR. YALE: I don't think that is a different standard. It's got to be admissible testimony, and this is not a -- a government statistical publication, it's an opinion of professors we may or may not agree with, I don't know, but that's what it is.

THE JUDGE: I think I've ruled.

What says the proponent for a briefing schedule?

MR. VETNE: Your Honor, the proponents of Proposal 1 would ask for a briefing deadline of Friday, February 10.

THE JUDGE: Usually what we do, Mr. Vetne, is we set it so in days after the posting of the transcript.

MR. VETNE: Yes, and I want to comment about that, too. Agri-Mark or proponents have made arrangements for the transcripts, as ordered by the Department, to be delivered up to the Department on an expedited basis. And we have assurance that the transcript will be delivered by close of business on Tuesday with the possible exception of today's version, which would be delivered early on Wednesday.

I have also been told that the transcript from Tuesday of this week is already in possession of the Department and can be posted on the website any time the Department likes. Usually it is a period from period from posting of the transcript to sometime after that, and I'm suggesting 10 days with the expectation that it will be ready by Tuesday or Wednesday morning.

THE JUDGE: And then the period after that time?

MR. VETNE: Ten days after the Department posts it.

THE JUDGE: You are asking for briefs to be due in 10 days?

MR. VETNE: Ten days. Really, this is an emergency.

THE JUDGE: Very well. Other comments?

MR. YALE: We don't want to be obstructionists, but that's just really unrealistic. I mean, we would prefer 30 days, but we would be willing to take at least two to three weeks after it is posted. Ten days really only gives us -- I mean, by the time it's posted and it's through the weekend, that's not a lot of workdays available. And there is a lot of material here that has to be sorted through to be made part of the record.

And this is -- although I know it's an emergency for them, but this is a significant, significant assault on producer prices. It has a huge impact, and it needs to be done carefully and done correctly.

THE JUDGE: Mr. Beshore.

MR. BESHORE: There are some legal issues that may need to be addressed in addition to factual discussion. I'm really not going to --

THE JUDGE: How about 14 days?

MR. BESHORE: We'll live with whatever you come up here. We respect Agri-Mark's position on that.

MR. VETNE: Your Honor, 14 days would take it to Tuesday, hopefully Tuesday the 14th, and I don't -- that's stretching it a bit, but we'll accept that.

I should note for those that are concerned about the posting that arrangements can be made with the reporter for an e-mail transmission of what is available now by the weekend. I mean, some of it would be available now already, and certainly by Monday, it would be available, maybe not in official form, but some it official and some of it not, so -- but 14 days at the latest.

THE JUDGE: Fourteen days at the latest, then, corrections at the same time as the briefs.

MR. VETNE: Yes.

MS. DESKINS: What about corrections of transcript? Would there be a due date for that?

MS. DESKINS: That's what I just said, the same time as the briefs.

Is that agreeable, Mr. Rower?

MR. ROWER: Yes.

THE JUDGE: Very well. We are adjourned. Thank you all for your patience and your attention.

[Whereupon, the hearing was adjourned at 5 p.m.]