

1 THE UNITED STATES DEPARTMENT OF AGRICULTURE
2 In the Matter of:)
3) Docket No. A0-14-A69, et al.
4 MILK IN THE NORTHEAST AND) DA-00-03
5 OTHER MARKETING AREAS)
6 Virginia Room
7 Embassy Suites Hotel
8 1900 Diagonal Road
9 Alexandria, Virginia
10 Wednesday,
11 May 10, 2000
12 The hearing in the above-entitled matter was
13 convened, pursuant to notice, at 8:05 a.m.
14 BEFORE: HONORABLE JAMES W. HUNT
15 Administrative Law Judge
16 APPEARANCES:
17 On Behalf of the USDA:
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1 P R O C E E D I N G S

2 (8:05 a.m.)

3 JUDGE HUNT: Good morning, ladies and gentlemen.
4 We'll resume now with the hearing and the testimony of Dr.
5 Barbano, who is now taking questions.

6 Yes, Mr. Rosenbaum?

7 MR. ROSENBAUM: Your Honor, I have a document I'd
8 like to have marked as an exhibit if I could to show to Dr.
9 Barbano. I'm not sure I know what the next number is.

10 JUDGE HUNT: It would be 19.

11 (The document referred to was
12 marked for identification as
13 Exhibit No. 19.)

14 MR. ROSENBAUM: I have extra copies, Bob. I have
15 extra copies for other people in the hearing room, which are
16 now being distributed.

17 Whereupon,

18 DAVID BARBANO

19 having been previously duly sworn, was recalled as
20 a witness herein and was examined and testified further as
21 follows:

22 CROSS-EXAMINATION RESUMED

23 BY MR. ROSENBAUM:

24 Q Dr. Barbano, I wanted to talk a little bit more
25 about the loss of milk that occurs during the cheese

1 processing, and what I've handed you is a handwritten flow
2 chart that attempts to follow that issue. I want to take
3 you through it and have you confirm its accuracy, or if
4 there are inaccuracies in it I want you to make the
5 necessary corrections so that we get this right.

6 We'll start in the upper left-hand corner where we
7 have the farm bulk tank which has milk in it, okay, and you
8 and I talked yesterday about the fact that it is at this
9 point that the milk is tested for components and volumes,
10 correct?

11 A Yes.

12 Q And it's at this point that the processor is
13 obligated to make payments according to the minimum price
14 regulations of the Federal Order system, correct?

15 A Yes. It would be tested for components, and
16 there's the measurement of the -- technically by volume, but
17 a conversion to weight of milk at that point.

18 Q Okay, but it's definitely this is the milk that
19 the cheese manufacturing plant pays for, correct?

20 A When they're paying producers. If they bought a
21 truckload of milk and are not paying producers, it would be
22 at the truck. If they were buying bulk milk instead of
23 buying directly from producers.

24 Q Okay. If you're buying from a producer, this is
25 where the testing is done, correct?

1 A Yes. Yes.

2 Q And any loss of milk you suffer along the way is
3 just sort of out of the pocket of the cheese processor,
4 correct?

5 A I assume, unless there's something else negotiated
6 between the processor and whoever is selling the milk.

7 Q Okay, but the processor has to pay the minimum
8 price by law, correct?

9 A Yes. Yes, that is correct.

10 Q So there's no negotiation under those
11 circumstances, correct?

12 A Okay. Yes.

13 Q All right. Now, from the bulk tank at the farm,
14 the milk goes to the tanker for hauling, correct?

15 A Yes.

16 Q And you'll see where I have an arrow showing that
17 movement, that direction?

18 A Yes. Yes.

19 Q But I've got little dotted lines going below that
20 showing loss of milk?

21 A Yes.

22 Q And you'll agree with me that there is some milk
23 loss between the bulk tank and the tanker, correct?

24 A Yes. Correct.

25 Q And obviously that milk will never make it into

1 cheese, correct?

2 A That's correct.

3 Q And so cheese manufacturers will never have income
4 from the sale of cheese. Well, putting it differently, that
5 milk will never end up in a finished product for which the
6 manufacturer gets money, correct?

7 A Correct.

8 Q All right. The next step in the process is that
9 the milk is transferred from the tanker to the silo at the
10 plant, correct?

11 A Yes.

12 Q And there is some loss of milk that occurs there,
13 correct?

14 A Yes.

15 Q Okay. And once again, as with all losses of milk
16 shown in this process, the lost milk never ends up in a
17 finished product for which the cheese manufacturer gets
18 paid, correct?

19 A Correct.

20 Q All right. Then after the silo at the plant, the
21 milk goes to the pasteurizer, correct?

22 A Yes.

23 Q And once again, there's some loss of milk in that
24 process, correct?

25 A There can be some loss, although depending on how

1 the plant is designed that's a relatively minimal effect
2 compared to the previous ones.

3 Q All right. And there's a loss of milk in the
4 sense that some of the milk sort of sticks to the sides of
5 the piping, and the pipe has to be cleaned, --

6 A Yes.

7 Q -- and it ends up in the waste stream, correct?

8 A Yes.

9 Q All right. Then after it's pasteurized it then
10 goes into another vat? Is that right?

11 A Yes.

12 Q Okay. And there's some loss of milk in the piping
13 between the pasteurizer and that vat?

14 A Yes. The material that stays on the sides of the
15 pipes, yes.

16 Q Yes. I think I said another vat.

17 A Yes.

18 Q I didn't really mean another vat. That's the
19 first vat, right?

20 A Right. That's the first vat.

21 Q Okay. All right. And then the milk from that
22 vat, which, of course, has now been pasteurized, is what
23 you're going to use to make cheese, correct?

24 A Correct.

25 Q And it is your testimony, based upon the

1 experience you've had, that 90 to 93 percent of the
2 butterfat that was in that vat will make it into the cheese,
3 correct?

4 A Correct.

5 Q Okay.

6 A Correct.

7 Q And obviously that by definition does not account
8 for in any way the loss of milk that has occurred up until
9 this point in the process, correct?

10 A Correct.

11 Q All right. Now, some of that butterfat will end
12 up in the cheese. Am I right in saying that the rest of the
13 milk goes to a separator, which separates what didn't go
14 into cheese into whey cream or sweet whey?

15 A I think more technically correct, from the arrow
16 going from the vat to the separator there's no milk in that
17 line. It's whey, --

18 Q Okay.

19 A -- so it's loss of milk components that might
20 occur between the vat and the separator.

21 Q Okay. Okay. So we should write the word Loss of
22 Milk Components on that little dotted line between the vat
23 and the separator to be accurate? Is that correct?

24 A Correct.

25 Q All right. Why don't you go ahead and do that,

1 and we'll end up maybe substituting what you've marked as
2 the official exhibit so we have one that's completely
3 accurate.

4 Okay. At that point we've got our whey cream, our
5 sweet whey, and we're done with the process, or at least --
6 I mean, there may be some more things we do, or there may
7 not be, depending upon the plant --

8 A Right.

9 Q -- at issue, but we'll stop with the process right
10 there, okay?

11 Now, your testimony yesterday was that -- well,
12 yesterday I was using the term shrinkage to describe loss of
13 milk. That's what you understood I meant --

14 A Uh-huh.

15 Q -- when I was talking about it yesterday, didn't
16 you?

17 A Yes.

18 Q Now, a Class III handler like a cheese
19 manufacturer has to pay the Class III price for the milk as
20 tested at the farm, correct?

21 A Yes.

22 Q So he's paying the Class III price for the milk
23 that's lost at these various points in the process, correct?

24 A Yes.

25 Q Okay. Okay. Now why don't you look at your

1 Exhibit 15, please, which is your testimony, and turn to the
2 spreadsheet that you actually had up on the screen
3 yesterday?

4 I don't think there's any reason to put that up
5 again, at least I don't think so. This is the spreadsheet
6 that appears after page 14.

7 A Right. I've got it.

8 Q Now, what this spreadsheet does -- let me wait and
9 let people get it out.

10 This is the spreadsheet that immediately follows
11 page 14 called Barbano's Calculation for Class III Minimum
12 Milk Price Based on Cheddar and Whey Powder, correct?

13 A Yes.

14 Q There's a lot of text obviously to your statement,
15 but ultimately what this document does is compare what the
16 current price is, minimum price is, for Class III milk to
17 what it would be if all the things you wanted to have happen
18 happened. Is that right?

19 A It's not what I want to have happen. It's just
20 that I'm pointing out as you go to Column 5. It's an
21 accumulation of all the issues that I see should be looked
22 at carefully in terms of whether there's something not
23 technically correct.

24 Q Okay. If you made all of the technical
25 corrections that you were suggesting, according to this you

1 would go from a current Class III price of \$11.51 to a price
2 of \$11.66, assuming 3.5 percent butterfat in milk?

3 A Yes. In Column 1, that is correct.

4 Q Okay. Now, you acknowledged yesterday that there
5 is an open dispute as to whether the current system reflects
6 a .75 or a .78 assumption as to the -- complete my sentence.

7 A As to the proportion of casein, of true protein or
8 actually initially of crude protein that is casein.

9 Q Okay. And you've said that one of the corrections
10 you would make, and indeed you have made, is to change that
11 from .75 to .78, correct?

12 A Yes.

13 Q Okay. But there's a question that's been raised
14 as to whether in fact the current system already is at .78,
15 correct?

16 A That's correct.

17 Q And if it's true that the current system is
18 already at .78, which indeed is our view, your testimony
19 yesterday was that doing the other things you think perhaps
20 should be done from a technical basis would end up with a
21 price 33 cents higher than the current price of \$11.51. Is
22 that correct?

23 A If I acknowledge that the current system is at
24 .78, yes, there would be a larger difference.

25 Q Okay.

1 A I don't acknowledge that the current system is at
2 .78.

3 Q I appreciate that, and there will be some more
4 testimony --

5 A Sure.

6 Q -- on that issue, and people will have to resolve
7 it one way or the other, but I'm just trying to get through
8 the --

9 A Right.

10 Q -- implications of your change so that the
11 difference between the current system and let's call it the
12 Barbano technically correct system is either 15 cents, --

13 A Right.

14 Q -- based upon an assumption that the current
15 system uses the .75 figure, --

16 A Correct.

17 Q -- or it's 33 cents, based upon the assumption
18 that the current system is actually at .78.

19 A I think there's in terms of the difference when
20 you go up to -- let's see. You're referring to the 30 cents
21 that I said yesterday?

22 Q Yes. I'm referring simply to the fact that when
23 you went into your spreadsheet and changed --

24 A Yes.

25 Q -- the .75 to .78, the spreadsheet shifted so that

1 instead of --

2 A Yes.

3 Q -- the Barbano price being \$11.66, the Barbano
4 price became \$11.84, correct?

5 A Correct.

6 Q And so in that sense it's a 33 cent difference,
7 correct?

8 A Yes. Yes.

9 Q Now, it was your testimony yesterday -- I assume
10 it's still your testimony today -- that there's nothing in
11 your calculations that adjust for what we've been calling
12 shrinkage, correct?

13 A That's correct.

14 Q Okay. And your testimony yesterday was that sort
15 of thing probably ought to be reflected in the make
16 allowance, correct?

17 A That's correct.

18 Q I'm not disputing potentially the logic of that,
19 but it needs to be reflected somewhere, correct?

20 A That would seem to be the logical solution, yes.

21 Q Now, your testimony yesterday was more or less to
22 the effect that there's sort of either 15 cents missing or
23 33 cents missing in the formula, correct?

24 A In the current way the price is established
25 compared to the value of products minus the make allowance.

1 Q Okay. And missing in a sense that it would look
2 at first blush like farmers are being underpaid?

3 A Yes.

4 Q That's what you mean by missing?

5 A Yes.

6 Q But, of course, farmers are being underpaid when
7 one looks at what one gets for cheese in the marketplace,
8 the NASS survey data, and then figure out all the processes
9 that lead you back to the minimum milk price, correct?

10 A Can you restate that? I'm --

11 Q Well, the 33 cents is derived by using the NASS
12 data as to what the finished product price is for cheese,
13 just like in the Federal Order system today, correct?

14 A Yes.

15 Q All right. And then figuring out what it is
16 you're making from the milk that goes into that cheese?

17 A Yes.

18 Q Okay. But if in fact the current system doesn't
19 reflect shrinkage, and indeed the Barbano system on this
20 piece of paper doesn't reflect shrinkage, the 33 cents
21 potentially is all eaten up by that shrinkage, right?

22 A I haven't tried to do any calculations of what any
23 shrinkage would mean in terms of the price and value of
24 milk.

25 Q Okay. Well, just to do the math with me, 33 cents

1 is, according to my helper's calculation, 2.6 percent of
2 \$11.51. I know you have a calculator in front of you.
3 Maybe you could just confirm that.

4 A Thirty-three cents, you're saying, --

5 Q Right.

6 A -- is out of \$11.50 is about 2.8 or 2.9 percent.

7 Q Okay. And if in fact shrinkage is pretty close to
8 that number, and I'll ask you to assume that --

9 A Okay.

10 Q -- then in fact nobody is being underpaid at all.
11 Isn't that a fair statement?

12 A I think we'd have to know what the shrinkage is.

13 Q Okay.

14 A That seems to be a large value to me.

15 Q I take it you have not been engaged in measuring
16 losses from the bulk tank to the hauling tank?

17 A No, I have not. I'm aware that in the Federal
18 Orders that's something that they do in terms of estimating
19 shrinkage --

20 Q Okay.

21 A -- and have allowances for that, but --

22 Q I mean, for example, Class I handlers are
23 permitted a two percent shrinkage, correct? Maybe you don't
24 know that.

25 A I don't know that.

1 Q All right. All right. But in any event, you
2 would agree with me that whatever that shrinkage figure is
3 for a typical cheese manufacturer, whatever that number is,
4 that will reduce the 33 cents, assuming I'm right about how
5 the current system works, or the 15 cents, assuming you're
6 right about how the current system works, correct?

7 A It will reduce either of them.

8 Q Yes. It could possibly work in the other
9 direction, correct?

10 A That's correct. That's correct.

11 Q So see if you agree with me with the following
12 statement. My testimony that farmers are apparently being
13 underpaid does not account for shrinkage, which if accounted
14 for could only bring down the amount of underpayment that
15 I've identified.

16 A It will bring it down. It can only bring it down,
17 yes.

18 Q Okay. And by how much it brings it down depends
19 upon what that shrinkage number is, correct?

20 A That's correct.

21 MR. ROSENBAUM: Okay. Thank you.

22 Your Honor, I would move Exhibit 19 into evidence
23 as marked by Dr. Barbano, because he made a little change in
24 the chart. I would propose that I'll make copies of that
25 corrected Exhibit 19 during the break and distribute it to

1 all the participants, as well as give copies to the
2 reporter.

3 JUDGE HUNT: Exhibit 19 is the flow chart that Mr.
4 Rosenbaum --

5 MR. YALE: Your Honor, we're going to object,
6 Proponent No. 1 and other proposals to this. This issue of
7 shrinkage is a distinct issue in the Federal Orders. It was
8 never noticed for this hearing. It has never been discussed
9 as an issue in make allowances.

10 It was never part of Yonkers' testimony as a
11 factor that goes into the reduction of the values, and it's
12 just improper to introduce this new issue at this time, and
13 we'd object on that basis.

14 JUDGE HUNT: I'm sorry. You're talking about the
15 exhibit, the proposed exhibit?

16 MR. YALE: The exhibit and the testimony. We'd
17 move to strike the testimony dealing with the shrinkage.

18 MR. ROSENBAUM: Your Honor, if I can just correct
19 that? Dr. Yonkers' testimony touched on a number of issues,
20 but one of the specific reasons why we testified there
21 should not be a change in the yield factor was because of
22 shrinkage.

23 That issue is discussed at length on page 38 and
24 39 of Exhibit 14, which came into evidence as a basis for
25 not changing the yield factor, which is the one of the

1 issues that was noticed for this hearing, unlike some of the
2 things I think Dr. Barbano has talked about, so I think this
3 goes to the heart of what's relevant.

4 MR. YALE: Your Honor, they were talking about
5 shrinkage in the butterfat, but not the shrinkage from the
6 farm to the silo.

7 JUDGE HUNT: Mr. English?

8 MR. ENGLISH: Your Honor, the incongruity of this
9 is certainly interesting. Mr. Yale was certainly happy to
10 have Dr. Barbano testify and allow that into evidence, but
11 apparently cross-examination that tests some of the
12 assumptions is not to be let in.

13 If you let any of Dr. Barbano's testimony in, I
14 think you have to allow Exhibit 19 in.

15 JUDGE HUNT: Anyone else on the comment on the
16 motion to introduce the exhibit? Yes, Mr. Vetne?

17 MR. VETNE: John Vetne representing Kraft. I
18 think there's a confusion in the objection that exploits the
19 fact that there is in the Order system an allowance for
20 shrinkage. Losses between the farm and the product made,
21 whatever the product is, are allowed up to a certain
22 percentage. In fact, that allowance has not been noticed
23 for hearing.

24 Shrinkage plays a very different role in the issue
25 that was specifically noticed, which is make allowance, and

1 make allowance or manufacturing margin, whatever the term is
2 used, is at issue.

3 The question of shrinkage for that discrete
4 purpose is a handler cost because the objective here is to
5 price milk at the farm, to account at the farm for the
6 volume of milk the producer has produced and introduces into
7 the system.

8 For purposes of accounting within the make
9 allowance, all handler costs at least are at issue because
10 they come someplace between the value of milk at the farm
11 and the value of the finished product when it's introduced
12 in the marketing stream. Those are real costs.

13 There's no proposal here to adjust the shrinkage
14 allowance in the Order. There are proposals, and
15 necessarily must be proposals, which would incorporate
16 handler costs, including losses, which do not appear in the
17 finished product that can be recovered at that point. They
18 are necessarily part of the make allowance. That's the
19 distinction, and that's the confusion.

20 Unfortunately, we use one word to describe a
21 regulatory allowance and the same word to describe a handler
22 cost in the process, so the objection to the extent it is
23 addressed to a change in the shrinkage allowance, then the
24 Order might be well taken, but that's not the importance of
25 this testimony.

1 Thank you.

2 JUDGE HUNT: Thank you, Mr. Vetne.

3 Mr. Christ, do you have a comment?

4 MR. CHRIST: Not on this subject, Your Honor.

5 JUDGE HUNT: Any other comments on the motion to
6 introduce the exhibit?

7 I will overrule the objection. I will admit
8 Exhibit 19 into evidence.

9 (The document referred to,
10 previously identified as
11 Exhibit No. 19, was received
12 in evidence.)

13 JUDGE HUNT: Does anyone else have any questions
14 of Dr. Barbano? Mr. Christ?

15 MR. CHRIST: Thank you, Your Honor. I'm Paul
16 Christ from Land O'Lakes.

17 BY MR. CHRIST:

18 Q Dr. Barbano, your first recommendation is that we
19 change the Class III pricing formula because the existing
20 formula will reduce the Class III price if the ratio of fat
21 to protein is below 1.28.

22 Are you aware of a publication called Federal Milk
23 Marketing Order Statistics, 1998 Annual Summary?

24 A No. I've not looked at it.

25 Q I guess for your information, the Judge took

1 official notice of this on Monday.

2 This publication shows a table on page 120 that
3 identifies the amount of product pounds and butterfat used
4 to produce cheese under Federal Milk Marketing Orders, and
5 the number for product pounds is 31,300,000,000, and the
6 amount for butterfat was 1,229,000,000.

7 I made the calculation, and the result was 3.95
8 percent butterfat. Would this be above or below your 1.28
9 threshold number?

10 A That reflects the average fat content of the milk
11 used, I'm understanding from what you said.

12 Q Yes. If the numbers are correct, the average
13 value or the average percentage fat in Federal Order milk
14 used to produce cheese. Would you expect that to be above
15 or below the 1.28?

16 A That average is probably close to the 1.28.

17 Q So in fact respect, with the actual milk being
18 used to make cheese it probably is a neutral effect?

19 A For the cheese maker. If I'm a producer that has
20 a lower ratio in my milk at the farm, it's not a neutral
21 effect. It's only a neutral effect for the producers that
22 are at 1.28.

23 Q The amount of money flowing to the pool would be
24 neutral, and the amount of money distributed to individual
25 producers could be different depending on his individual

1 circumstances.

2 Is the amount of money flowing the producers
3 different because of differences in composition now,
4 irrespective of this factor?

5 A Yes. Yes.

6 Q Yes, so this is another source of variation?

7 A Yes.

8 Q The second issue I'd like to raise with you is the
9 issue that you make the recommendation that we measure the
10 yield of barrel cheese at the moisture content that it's
11 actually made at. Are you aware of a thing called moisture
12 premiums in cheese transactions?

13 A Yes.

14 Q Would you agree that this is a method of adjusting
15 the value of barrel cheese so that the maker is paid for the
16 pounds of cheese as though it contained 39 percent moisture?

17 A (Non-verbal response.)

18 Q So the revenues a barrel cheese manufacturer can
19 expect are associated with more pounds than he actually
20 produces, representing the amount of pounds that would have
21 been available at 39 percent moisture?

22 A My knowledge of that calculation when it's
23 adjusted to 39 percent moisture and the price is adjusted is
24 that it does not factor in a make allowance as if you made
25 that higher amount of cheese in terms of the costs.

1 If you produced -- because if the cheese was truly
2 39 percent moisture, there would be a lot more cheese, and
3 there would --

4 Q Yes.

5 A -- be a cost associated with that. Those costs
6 were never incurred in reality in making the cheese. It's
7 my understanding that that is not factored in in that
8 moisture adjustment in terms of payment on the 39 percent
9 basis.

10 Q The moisture adjustment deals only with the
11 revenue side, not with the cost side? Is that your
12 understanding?

13 A That's my understanding.

14 MR. CHRIST: Okay. Thank you very much.

15 JUDGE HUNT: Yes, sir?

16 MR. CONTENTE: Thank you, Your Honor. I'm Joaquin
17 Contente. I represent National Farmers Union, and I'd like
18 to ask Dr. Barbano.

19 BY MR. CONTENTE:

20 Q Mr. Barbano, has any producer solicited you to
21 come here and testify?

22 A No.

23 Q Or producers?

24 A No.

25 Q Have any processors?

1 A No. And if they had, I'd have refused to come and
2 testify on their behalf.

3 Q That's good. Thank you. You are considered an
4 expert in all types of cheese made in the United States? Is
5 that right?

6 A My main expertise is in cheddar and mozzarella. I
7 wouldn't say all types of cheese made in the United States.

8 Q What is the major cheese that's made in the United
9 States?

10 A Cheddar is the big one. Mozzarella is also big.

11 Q Are they fairly close in volumes?

12 A They're getting closer. I haven't watched the
13 exact statistics, but mozzarella is getting close.

14 Q Do you feel that the current Class III pricing,
15 end product pricing system, reflects the true value of
16 mozzarella?

17 A I don't think the current system is intended or
18 even attempts to do that. The current system, as I
19 understand it, for establishment of the minimum Class III
20 price is focusing exclusively on cheddar cheese and ignores
21 mozzarella cheese.

22 Q Would you have any recommendations on how to
23 correct the situation?

24 A I'm not sure that for the Class III price that
25 there's any correction for the minimum Class III price. I

1 think cheddar is the appropriate product.

2 I think mozzarella is a separate issue, and if you
3 go back 30 or 40 years ago it was a relatively insignificant
4 product, but with time its total -- the total amount of milk
5 produced in the United States that is being used to make
6 mozzarella -- mozzarella has become a very important
7 product, and considering its importance it's kind of
8 interesting to me that it's not recognized explicitly as a
9 product in a particular class, whether it be three or some
10 other class, considering the importance and the volume of
11 milk that's used for it.

12 MR. CONTENTE: Thank you.

13 JUDGE HUNT: Yes, sir?

14 MR. BROWN: Good morning. I'm Mike Brown with
15 National All Jersey. I have a couple questions for Dr.
16 Barbano and first want to thank him for coming down here. I
17 feel like I'm taking a food science class again, and it's a
18 good thing to hear. I'm learning some good things.

19 I have a couple questions, more technical, more
20 looking at how different people have evaluated data, to see
21 if they're appropriate.

22 BY MR. BROWN:

23 Q First, a lot of us are trying to look at, of
24 course, a true protein for the first time because all the
25 data in the Federal Orders is on a crude basis. We're using

1 basically a .19 subtraction factor to convert from crude to
2 true protein. Is that an appropriate way to do that kind of
3 analysis?

4 A In terms of going back to old data that --

5 Q Yes. Using historic --

6 A -- is on crude?

7 Q Right.

8 A I think that's a fair way of doing it, .19.

9 Q Okay. All right. The second question I have is
10 as many of you are aware, National All Jersey works with a
11 lot of plants with premium programs, particularly cheese
12 plants, particularly cheese yield, and they all have
13 different formulas. There's a couple different factors that
14 I see different and I wanted your opinions on that they use.

15 For example, some plants, depending who they are,
16 I have use between 90 and 93 percent fat recovery in their
17 cheese yield formula for payment to producers. From what I
18 understand, do you think that's a reasonable range?

19 A For cheddar cheese, that's --

20 Q Right.

21 A -- a reasonable range.

22 Q These are cheddar formulas.

23 A Yes.

24 Q The second question I have is that several of the
25 plants I work with, instead of using a minus .1 factor for

1 casein adjustment in the VanSlyke use a 96 percent of casein
2 adjustment factor. In other words, instead of saying 78
3 percent times protein minus .1, it says 78 times protein
4 times .96. Is that a reasonable substitution?

5 A I think for the type of purpose it's a reasonable
6 substitution and has been typically done. I don't
7 technically like it as much, but it's close.

8 Q Okay. Thank you. The third question I have is
9 mozzarella plants, which I have to admit from the standpoint
10 of All Jersey has been a challenge working with cheese
11 yield, and one of the reasons for that challenge has been
12 differences in the price of skim milk and differences in the
13 price of fat.

14 From my experience, and again there are
15 exceptions, but most of the mozzarella plants I work with
16 generally either buy cream or sell nonfat solids to
17 standardize their milk, depending on the price of butter.
18 Most of the time they buy nonfat solids. Would that be
19 similar with your experience?

20 A You said quite a few things there, and I --

21 Q Okay. All right.

22 A -- want to make sure I've got it all correct.

23 Q Most of the mozzarella plants that I work with
24 also buy other milk ingredients to make their cheese.

25 A Correct.

1 Q They usually buy nonfat solids or condensed skim
2 milk.

3 A Yes.

4 Q The other thing, at times, particularly when fat
5 has gotten very, very high, they've decided to sell cream.
6 From your experience, are those the two decisions most
7 mozzarella plants usually are looking at, whether they
8 should fortify with skim or by selling fat?

9 A Yes.

10 Q Okay. My question related to that would be then
11 when you're running a mozzarella plant would the value of
12 butterfat in skim components outside of cheese, other prices
13 on other products, particularly nonfat dry milk and butter,
14 be perhaps more important than if you were running a cheddar
15 plant because of the standardization issue?

16 A I think it's important in both, and in terms of
17 comparing, when you say cheddar cheese I think you have to
18 acknowledge that there's different cheddar cheeses made for
19 different purposes.

20 When I'm making barrel cheese as a raw material
21 for processing, that cheese maker would be much more likely
22 to buy additional solids and fat to fortify to improve their
23 performance efficiency. A cheddar maker making long hold
24 cheddar probably would not do that type of thing because of
25 quality issues, or they'd be much more conservative in doing

1 it.

2 I think you have to make the comparison for
3 mozzarella to sort of the group within cheddar that's more
4 on a par in terms of how the product will be used, so I
5 think in that case both the cheddar of a comparable nature
6 to mozzarella would have the same incentives to consider
7 seriously the purchase of cream, extra fat and solids for
8 fortification.

9 MR. BROWN: Okay. Very good. Thank you very
10 much.

11 MR. CHRIST: Your Honor, I have one more question.

12 JUDGE HUNT: All right, Mr. Christ.

13 MR. CHRIST: Paul Christ from Land O'Lakes.

14 BY MR. CHRIST:

15 Q Dr. Barbano, when I asked you the question about
16 the relationship of butterfat to protein earlier, you
17 quickly made the conversion. Can you give us the formula
18 for making that conversion? I think that would be useful
19 for the record.

20 A When I was making --

21 Q I asked you earlier whether the 3.95 percent
22 butterfat reflected the 1.28 ratio or some other number, and
23 you apparently made a quick conversion.

24 A I made a quick conversion. The thing that you
25 have to do is say okay, at what protein content.

1 Q Yes.

2 A My quick conversion saying I've got to assume some
3 true protein that I was at -- let me just check here. If
4 you've got a 3.0 true protein, which would be close to what
5 you would have, probably that's a couple of hundredths
6 higher, if the skim portion was that magic 3.1 true protein.

7 Q Okay.

8 A That's kind of it. So I took approximately three
9 percent and divided it into 3.95.

10 What would be better, if you wanted the actual
11 number, is if you knew the protein test of that milk supply
12 like you know the 3.95. You could calculate it directly.

13 Q Okay. So you were assuming a constant true
14 protein in the skim milk portion of the milk irrespective of
15 butterfat?

16 A Since you gave me no base --

17 Q Yes.

18 A -- in terms of protein.

19 Q I understand that. Is it correct that there is a
20 correlation between say true protein levels and butterfat
21 levels? As butterfat increases, true protein also
22 increases?

23 A That correlation is pretty weak, --

24 Q Okay.

25 A -- particularly when you get to individual

1 producers.

2 MR. CHRIST: So you were comfortable with assuming
3 the constant true protein? Good enough for me. Thank you.

4 JUDGE HUNT: Yes, sir? Mr. Pacheco, is it?

5 MR. PACHECO: Good morning. Frank Pacheco with
6 National Farmers Organization.

7 BY MR. PACHECO:

8 Q Good morning, Dr. Barbano. I've got a question
9 concerning on page 17 you have the VanSlyke theoretical
10 cheddar cheese yield formula. I'm going to reference that
11 in terms of on page 18 we have the fat recovery in cheese.
12 As you well know, the current valuation is the 90 percent.
13 You say that higher cheese recovery, the value of .93
14 recovery, is achievable at the commercial level.

15 I believe yesterday you said that there has been a
16 transformation in technology or equipment in the late 1980s.
17 In the best estimation you can give, is there a majority of
18 the plants commercially today able to achieve that type of
19 level?

20 A In the .90 to .93 range, I would say the majority
21 of modern plants should be able to achieve that level.

22 Q Okay. On the theoretical side of it, it has a
23 .93. Now, the .93, is that like an averaged theoretical?
24 Could it be higher than .93, for instance? Could it be .94,
25 .95?

1 A Let me step back and explain where the .93 came
2 from originally. In what is a theoretical yield formula,
3 based on the observations that a person by the name of
4 VanSlyke was going out and measuring cheese yield, measuring
5 fat content of milk, actually at that time in the 1890s
6 measuring casein content of the milk, that his observations,
7 so empirical numbers, said yes, there's people that get much
8 lower fat recovery. There's people that get a little higher
9 than .93. Based on his observations, he said .93 is
10 achievable. Don't be satisfied with .85, .86. You can do
11 better in terms of yield performance. That's where the .93
12 came from.

13 Going through time as we changed equipment, up
14 sized, there were some mistakes in equipment design that
15 caused the average industry performance to fall below what
16 VanSlyke said. For a time period, the industry was saying
17 oh, he must have been wrong. You can't achieve this. With
18 time and looking seriously when some of us in research were
19 saying it is achievable, started working with companies that
20 design vats, and they had their own engineering staffs.
21 Things were improved.

22 I think right now we're back in the zone where
23 VanSlyke would say we should be. To me there's nothing
24 magic about what VanSlyke says in terms of .93. That's
25 based on his observations with very traditional cheese

1 making in the 1890s. Possibly in the future we will do
2 better with new technologies.

3 Q So, Doctor, basically you just referred that we're
4 back to the zone of the 93 percent is achievable that
5 VanSlyke was basically advocating at that time?

6 A Right.

7 Q And also, .93 is not the maximum. There are
8 possibilities that it could be higher, but .93 is, you know,
9 something to achieve.

10 A Yes. I think I wouldn't rule out the possibility
11 that in the future equipment designs, technology changes
12 could further improve what we recover in terms of fat in
13 cheese.

14 MR. PACHECO: Thank you, Doctor.

15 JUDGE HUNT: Mr. Beshore?

16 BY MR. BESHORE:

17 Q Dr. Barbano, when the VanSlyke was being derived,
18 at what point where the components of the milk being
19 evaluated?

20 A They would have been measured at the vat.

21 Q At the cheese vat?

22 A At the cheese vat. Correct.

23 Q Now, where in Exhibit 19, the flow chart that Mr.
24 Rosenbaum discussed with you this morning -- would you agree
25 with me that the dairy farmer's control of the process for

1 handling his milk ends when the milk leaves his farm bulk
2 tank and is loaded onto a truck and goes --

3 A Right. The farmer loses control of it at that
4 point, the individual farmer, yes.

5 Q And the handler of the milk has exclusive control
6 of the process from that point on?

7 A From that point on until it arrives and connects
8 to the plant and is pumped into the silo. At that point,
9 the handler loses control.

10 Q The marketing handler, but --

11 A The marketing handler.

12 Q -- the manufacturing handler would --

13 A That's right.

14 Q And from the point it enters the silo at the
15 cheese plant, any losses within the plant operations are
16 within the domain -- managing those losses, managing that
17 entire operation, is the responsibility and the sole domain
18 of the plant owner and operator, correct?

19 A Yes.

20 MR. BESHORE: Thank you.

21 JUDGE HUNT: Mr. Rosenbaum?

22 BY MR. ROSENBAUM:

23 Q Dr. Barbano, to follow up on that line of
24 questioning, I suppose everything in the make allowance is
25 not in the control of the farmer, but in the control of the

1 handler, correct?

2 A Everything in the make --

3 Q I mean labor costs at the plant, obviously how
4 much you're going to pay your employees, is not the --

5 A Right.

6 Q -- farmer's responsibility.

7 A Right.

8 Q It's the handler's responsibility, correct?

9 A Correct.

10 Q But obviously that's built into the current
11 formula, correct?

12 A That is built into the current make allowance that
13 goes into some calculation in the formula.

14 Q Making sure you get the best deal possible for
15 your energy purchases. That's a concern of the handler,
16 correct?

17 A Correct.

18 Q Not the farmer's responsibility, correct?

19 A Right.

20 Q But it's still built in the make allowance,
21 correct?

22 A It should be, yes.

23 Q Okay. And really the only question as to
24 shrinkage is the question of whether it ought to be included
25 in the make allowance, which you say it should be, although

1 it's not right now, or whether it should be reflected in
2 what you may think of as a sloppy, but, nonetheless, a yield
3 factor, right? Those are the two choices.

4 A Those are the two choices. Given a choice, I
5 don't -- you get confused by changing yield factors for
6 purposes other than what really happens in the cheese
7 making.

8 Q Okay.

9 A Right.

10 Q Well, but arguably a reason not to change the
11 current yield factor is because the current yield factor of
12 .90 -- well, let me rephrase that. The current yield factor
13 reflects an assumption that .90 of the butterfat is retained
14 in the cheese, correct?

15 A It reflects that assumption. I'm not sure that
16 it's been carefully thought through whether that assumption
17 includes losses from the farm or was looking at it from the
18 vat.

19 Q Okay.

20 A Since I didn't set up that .9, I don't know what
21 the assumptions are.

22 Q Okay, but if we're not going to capture shrinkage,
23 and by that I mean loss of milk in the process, through the
24 make allowance, then one could account for that through the
25 yield factor in the formula?

1 A Well, the thing is that when you talk about
2 shrinkage you're losing everything.

3 Q Right.

4 A Yes, so you'd want to be very careful about how
5 you account for it or try to take care of it in a yield
6 factor because there's several factors all through the whole
7 system, and placing it in different factors produces
8 different effects because it's not where it really occurs.

9 Q But it's got to be put in somewhere? You and I
10 agree as to that?

11 A It's a real cost in terms of loss of milk no
12 matter where it occurs.

13 MR. ROSENBAUM: Thank you.

14 JUDGE HUNT: Mr. Beshore?

15 BY MR. BESHORE:

16 Q Are you aware, Dr. Barbano, of any studies with
17 respect to shrinkage type losses in cheese manufacturing
18 plants like what's achievable, what's an efficient level
19 that can be achieved by a reasonable plant operator?

20 A Yes. I have not been involved in any studies like
21 that, and --

22 Q Are you aware of any that other people have done?

23 A I'm not aware of any in the research literature
24 that have been formally done. I'm sure there's some that
25 have been industry type studies, and I'm not so aware of

1 those. I really don't know.

2 MR. BESHORE: Thank you.

3 JUDGE HUNT: Mr. Vetne?

4 Mr. Vetne assured me that he would not duplicate
5 that questions that were asked before.

6 MR. VETNE: And if I happen to stumble on some,
7 Dr. Barbano assured me that he would bring it to my
8 attention.

9 BY MR. VETNE:

10 Q Dr. Barbano, the relationship between the nonfat
11 solids price and particularly the protein price that you
12 describe as a current problem when milk is used for cheese
13 because protein is not priced on the base of cheese; it's
14 priced as a default value based on the price of butter.

15 Would it be correct to say that that same problem
16 characterized not only the current system as you describe
17 it, but characterized the skim and butterfat accounting when
18 the M-W was used and the skim and butterfat or component and
19 butterfat accounting when the BFP was used?

20 A I think that the scope of that goes well beyond,
21 you know, my knowledge and experience going back into the
22 old BFP, and I don't think I can answer that.

23 Q You are aware, are you not, that in the skim and
24 butterfat accounting that the skim price was a default value
25 after the butterfat value was calculated?

1 A Correct.

2 Q And to the extent that skim milk, it was used with
3 fat to make cheese, the skim and the components of skim,
4 prices would go up or down based on butterfat value the same
5 way you've described now as a problem?

6 A Correct. Correct.

7 Q Okay.

8 A That's correct.

9 Q I did not intend to draw on your knowledge of the
10 details of how that formula was arrived, but rather the
11 mechanics of translating a solids price without going into
12 the details of the components.

13 A Right.

14 Q A solids price to the nonfat portion of the milk,
15 and that would --

16 A And the dependency on fat that when fat goes up,
17 because it's a residual, solids value goes down.

18 Q Okay. Now, in the past are you aware that, let's
19 say going back 20 years or more, skim milk going to cheese
20 plants was commonly priced not only under the Federal Order
21 system, but competitively, just at a volume basis?

22 A Yes.

23 Q And the industry subsequently took the lead,
24 noticed that protein or nonfat solids had value independent
25 of the volume of solids and water in skim milk, and the

1 industry took the lead in implementing competitive premiums
2 for either protein or nonfat solids or other components in
3 the skim portion of milk, correct?

4 A Yes, that is correct.

5 Q Okay. After that had occurred for a great number
6 of years and became a competitive market practice, the USDA
7 followed with implementing component pricing roughly
8 mirroring the competitive market in some of the north, heavy
9 cheese producing markets?

10 A I guess the question --

11 Q Is that correct?

12 A Well, what happened -- I think it's correct.
13 Whether the industry led USDA or USDA followed I'm not sure.
14 In terms of what you're saying, I think the industry had to
15 request USDA to consider components.

16 Q And are you not aware that the industry had for a
17 number of years employed competitively premiums based on
18 solids before USDA introduced that system into regulation?

19 A Yes.

20 Q Are you familiar with a series of reports by one
21 of the midwest market administrators describing the elements
22 of component based competitive pricing, part of the record
23 in the component regulated pricing hearings?

24 A Yes. I think I recall and I receive annual
25 things, publications from USDA, about the number of areas

1 using component pricing and programs, yes.

2 Q Are you aware of whether in the cheese
3 manufacturing industry there are plants that competitively
4 employ the type of formula that is included in your
5 proposal?

6 A There are plants that competitively apply a cheese
7 yield formula, which would be a portion of what I have.
8 Mine includes the whey also, but particularly applying the
9 cheese yield formula to pay for milk based on its cheese
10 yield.

11 Q Within the Federal Order system, are you aware of
12 whether that kind of cheese yield formula pricing has
13 achieved the same market or competitive dominance that
14 component pricing had achieved when USDA incorporated
15 component pricing and regulation? Do you know the extent to
16 which that actually is employed in the market?

17 A Today?

18 Q Yes.

19 A The extent is relatively small. I can think of a
20 few cheese making factories that apply a yield calculation
21 based on individual producers' milks to determine that
22 producer's price.

23 Q Okay. With respect to those few that you are
24 aware of, are you aware of whether or not those plants
25 incorporate a system of weighing the protein price and the

1 fat price in the cheese yield formula the same way that
2 you're proposing now?

3 A The weighing that they use is based on the
4 VanSlyke formula, so it would be -- when you say as I'm
5 proposing now, you're referring specifically to what I have
6 in that first column of the spreadsheet? Is that --

7 Q I'm referring specifically to take the weight of a
8 block of cheese and figure out the weight of butterfat in
9 it --

10 A Right.

11 Q -- and so forth.

12 A There are two different ways of saying the same
13 thing on the cheese side; that what I have is calculating
14 the amounts of cheese and where components go.

15 Q Are you familiar within the regions, for example,
16 in the upper midwest? Do you have any idea how many plants
17 now competitively in relation to total cheese production
18 employ that kind of payment system?

19 A No, I don't. I don't know the number of plants.

20 Q Okay. Would the same answer be true for other
21 markets?

22 A Correct.

23 Q I think you've indicated, and if you haven't would
24 you agree with me, that the proposal would affect, if
25 implemented, some change in the competitive equilibrium that

1 is now experienced between cheese plants and between
2 markets? Is that correct?

3 A When you say the proposal, you're referring to?

4 Q Your proposal to change the weight of value
5 attributed to protein versus the weight of value attributed
6 to fat in milk used for cheese.

7 A Okay. So that would go to changing the fat value
8 to the cheese price instead of -- that's the first step.

9 Q I'm coming to that.

10 A Okay.

11 Q After all of those steps are done, --

12 A Right.

13 Q -- it will change in reality competitive
14 relationships between plants that produce different
15 varieties of cheese and have different protein content in
16 their cheeses, different fat content in their cheeses.

17 A The calculation I've done produces a price per
18 pound of fat and a price per pound of protein, a price per
19 pound of other solids. I don't see that it changes the
20 relationship between manufacturers that make different types
21 of cheese other than the big differences there are already
22 between manufacturers that make different types of cheese.

23 Q All right. We'll get into that a little bit more.
24 Are you aware that plants in California pay for milk
25 components going into cheese on the basis of solids, not

1 fat, and fat content in producer milk?

2 A I'm aware of it, but I'm not as familiar with the
3 details of how they do that in California.

4 Q Okay. My questions don't require you to be aware
5 of the details, just of that simple fact.

6 Within the Federal Order system, the proposal you
7 have advanced will change the amount that a handler must
8 account for solids, not fat, and protein in particular, but
9 of necessity it will not change the way handlers in
10 California account for solids, not fat, including the
11 protein, correct?

12 A Correct.

13 Q Okay. With respect to the total cost of milk used
14 to make cheese, your proposal would in particular increase
15 the minimum price charged to manufacturers of lowfat cheese,
16 such as mozzarella and other cheese that don't have the
17 VanSlyke percentage of fat?

18 A When you make --

19 Q I'm sorry. When fat prices go up in butter.

20 A When you say increase the price, the thing is that
21 if you're making, as you said, lowfat cheddar or mozzarella
22 that you have two options to consider. You're not going to
23 make the cheese directly from the milk that you purchased
24 from the farm because it's got the wrong ratio of casein to
25 fat --

1 Q Yes.

2 A -- so the amount that you pay for the milk is
3 going to be net of the cream that you remove, or you're
4 going to be doing some fortification.

5 Q I'm sorry. My question was incomplete. Let's
6 look at the skim portion of milk.

7 A Okay.

8 Q Some fat is removed and accounted for differently,
9 and the fats and the solids that go into cheese are the fat
10 and solids that are important for your formula.

11 For a plant producing a lowfat cheese, when,
12 according to your formula, the farmer isn't achieving enough
13 revenue on the protein portion the formula would correct
14 that, and the protein price would go up, correct?

15 A Yes. The protein price would not go down or up
16 when fat goes up and down.

17 Q And whatever that price is, whether it's low or
18 higher than would be under the current system or under the
19 previous M-W and BFP systems, it will be a change in price
20 relationship that is not experienced by California
21 manufacturers because they're not subject to the same price?

22 A Again, I'm not familiar with the California system
23 in terms of the fat and skim value relationship.

24 Q But you would not disagree with me that if
25 California does not incorporate this same system, there will

1 be introduced a new difference between lowfat cheese made in
2 California and lowfat cheese made elsewhere?

3 A I'm still not sure that if you take -- let's say
4 you make lowfat cheese here. We're not in California.

5 Q Okay.

6 A I remove cream from the milk to make the lowfat
7 cheese or the simple, straightforward case. I take that
8 cream, and it's going to go out of the plant and be sold.

9 I would assume that if that was the case, and
10 given my scenario that I valued the fact purchased from the
11 farm at the price per pound of cheese, that when that cream
12 goes out of the factory it will be changed depending on what
13 it's used for in terms of the value of that fat, in terms of
14 what utilization it goes into.

15 Q I see.

16 A So it seems like that would correct --

17 Q You're assuming that the handler receives raw
18 milk, and any offsetting increased costs in the protein
19 portion would be offset by reduced costs for the fat
20 portion? Is that correct?

21 A If you're making lowfat products and you will need
22 to either remove cream or fortify, that if you're taking the
23 approach of removing cream then the ingredient costs, both
24 in California or outside of California, would not reflect
25 that total milk cost, but the --

1 Q Yes.

2 A Given the way I've done it, that cream value was
3 paid for at the price per pound of fat that would be equal
4 to the cheese price, but if that fat was not going to be
5 used in cheese and was going to go into another utilization,
6 then as it goes to another class it would be revalued at
7 least the way I'm aware of things moving between classes in
8 the current system.

9 Q So if butter is -- if the fat value in your
10 formula of cheese is lower than butter and the cream ends up
11 in a churn and gets converted to butter, either the cheese
12 maker or somebody has to account to the market for the
13 higher value of fat and butter, and either the cheese maker
14 or somebody to whom the cheese maker sells -- there would be
15 no ability for the cheese maker to offset that cost because
16 the system forces it at a higher price? Offset the cost of
17 fat not going into cheese against the increased cost of
18 protein going in cheese.

19 A The cheese maker making that lowfat product always
20 has the option to keep that fat and buy nonfat solids to
21 double standardize.

22 Q But the nonfat solids then coming in let's say in
23 the form of condensed. Are you aware that condensed milk is
24 priced at the classification for which condensed milk is
25 used, so it's separate at some place, but when it comes to a

1 cheese maker it would, under your proposal or any proposal,
2 it would be priced at the protein or solids or skim milk
3 price --

4 A Yes.

5 Q -- at ultimate use? I'm sorry. Your answer was?

6 A Yes. Yes.

7 Q As I recall, milk which is standardized to 3.5
8 percent butterfat and in an illustration of the problem that
9 you perceive there would be some increase in the 3.5 cost of
10 milk when fat prices have gone up, but protein prices
11 haven't adjusted correspondingly.

12 A Can you --

13 Q You indicated a 30 cent increase, one bottom line.
14 Do you recall that number?

15 A Right. Yes, I do.

16 Q Are you aware that at some threshold Class I
17 prices can be driven by Class III prices?

18 A I'm aware of that, but it's not something that
19 I've specifically looked at within the scope of what I'm
20 working on in this Class III price in establishing the
21 factors in protein and fat values.

22 Q Okay. Are you not prepared to address then the
23 impact of the proposal on skim milk prices when Class III
24 drives the Class I price?

25 A I did not prepare for that because it really was

1 outside of the scope of what I was reading in the hearing
2 notice and that the -- I'm focusing specifically on trying
3 to get a technically correct value per pound of fat, per
4 pound of protein, per pound of other solids.

5 Q The proposal, I hope you will agree -- I'm asking
6 you to agree or disagree.

7 A Okay.

8 Q -- would disconnect more than is currently the
9 situation the protein price for milk used in cheese from
10 other uses in the pool.

11 A And I think I said in my testimony that I
12 acknowledge that there are things that have to be considered
13 about that in terms of the impacts outside of Class III, and
14 those things need to be evaluated.

15 Q Okay. Would it be correct that you have not
16 evaluated the impact of the proposal on the incentive of
17 plants, particularly plants making lowfat cheeses, to take
18 their milk and milk supplies and plants off the pool, the D
19 pool?

20 A Right. I have not evaluated that.

21 Q Would you agree that it would create new
22 incentives or at least new considerations in decisions to
23 pool or not pool?

24 A I think any time you change anything that you
25 reevaluate all of those decisions.

1 Q The VanSlyke formula -- well, strike that. If my
2 recollection is in tune, and frequently it's not, I recall
3 at prior hearings on component pricing that you have
4 testified to an optimal relationship between casein content
5 and fat content in producer milk to achieve highest yield
6 from those components in cheddar cheese.

7 A I think I've testified to the optimum ratio.
8 There's an optimum ratio to get quality in terms of the
9 quality characteristics of the product, and that's a little
10 different depending on whether you're making barrel cheese
11 for processing or you're making cheddar cheese for aging.

12 Q If the optimal relationship between casein and
13 protein does not exist, let's say there is -- well, again
14 strike that.

15 My recollection, and forgive me if it's wrong, is
16 that you've testified that there's some binding that takes
17 places between the casein and fat to produce the product.

18 A That's correct.

19 Q Casein adheres to fat or vice versa or both.

20 A The casein traps the fat and holds it, and by -- I
21 think the use of the word optimal is not quite the correct
22 term; that at some point there's a limit, a maximum limit
23 above which you've got too much fat, and you both change the
24 characteristics of the product to make it technically
25 unacceptable from a quality point of view, but you start

1 getting to the point where you would have fat losses that
2 will be higher than what you want in your cheese making.

3 Q Okay. That was my next question. At some point
4 if it's out of sync with optimal, more of the fat goes out
5 in the whey. Is that correct?

6 A Yes.

7 Q And if the converse is true that you have too
8 little fat compared to the casein, more of the protein goes
9 out in the whey?

10 A No.

11 Q No?

12 A That's not true.

13 Q That portion is not true?

14 A That portion is not true.

15 Q Why is that?

16 A When you get down to too low fat, what happens is
17 in cheddar cheese once you go below the amount of fat that
18 would give you 50 percent fat on a dry basis it no longer
19 meets the legal minimum for composition in terms of fat on a
20 dry basis.

21 Q Okay. With respect to the production of cheeses
22 other than cheddar cheese, does the same general chemical
23 principles hold true?

24 A In general, yes. Both chemical and issues of
25 product standards in terms of minimum fat contents that are

1 allowed in particular standardized products.

2 Q Okay. With respect to non-cheddar cheese, you
3 would also expect if the fat to casein ratio is out of sync
4 more of the fat to be lost in the whey?

5 A I would expect that, but those ratios are usually
6 well above or they are above where you would start to have
7 quality problems with the product itself.

8 Q And where the incoming producer milk does not have
9 optimal characteristics, that's where a handler would want
10 to consider purchasing either cream or condensed milk to
11 produce the optimal relationship in the vat before or in the
12 silo before it goes into the vat?

13 A I think that for a number of reasons the cheese
14 maker wants to reach an optimum from the standpoint of the
15 quality of the product, the recovery of solids and the
16 efficiency in terms of the total pounds of cheese per fill
17 of vat that you produce in that plant, so you would control
18 that ratio, both the ratio of casein to fat and the sum of
19 the two to the level to optimize several things at once.

20 Q The formula that you have introduced and I guess
21 the formula even currently in place assumes a fat to protein
22 -- I'm sorry. A casein to protein ratio.

23 A The one -- it has a ratio in there. It assumes a
24 ratio, and that is something that you have to select.

25 Excuse me. Can you repeat that?

1 Q The question is simply it assumes a ratio of
2 casein to protein, whether it's true protein or --

3 A Yes. Yes.

4 Q It does?

5 A Yes.

6 Q It doesn't measure casein in incoming milk or
7 doesn't measure casein or protein in outgoing product?

8 A That's correct.

9 Q It's all based on the assumptions. There are
10 differences, are there not, in casein to protein ratio in
11 producer milk?

12 A Yes.

13 Q And those differences are observed from farm to
14 farm, region to region and season to season, correct?

15 A There are differences, yes.

16 Q And if incoming producer milk has less casein to
17 protein, more of the non-casein protein goes out into the
18 whey. Am I correct?

19 A That is correct.

20 Q And this proposal and I guess the existing system
21 would charge for that protein as though it stayed in the
22 cheese because of the assumption? Is that also correct?

23 A Well, I -- no, it's not correct because I think
24 that when you look at -- when you have a producer's milk
25 where the casein as a proportion of protein is abnormally

1 low what you'll find a large proportion of the time is the
2 somatic cell count of that milk is abnormally high, and in
3 the calculation of the prices in the Federal Orders where
4 they're using somatic cell count, that higher somatic cell
5 count would factor in a negative on the price to account for
6 that loss of protein or loss of yield in cheese.

7 Q Is somatic cell count -- strike that also. There
8 is, however, occasions of lower casein to protein for
9 reasons other than somatic cell count. Seasonal, regional.

10 A In my opinion, I think most of the difference is
11 due to somatic cell count. The other factor, in my
12 experience, that seems to be important in that if the
13 somatic cell count is low but you say I have milk from a
14 herd where the casein as a proportion of protein is
15 abnormally low that in my experience the reason why that has
16 occurred in the past is that that would tend to be a herd
17 that has as average age of cows in the herd that is high.

18 In my experience, the average age of cows in dairy
19 herds has been going down because of the change in size of
20 herds and the management style of herds, so I think that's
21 becoming less significant, so I think somatic cell is
22 explaining more of the variation in that casein as a
23 proportion of protein than it used to.

24 Q Okay. When somatic cell is the explanation for
25 low casein to protein, have you calculated whether the

1 somatic cell adjustor captures the difference in price, the
2 new difference in price that would be created under the
3 proposal when protein that's assumed to be in the cheese
4 actually is not in the cheese?

5 A I have not calculated specifically that adjustor.

6 Q Okay. Are you aware of a study -- I think it came
7 out of UC-Davis or maybe within the California Department of
8 Food and Agriculture -- by Lee Jensen in which regional
9 differences within California of casein to protein were
10 observed with lower casein to protein in southern
11 California, higher in northern California?

12 A I have not seen that study.

13 Q Do you know whether there is a difference in
14 protein or casein recovery in non-cheddar cheese compared to
15 cheddar cheese?

16 A My experience, and when you say non-cheddar
17 cheeses, my direct experience has been in lowfat cheddar
18 cheeses and all fat levels of mozzarella, and my experience
19 in those two cheese, which is extensive in terms of cheese
20 making for research purposes. There is no difference in
21 protein recovery in the cheese whether I'm making lowfat
22 mozzarella, mozzarella, cheddar, lowfat cheddar. Given good
23 manufacturing conditions, the proportion of the true protein
24 that I retain in the cheese is on a par.

25 Q Do you have any information or knowledge

1 concerning whether the recovery of fat that goes into the
2 vat in non-cheddar cheese is proportionately greater or
3 lesser than in cheddar cheeses? I'm not talking of fat in
4 producer milk.

5 A Right.

6 Q I'm talking the recovery of fat that actually goes
7 into the vat; whether the proportion is different.

8 A Particularly in mozzarella cheese where I have
9 quite a bit of experience, the proportion of the fat that
10 you start out with in the milk that's retained in the cheese
11 is lower, but typically you're starting out with a very
12 different fat to casein or fat to protein ratio.

13 There's a lower proportion of fat, so even though
14 there's a big percentage difference, let's say for
15 mozzarella the average is 85 percent of the fat --

16 Q Recovered in the cheese?

17 A -- recovered in the cheese versus a 90 to 93 in
18 cheddar. That's 85 percent of a smaller percentage fat in
19 the milk because you're starting with a lower fat milk, so
20 on an absolute basis it's not quite as big as those
21 differences in percentages would show.

22 Q Okay. I may have said this before, but bear with
23 me. As I understand the proposal, when milk of average milk
24 supply composition is received and cheddar cheese of
25 standardized fat and moisture relationship is produced, the

1 proposal that you've advanced will not change handlers' milk
2 costs, but reallocate those costs between fat and protein.
3 Is that correct?

4 A Can you repeat? There were several things there.
5 I want to be sure I understand correctly what you've asked.

6 Q Okay. Let's take your proposal in its whole. It
7 starts out with a cheese price, a market cheese price.

8 A Correct.

9 Q Okay. It subtracts from that cheese price a make
10 allowance?

11 A Yes.

12 Q And --

13 A Now, my proposal doesn't do that. The current
14 system does.

15 Q But the current system does that?

16 A Yes.

17 Q Okay. You end up somewhere between a cheese price
18 after subtracting a make allowance with handler cost, a
19 minimum price?

20 A Yes.

21 Q Okay. Am I correct that the proposal that you
22 advanced with respect to that minimum price for standardized
23 cheese and standard milk doesn't change the handler's total
24 costs, but instead reallocates those costs between fat and
25 protein?

1 A I think that it reallocates the cost between fat
2 and protein for sure. It does -- the way -- even at the 75
3 percent, the assumption of 75 percent of the true protein is
4 casein, so it would be Column 1 in what I presented; that
5 that arrives at a milk price of \$11.66 where the current
6 system would arrive at a milk price of \$11.51 with a 3.5
7 milk, so there's a difference in price.

8 Q Okay. I'm sorry. My question did not assume 3.5
9 milk. My question assumed the --

10 A The 3.6?

11 Q -- 3.67 or whatever the standard.

12 A Okay.

13 Q The supply that gets in the milk supply to the
14 cheese plant.

15 A Okay. If you take the 3.67 and you want to
16 compute the price per pound of protein at 3.67?

17 Q Yes.

18 A That is not a combination that's shown on my
19 sheet, but I could do it if you --

20 Q Okay. What I wanted to know is whether the actual
21 cost of fat and protein combined in your formula after some
22 make allowances --

23 A Right.

24 Q -- is changed?

25 A It's changed, and at 3.67 actually the difference

1 between my calculation and the current calculation at 3.67 I
2 think is a little smaller than the difference that exists at
3 3.5 fat.

4 Q Okay. The added price --

5 A Yes.

6 Q -- comes as a result of placing more importance on
7 the nonfat portion of milk at 3.5, the difference that you
8 described?

9 A Yes. Yes. It reduces the fat value and increases
10 the protein value. That's correct.

11 Q Okay. And because standard milk, what we use as
12 3.5, is not representative of the milk supply?

13 A Correct.

14 Q You speak in your testimony frequently about
15 sending signals, and on page 23 you indicate that this would
16 deliver payments to each producer links directly to the
17 value of cheese.

18 In prior -- I guess it's near the bottom of the
19 page there towards the end of a paragraph. I can find it
20 for you.

21 A Yes. I've got it.

22 Q Do you see it? Okay. In prior cross-examination,
23 would it be correct to say that you've changed your opinion
24 on the linkage between the cheese price and the signal
25 received by the producer?

1 A I don't think I've changed my opinion. I think
2 the thing is that when you say by the producer, as soon as
3 you say producer I think of individual producers, not that
4 aggregate silo milk at 3.9 something. As individual
5 producers, the way the current system is working the ones
6 below that ratio don't receive a signal that is sensible.

7 Q In that case, I would just ask a couple questions.
8 The producer, the individual dairy farmer, --

9 A That's right.

10 Q -- in a regulated market under your proposal will
11 not receive the price or the price differences incorporated
12 in the proposal for a number of reasons. First of all, what
13 the producer receives is dependent upon other classes in the
14 market.

15 A Correct.

16 Q Okay. And those values are blended before it gets
17 to the producer?

18 A Yes.

19 Q And the degree to which a market has other uses,
20 the more those other uses the lower this signal to
21 producers?

22 A I have --

23 Q The smaller portion of the signal is translated
24 into the producer price.

25 A I suppose. You'd have to calculate and look at

1 how that would work. Yes.

2 Q Okay. And in fact the proposal, even in markets
3 that are heavily influenced by cheese, does not include a
4 subproposal to recalculate the way in which the producer
5 component price is calculated and actually paid to
6 producers. I think you answered yes to that before.

7 A That's correct.

8 Q Okay. So both of those things, both other uses
9 and the non-translation of these price differences into the
10 ultimate signal received and the producer's paycheck, would
11 dilute what you describe as an important signal?

12 A There would probably be some dilution, yes.

13 MR. VETNE: I want to address for a minute amended
14 Exhibit 19 and offer some additional amendments myself.
15 I'll give you a copy on which I've made some writing. I
16 haven't made extra copies of this, but --

17 JUDGE HUNT: If you modified 19, we better make
18 that a separate exhibit, Mr. Vetne. Do you want that marked
19 as proposed Exhibit 20?

20 MR. VETNE: Sure.

21 JUDGE HUNT: All right.

22 (The document referred to was
23 marked for identification as
24 Exhibit No. 20.)

25 //

1 BY MR. VETNE:

2 Q On proposed Exhibit 20 I have written some numbers
3 in blue ink so that they're distinguishable from Exhibit 19.
4 Going to the bottom of the page where Mr. Rosenbaum has a
5 little square right of center indicating a cheese vat, --

6 A Yes. I see that.

7 Q -- I've introduced a new arrow there indicating
8 loss of components between the vat and the cheese. Would
9 you agree that some cheese is lost between the vat and the
10 package?

11 A Yes.

12 Q And then on top of the page coming from, and you
13 all will see this. We'll get copies. Coming from the
14 tanker I've introduced a new step, an additional step, where
15 some milk coming from the farm tanker takes an intermediate
16 route and goes to a creamery where milk is separated and
17 condensed.

18 In that transaction, some milk would be lost from
19 the tanker to the creamery, as it is in every transaction
20 from the farm to the first plant, correct?

21 A Yes.

22 Q Okay. And in the milk going to the condensory
23 there would be some plant losses of components in the
24 condensing process. Am I correct?

25 A Yes.

1 Q Okay. And when condensed milk or cream is loaded
2 onto a truck from the condensory there would be some losses
3 in the pipes and lines and truck and so forth before the
4 condensed milk or cream comes to the cheese plant
5 pasteurizer, correct?

6 A It's correct, but we're really dealing with two
7 different plants, and we're receiving milk that is not going
8 to cheese at its point of first receipt.

9 Q I understand. That's true, but are you not aware
10 that when either the condensed milk and/or the cream hits
11 the pasteurizer or the silo -- I'm sorry. I had it going to
12 the pasteurizer. It should go to the silo --

13 A The silo.

14 Q -- of the plant.

15 A That's right.

16 Q So that arrow is wrong, but when it hits the silo
17 of the cheese plant somebody, the cheese plant or the
18 creamery operator, will have to account to the pool for use
19 of that condensed milk and solids in the condensed milk, as
20 well as the fat in Class III, correct?

21 A When it arrives at the plant at that point, but it
22 would be, and again I'm not as familiar with this, but once
23 that tanker unloads at a creamery and it's going to be
24 processed, the associated losses of milk components then
25 should be factored into the cream and condensed price that

1 are the products that that processing unit is selling.

2 Q Yes?

3 A So the cheese maker who's buying those components
4 has to look at that, and there's some -- there probably is
5 some losses factored into the price of those and would make
6 a decision whether those are a reasonable way of buying raw
7 material or whether they should be getting more of their
8 milk components directly into the silo from the farm.

9 Q I understand. I've made a correction on the
10 exhibit which shows the cream and the condensed going to the
11 silo of the cheese plant rather than the vat of the cheese
12 plant. That is more accurate?

13 A That's more accurate, yes.

14 Q It's your understanding, or maybe it's not. Is it
15 your understanding that someone in the system under your
16 proposal or any others would have to account when cream and
17 condensed are used in this manner, would have to account to
18 the pool at the Class III price, at the Class III protein
19 price, at the Class III fat price, for whatever volume of
20 milk is produced at the farm, whether it goes through a
21 condensory and separator or not?

22 A Someone would have to account for it, but I would
23 assume the way you have drawn this that since the creamery
24 sounds like something that's a separate site --

25 Q Yes.

1 A -- where these condensed and cream are being made
2 that that creamery is responsible for its own losses, and if
3 it needs to recoup those losses in handling would need to
4 reflect that in the price that it charges for its cream and
5 its condensed.

6 Q Okay. With reference to yield, if yield of
7 product is calculated by reference to volume of milk
8 produced at the farm, when milk goes through a condensory or
9 separator at another site the yield would be lower for that
10 portion of milk because of those intermediate losses,
11 correct?

12 A The amount of milk arriving at the cheese plant
13 would be less. The yields per unit volume are the same of
14 the milk they started with.

15 Q Well, the yields -- again, my question was by
16 reference to the volume of milk and components produced at
17 the farm.

18 A Right.

19 Q Your answer was yield by reference to volume of
20 milk received in the silo.

21 A Right.

22 Q Okay.

23 A Okay.

24 Q And your answer to each of those propositions was,
25 "Right." Correct me if I'm wrong.

1 Okay. As I understand your proposal and your
2 concerns and the problem to be addressed is that it's very
3 important for a cheese plant to pay and for the producer
4 milk price system, however it's translated, to receive
5 accurate accounting of the actual value of the components in
6 milk when it's used for cheese, correct?

7 A Yes.

8 Q So there's a protein price which goes to the
9 fourth decimal, and the protein value assumed to be retained
10 in the cheese is calculated different from the protein value
11 assumed to go out in the whey, correct?

12 A Correct.

13 Q And both of these it's important to bring them out
14 to multiple decimals because we're dealing with
15 hundredweights of milk, and cheese is multiplied by roughly
16 ten when you get there so a mil becomes a penny when you get
17 to a hundredweight price, correct?

18 A Yes.

19 Q With respect to the fat value of milk going into
20 cheese, under your proposal there is one fat value when you
21 get down --

22 A Right. For cheese.

23 Q For cheese. And that fat value is based on the
24 weight of fat in cheese?

25 A And it's based on the -- the fat value per pound

1 is based on the price per pound of cheese in the system that
2 I have proposed.

3 Q Right. All of the value of fat received in
4 producer milk is assigned to the value of fat in cheese
5 under your proposal?

6 A That's correct.

7 Q Okay.

8 A That's correct.

9 Q The handler or manufacturer or processor pays for
10 fat that comes out in the whey on the same price?

11 A That's correct.

12 Q Unlike protein, the ten percent or so of fat that
13 goes out in the whey is not adjusted for market value if it
14 differs from fat which is retained in the cheese?

15 A At the point that that fat is no longer in the
16 cheese and it's recovered as whey cream, if it would be sold
17 outside the plant as whey cream then if the value in the
18 marketplace for fat was higher than the fat value assigned
19 to Class III you might be able to get more for that fat than
20 what you paid for it. The opposite is also true if the
21 values were lower.

22 However, in my opinion, particularly for the type
23 of cheese manufacturer that would be doing what -- making
24 cheese relative to the Class III scenario, the barrel type
25 cheese, the current block cheese, that another alternative

1 for that manufacturer when fat value outside of Class III is
2 lower is to capture and reincorporate that whey cream or
3 that fat that's lost today in the process the next day,
4 which would allow them to recover the value of that fat in
5 product at the price that they paid for it.

6 Q Are you aware of the extent to which, first of
7 all, cheese makers are able to reprocess and recover all of
8 the whey cream back into the next vat of cheese?

9 A It's not done into the next vat of cheese. It's
10 usually done in terms of later in the day or the next day,
11 but it's being done, and it's being done much more
12 effectively than people thought it could be done.

13 Q What portion of cheese plants, if you know, do
14 this?

15 A I don't know what proportion exactly do this, but
16 many of the cheese plants I talk to are doing it.

17 Q Of the plants that do it, do you know whether they
18 are able to reprocess and recover as cheese fat all of the
19 whey cream, all of the fat and whey cream that comes out of
20 the process?

21 A What I know and what my experience has been is
22 that when you take the whey cream from today and utilize it
23 when you're fortifying tomorrow in your cheese making and
24 you needed cream anyway that your fat losses using that whey
25 cream the next day are virtually identical to what you had

1 with fresh cream coming in.

2 Q My question -- that was almost the answer to my
3 question, but I think something is missing. To the extent
4 that processors actually do that, and you don't know the
5 extent. You think --

6 A I don't know the exact extent.

7 Q Okay. Do you know of those processors whether
8 they also do something else with some of their whey cream?

9 A At times if the whey cream -- if they make a
10 decision not to use additional cream then usually that's a
11 scenario where the fat is of more value outside the cheese
12 and that they're selling that cream. It's going to another
13 use.

14 Q Okay. You also indicated in answer to the
15 question an assumption, I think, that if they're going to
16 buy cream anyway this is what they ought to do. Was I
17 correct?

18 A That's correct.

19 Q Okay. If the fat in the incoming producer milk is
20 already at a level that they don't need to buy cream, there
21 would be no reason to reprocess the whey cream into cheese.
22 Am I correct there also?

23 A Well, not necessarily. Let's say that you
24 indicate that the fat in the milk is adequate. Let's say
25 that it's giving me an FDB of fat on a dry basis in my

1 cheese of 53.5 percent.

2 If I had some additional cream and added it to the
3 vat and raised my fat on a dry basis to 54 percent, if that
4 product is acceptable from a quality point of view to my
5 customers then it's more profitable for me to make a higher
6 FDB cheese if I can make my moisture, so recovering that fat
7 from the whey cream, even though it will make -- because
8 it's a relatively small volume of the total fat that came
9 into the plant, the seven to ten percent minus whatever
10 disappeared on the way to the plant, that if I can capture
11 that in the cheese and sell it as cheese usually that's the
12 best thing to do. I think that you would consider it
13 whether you had enough fat or not.

14 Q Okay. When or if a handler does reintroduce whey
15 cream into -- mix it with producer milk to make cheese,
16 would it be reasonable to assume that the portion of the
17 whey cream that's not fat is just reprocessed through the
18 system and comes out again as a little more whey --

19 A As whey.

20 Q -- than you would otherwise have?

21 A That's correct.

22 Q Okay. So there would be more whey and maybe a
23 little more whey processing cost as a result?

24 A Actually, there would be more yield of whey powder
25 as a result, too.

1 Q Okay. Yes. Now, you do indicate that you don't
2 know how much this is actually done in real life by cheese
3 plants?

4 A That's correct. I don't have any exact numbers.

5 Q To the extent that handlers for whatever reason --
6 they don't need fat, they don't have that system -- are
7 unable to employ it that way, what is commonly done with the
8 whey cream, if you know?

9 A Usually it would be -- well, there's a couple
10 different things. One, it would be sold as whey cream.
11 That's normally the least desirable thing to do in a cheddar
12 plant.

13 In a mozzarella plant, that whey cream, if they're
14 doing some separating anyway, is probably blended with fresh
15 cream and will go out for other utilization outside the
16 plant and sold right along as a mixture with the fresh
17 cream.

18 Q And some plants or the customers of cheese plants
19 make whey butter out of it and sell it for manufactured like
20 cookies?

21 A If you were using -- if you were taking 100
22 percent whey cream, yes, some plants would make whey butter,
23 and it would be used as an ingredient--

24 Q Okay.

25 A -- in other foods.

1 Q Do you know either in any detail or generally what
2 the market value of fat and whey cream disposed of in that
3 manner is in relation to any other market fat?

4 A I know it's lower than what would be in fresh
5 cream, but I don't have any specific factor of value for it.

6 Q Okay. To the extent that whey cream is not
7 recaptured in a later vat of cheese and it's important to
8 calculate the value of components to the fourth decimal,
9 would it not be more technically accurate to segregate that
10 portion of fat and price it as you have priced protein
11 that's not captured in cheese differently based on a market
12 value for whey fat?

13 A If that was done, if the market value of that whey
14 cream fat is higher or lower than the price that the fat for
15 Class III has been established at, then that would be one
16 way of reflecting its value. It could go either way.

17 Q Okay. And with respect to whey cream, fat in the
18 whey, to the extent a handler experiences costs of disposing
19 of that either in reprocessing or selling at a lower price,
20 let's say, for example, that whey cream is sold to somebody
21 that does whatever with it, and the fat value in that whey
22 cream is priced substantially less than the value of fat in
23 cheese or the value of fat in butter.

24 Would you agree that that is a cost that the
25 handler has to deal with?

1 A I guess the question of whether you call it a cost
2 is whether the choice -- whether other alternatives to get
3 higher value uses of that cream, selling it as whey cream
4 versus trying to reincorporate it into the cheese or so on,
5 is a decision, a management decision of a cheese maker, and
6 I guess as I work with cheese makers I usually try to advise
7 them to follow management courses that would maximize their
8 return.

9 If they choose that course, I guess it's sort of
10 a philosophical issue of, you know, should they be
11 compensated for taking that course when it was a lower value
12 option. I'm not sure that that's the right thing to do.

13 Q Well, okay. Let's look at market behavior --

14 A Yes.

15 Q -- rather than market advice. If the way the
16 market behaves and manufacturers behave as opposed to how you
17 want them to behave --

18 A Okay.

19 Q -- revealed that when whey cream is sold, when fat
20 and whey recovers to the manufacturer a lower value than the
21 manufacturer has to account to producers for that fat and
22 whey, that portion of difference between price and market
23 recovery is a real cost that has to be incorporated by a
24 handler in the business of making money someplace in the
25 system, correct?

1 A That's correct, and I think it would be very
2 useful for everyone to know what really is happening in
3 terms of the extent of utilization of whey cream that way
4 versus other options.

5 MR. VETNE: Okay.

6 (Witness excused.)

7 JUDGE HUNT: Let's take a break at this point --

8 MR. VETNE: Thank you.

9 JUDGE HUNT: -- and resume when we get back. Ten
10 minutes.

11 (Whereupon, a short recess was taken.)

12 JUDGE HUNT: Back on the record.

13 Whereupon,

14 JOAQUIN CONTENTE

15 having been duly sworn, was called as a witness
16 and was examined and testified as follows:

17 JUDGE HUNT: We're going to take Mr. Contente out
18 of order. He has a plane to catch, so we'll resume with Dr.
19 Barbano after Mr. Contente gives his testimony.

20 All right, Mr. Contente. Could you state your
21 name and spell your name for the record, please?

22 THE WITNESS: It's Joaquin Contente,
23 J-O-A-Q-U-I-N, C-O-N-T-E-N-T-E.

24 DIRECT EXAMINATION

25 THE WITNESS: My name is Joaquin Contente. I'm a

1 dairy producer from Hanford, California, operating an 800
2 cow dairy. I am president of the California Farmers Union,
3 and I serve on the National Farmers Union dairy committee.
4 I am here today to give testimony on behalf of National
5 Farmers Union.

6 The National Farmers Union was founded in 1902 as
7 a general farm organization and today has 300,000 family
8 farm members across the United States. We have offices in
9 Denver and Washington, D.C., and over 26 states across the
10 United States. We represent the interests of independent
11 family farmers like myself.

12 In most of the United States, my dairy would be
13 considered large. In California, my dairy is about average.
14 When my father and uncle started dairying, we had ten cows.
15 Over the years, my brother and I have built the dairy to
16 what it is today. Sometimes I am asked by dairymen from
17 other states why I have chosen to build my dairy to this
18 size. My brother and I felt that we do not have much choice
19 not to expand, given the dairy pricing system in California.

20 I am here today because I am concerned about the
21 future of dairy farming in the rest of the country and the
22 future for myself, my brother and my children if the Federal
23 Order begins to mimic California's pricing system.

24 On behalf of the Farmers Union, I would like to
25 thank the United States Department of Agriculture for the

1 opportunity to testify at this hearing to reconsider the
2 Class III and Class IV milk pricing formulas.

3 The hearing notice stated that the hearing purpose
4 was to receive evidence with respect to economic and
5 marketing conditions related to reconsideration of the Class
6 III and Class IV milk pricing formulas. There are two
7 issues I would like to address. The first is the pricing
8 formula itself, and the other is the disastrous effects that
9 the implementation of a California style make allowance will
10 have on the rest of the United States.

11 Section 608(c)(18) of the Agricultural Marketing
12 Agreement Act of 1937 requires the Secretary of Agriculture
13 to balance several factors in establishing milk prices.
14 This balance requires consideration when the national parity
15 price for milk does not adequately reflect the price of
16 feeds, the available supplies of feeds and other economic
17 conditions which affect market milk and demand for milk in
18 the marketing area to which Marketing Agreement Orders
19 relate.

20 In such a circumstance, the law dictates that he,
21 the Secretary, shall fix such prices as will reflect such
22 factors, insure sufficient quantity of pure, wholesome milk
23 and to be in the public interest. Thus, to insure a
24 sufficient quantity of wholesome, safe milk at a reasonable
25 price the Secretary must balance the producer interest and

1 the public interest.

2 The current system lacks the mechanism to balance
3 supply and demand and has resulted in extreme price
4 volatility that is detrimental to both producers and
5 consumers. Part of the problem can be attributed to a
6 processor manufacturing allowance that is too high. As long
7 as producers and taxpayers are paying for the market risk
8 through the manufacturing make allowance and Commodity
9 Credit Corporation purchases, there will be distorted
10 signals transmitted to the farmer.

11 Current dairy policies have brought extreme
12 volatility to the dairy industry primarily because farmers
13 do not receive accurate market signals from the processing
14 plants. This means that prices paid to producers, in
15 addition to being extremely volatile, often fall below the
16 cost of production.

17 The Class III milk price received by dairy
18 producers has decreased from \$16.26 per hundredweight in
19 September of 1999 to \$9.54 per hundredweight, which is the
20 Class III price for April of 2000. This is an over 40
21 percent drop in the price that dairy producers receive.

22 Simultaneously, the consumer price index for
23 cheese and related products for April, 2000, calculated by
24 U.S. Department of Commerce was 162.3, which is a decline of
25 1.4 percent for the same period of time. In other words,

1 prices to producers are dropping, but prices to consumers
2 don't follow.

3 Today's milk price is far below farmers' milk
4 production costs. The best evidence of the negative effect
5 of the volatility of America's dairy industry is the loss of
6 dairy farms over the years. Over the past eight years,
7 43,866 dairy operations went out of business. That is, from
8 1992 to 1999 one-third of America's dairy operations went
9 out of business. This is a crisis that is threatening our
10 rural communities and pushing the production of milk and
11 milk products further and further away from where they are
12 consumed.

13 The current milk prices and the adoption of a
14 California style manufacturing allowance system in the rest
15 of the United States will insure the demise of greater and
16 greater numbers of dairies. An increasing amount, currently
17 over half, of America's milk production is being utilized
18 for production of dairy products rather than fluid milk.
19 Therefore, from the perspective of balancing the public
20 interest and the producer price there is little
21 justification for treating fluid milk, whose consumption has
22 decreased, differently than milk used in other dairy
23 products.

24 In the past, the USDA Federal Milk Marketing Order
25 program has viewed milk for manufacturing of cheese, butter

1 and nonfat dry powder as reserve milk. This milk has much
2 value today to consumers as milk utilized in the fluid
3 market. Public interest no longer only involves a milk
4 supply for fluid consumption. Increase in America's
5 consumers' consumption of dairy products show this to be
6 true. America's consumers are relying on manufactured dairy
7 products, as well as fluid milk, to be readily available in
8 stores at reasonable prices.

9 The majority of dairy production in Class III and
10 Class IV products includes cheese, butter, nonfat milk used
11 in other products such as cheese, yogurt and ice cream.
12 With the shift of production to these cheese, dairy farm
13 income is affected to greater and greater degrees by what
14 happens to the Class III price. That is why this milk
15 hearing is so important and so crucial to America's dairy
16 producers.

17 In addition to the problems associated with the
18 pricing formula itself, I would like to address the problem
19 of make allowance. The main factors involved in
20 establishing USDA's current producer milk price formulas are
21 the dairy product price, the product yield and the plant
22 make allowance. The problem with the USDA milk pricing is
23 that the make allowance is a fixed number, while the price
24 received by the producer is a highly volatile and until now
25 has not included the dairymen's cost of production.

1 A milk pricing system that is balanced requires
2 that the dairy product prices, producers' cost of production
3 and plants' cost of production, the make allowance, all be
4 given consideration when determining the value of milk.
5 Each of these items sends signals to one another in a free
6 market environment so that the proper price and production
7 adjustments will occur.

8 However, in California's milk pricing system there
9 is insufficient marketplace balance between these factors
10 because the make allowance guarantees that the cost of
11 processing segment of the industry are covered. In fact,
12 the make allowance includes cost plus a profit for an
13 efficient plant. Over supply can actually be a benefit to
14 proprietary processors because it lowers the raw product
15 costs. This is less true for cooperatives, whose members
16 are dairy farmers and affected by lower milk prices.

17 The California end product pricing system is an
18 example of this point. We must not make the same mistake in
19 the rest of the United States. California has allowed
20 plants to be profitable and expand processing of the lowest
21 value dairy products regardless of true market demand
22 because producers covered the plant costs. This has
23 resulted in lower producer milk prices. Processors with a
24 generous make allowance level use this margin to discount
25 the product price to gain market share at the expense of

1 producer pay prices and at the expense of other
2 manufacturers in the rest of the United States.

3 Unfortunately, the plants are merely operating by
4 the rules of the system. We have created a race to the
5 bottom where all producers will lose. I am asking that we
6 find a true market oriented system rather than continuing
7 the mistakes of the past.

8 Looking at California's milk production history
9 may allow USDA to see forward into the future in terms of
10 how the California system has affected milk production and
11 farmer income. Last year, -- excuse me. In 1975,
12 California production was 10.06 billion pounds with a 57
13 Class I utilization. Last year, in 1999, California
14 produced over 30 billion pounds of milk with a Class I of 20
15 percent utilization. Annual utilization in milk production
16 for this time period are attached as the final page of my
17 statement. That's a 300 percent milk production increase in
18 24 years.

19 California now produces 100 percent more than what
20 is consumed in the state, even with ten percent of America's
21 population residing there. California dairy producers have
22 been in a constant growth mode. When prices are good, we
23 add cows. When prices go down, our bankers tell us to add
24 cows in order to cash flow. Even though historically
25 California has had some of the lowest mailbox prices in the

1 nation, California's milk pricing system has been the
2 largest contributor in creating a dairy industry that is
3 constantly dependent on CCC as a customer of last resort.

4 There is no economic signal that communicates to
5 the processors to regulate the amount or kind of product the
6 market demands. California's Class IV-A and Class IV-B milk
7 pricing formulas, which are similar to USDA's new Class III
8 and Class IV pricing formulas, have isolated one segment of
9 the industry from participation in a true market. This will
10 continue to devastate dairy farm income and will continue to
11 burden the government programs. Consumers will also suffer
12 through a lack of options at the retail level as the
13 processing side of the industry continues to consolidate.

14 The quality of the communities has changed as well
15 as many family dairies have been displaced by a few larger
16 dairies with many employees. The concentration of cattle
17 into these feedlot style dairies also burdens the
18 environment to a much greater degree in the smaller, more
19 balanced areas.

20 This has been a lucrative time for the processors
21 in the State of California, The fixed make allowance
22 mechanism has led to the development of the mega dairies
23 that make my 800 cow operation look puny. The mega dairies
24 are welcomed by the processors that benefit from the
25 abundant and zero risk as they expand production, zero risk

1 since producers are covering the plant manufacturing costs.
2 At the same time as producers are financing their expansion,
3 high supplies of milk drive our prices down. Excuse me.
4 High supply levels drive our prices down.

5 There are consequences to farmers in the rest of
6 the country as well. An abundance of low priced milk in
7 California has attracted many factories to the state to the
8 detriment to farmers in the Federal Order who are now being
9 forced to bring their prices down to meet artificially low
10 prices. As long as the manufacturing allowance is fixed at
11 the processors' cost plus a return on investment and is paid
12 for by farmers, the processing segment of the industry will
13 be unconcerned with market signals.

14 Up to the turn of the millennium, the Federal
15 Order system did not provide an incentive to stimulate
16 production not demanded by the market. The main difference
17 between the old federal system and the reformed system is
18 that the marketplace accountability is not present in the
19 new system. We need a system that works with the
20 marketplace at all levels, producer, processor, wholesaler,
21 retailer and consumer, to provide an equitable, stable,
22 viable economic environment for all segments of the
23 industry.

24 The National Farmers Union strongly urges the
25 Secretary to take two actions. First, to reduce the make

1 allowance and, second, link it to the producers' income
2 through a variable make allowance.

3 Reducing the make allowance. The National Farmers
4 Union urges revising the make allowance based on the
5 weighted average for the California Department of Food and
6 Agriculture and the Rural Business Cooperative Survey. The
7 proposed new make allowance for cheese would be .1521 versus
8 the current .1702. The proposed make allowance for butter
9 would be .0945 versus the current .114. The proposed make
10 allowance for nonfat, .1385 versus the current .137. The
11 whey proposed make allowance, .137, would be the same as the
12 current level.

13 Implementing a variable make allowance. Our
14 members support the concept of a variable make allowance
15 based on the producer's milk price. It is unfair and market
16 distorting to force the producer to always cover the costs
17 of processing, including a profit, when the producer has no
18 similar recourse. Certainly the producer is not guaranteed
19 that production costs will be covered. Market signals need
20 to be given to both the processing and the producing
21 segments of the industry.

22 The formula to adjust the base make allowance.
23 The Class III milk price would be divided by the average
24 national cost of production. That would equal the make
25 allowance adjustor. The make allowance multiplied by the

1 adjustor then would become the new variable make allowance
2 for Class III.

3 In the Class IV it would be the same process. The
4 price, the milk price, divided by -- that would be that
5 Class IV milk price divided by the average national cost of
6 production would equal the make allowance adjustor and then
7 the make allowance multiplied by the adjustor. Use of a
8 formula based on this concept would make both producers and
9 processors market oriented with both sectors benefitting in
10 times of high prices and receiving a signal to decrease
11 production in times of low prices.

12 Thank you for your time. On behalf of National
13 Farmers Union, I urge you to look to California for the
14 future of dairy farming in the rest of the country should
15 you adopt a California style system. We must act now to
16 halt this race to the bottom of the pay scale for dairy
17 farmers across the country.

18 JUDGE HUNT: Any questions of Mr. Contente?

19 MR. ROSENBAUM: Steve Rosenbaum.

20 CROSS-EXAMINATION

21 BY MR. ROSENBAUM:

22 Q Mr. Contente, the use of product price formulas in
23 California goes back to 1955? Is that right?

24 A Yes.

25 Q And that's for butter and nonfat dry milk,

1 correct?

2 A They had one for butter. I don't know if they had
3 it for nonfat dry back at that point.

4 Q Okay. And it's been used, the product price
5 formula system has been used, for cheese in California since
6 1989, correct?

7 A Correct.

8 Q And under that system, by your own testimony, milk
9 production in California has increased 300 percent in the
10 last 24 years, correct?

11 A Correct.

12 Q An increase that vastly outstrips increase in milk
13 production in the rest of the country, correct?

14 A Astronomical.

15 Q So whatever price signals the California system
16 has sent, it has sent a price signal that has induced milk
17 production in California well in excess of the rest of the
18 country, correct?

19 A True.

20 Q And I assume you'll agree that for a farmer the
21 more money, the more milk he's going to produce?

22 A When the price is high, producers have the
23 tendency to put on more production, such as the same thing
24 would happen with a processor.

25 Q I agree completely. Over the last 24 years, by

1 your testimony, the price signal from a make allowance
2 system and a product price formula system has induced a 300
3 percent increase in milk production, correct?

4 A Yes. Yes.

5 Q And you're aware that the make allowance in the
6 federal system today is actually less than the make
7 allowance that was in effect in California at the time that
8 that data was developed?

9 A Well, actually the make allowance today in cheese
10 is probably as high as it ever was in California because you
11 have the whey make allowance, which we never had.

12 Q Well, let me rephrase it a little bit. Are you
13 aware that when the final rule was adopted last year the
14 make allowance that was put in place was a downward
15 adjustment to the California make allowance because it was a
16 merging of the California and the rural business cooperative
17 survey make allowance, which was lower?

18 A Lower than?

19 Q The California make allowance.

20 A Our make allowance for cheese in California is
21 16.9. Yours here is 17.02.

22 Q Sixteen point nine today based on the most current
23 data, correct?

24 A Yes. Yes.

25 Q That's very recent data, correct?

1 A Yes, but it was very similar to that last year.

2 Q Okay.

3 A I've got some stuff I could show you later.

4 Q Okay. Well, all right. So the current make
5 allowance in California and the current make allowance under
6 the federal system are quite similar, correct?

7 A Yes. Yes.

8 Q And I take it dairy production continues to
9 increase in California under that make allowance, correct?

10 A It's wide open.

11 Q Okay. And although an 800 dairy herd may not be
12 huge in California, by the --

13 A It's average.

14 Q By the standards of the rest of the country it's
15 pretty sizeable, correct?

16 A Yes.

17 Q Okay. And you found the economic incentives
18 presented to be such that you've expanded from what your
19 father and uncle started with with ten cows to something 80
20 times as big?

21 A Yes. You're forced to enlarge or get out of
22 business.

23 Q Okay. Now, I do want to clarify. You do
24 understand that as to the make allowance under the federal
25 and the California system, for that matter, it's a weighted

1 average make allowance?

2 Let me rephrase that. That was poorly phrased.

3 Are you aware that the make allowance is based upon the
4 weighted average cost of production?

5 A Sure.

6 Q And that by definition means that 50 percent of
7 the cheese is being produced at a higher cost than the make
8 allowance reflects?

9 A I'm not sure of the actual percentage, but there
10 is some cheese produced about that level, yes.

11 Q Well, I think the idea of a weighted average --

12 A I understand what that means.

13 Q -- is that half is above, half is below.

14 A Sure.

15 Q So that's why I say by definition --

16 A Okay.

17 Q -- 50 percent. I don't mean 50 percent of plants
18 necessarily, but 50 percent of production is going to be at
19 a cost of production that's higher than the make allowance.
20 Do you follow me?

21 A Yes.

22 Q So that you would agree with me that as to half
23 the production those people are going to be under pressures
24 to either reduce their costs or exit the business if they
25 just can't cut it?

1 A Unless they're making a higher value product that
2 reflects higher returns.

3 Q As to the products that are the basis for the make
4 allowance, though, that's correct, right? Cheddar cheese?

5 A Cheddar cheese, yes.

6 Q Okay.

7 A Which, by the way, in California in the past we've
8 had the majority of our cheese was mozzarella.

9 Q Okay. In the federal system cheddar is still 35
10 percent of total national cheese production, right?

11 A In the federal system?

12 Q In the United States as a whole.

13 A I'm not sure of the federal system. I've got a
14 document here on California, and it shows that mozzarella is
15 the largest.

16 Q Okay. Well, actually that may be helpful for me.
17 The information put out by the Department of Agriculture is
18 national data. I'm not aware that AMS tracks the kinds of
19 cheese, so actually that may help us derive a number.

20 Let's assume that 35 percent of national cheese
21 production is cheddar, which is the most recent data from
22 the Department of Agriculture.

23 A Uh-huh.

24 Q You're saying about what, 20 percent roughly of
25 that is California production, I think. A little less.

1 Seventeen to 20 percent.

2 What's the data for California? Relative
3 production of --

4 A These are cheese production by varieties.

5 Q Okay. Is there a total number?

6 A Well, it goes up to 1996.

7 Q Right, but I'm just saying is there a total for
8 all cheeses?

9 A You're asking California's production --

10 Q Yes.

11 A -- on cheese? It's about 1.2 billion pounds
12 today.

13 Q Okay. And what's the breakdown of that by type?

14 A Okay. Well, this here doesn't have quite the 1.2
15 billion pounds because this is 1996, but --

16 Q Okay. Then give us the 1996 figure, if you would.

17 A Okay. The cheddar category is probably 230
18 million pounds. The mozzarella category -- I'll have to
19 measure this. It's over 300 from the looks of it. Over 300
20 million pounds here versus a little over 200 million pounds.

21 Q And what is the total cheese production in that
22 year?

23 A In this particular year here?

24 Q 1996 that you're referencing.

25 A Yes. It shows a little over a billion pounds.

1 Q Okay. So I think I'm right that if 35 percent of
2 national cheese production is cheddar and that that's more
3 than mozzarella, but in California it's actually the
4 opposite, you have more mozzarella than cheddar, that means
5 in the rest of the country the percentage of cheese
6 production that's cheddar is actually higher than 35
7 percent, right?

8 A I suppose.

9 Q Okay. On your notion of introducing an adjustor
10 to the make allowance, which you set forth on the last page
11 of your testimony, your adjustor is based upon the cost that
12 a farmer incurs in producing milk, correct?

13 A Correct.

14 Q There's no adjustor for demand of Class III
15 products?

16 A The demand would be the market price.

17 Q Yes, but your adjustor doesn't attempt to
18 incorporate that in some fashion?

19 A Sure it does. You take the Class III price, --

20 Q For milk.

21 A -- and you divide it by the cost of production.
22 That gives you the adjustor fact.

23 Q Right.

24 A So that price is telling you what the market
25 demands.

1 Q Well, let me put it a little differently. Let's
2 assume we're set the Class III price at whatever it's set at
3 today, and then you put your adjustor into effect to change
4 that, the make allowance, correct?

5 A Correct.

6 Q The change in the make allowance is driven by
7 changes in cost of production?

8 A And market price. You don't see the relationship
9 there?

10 Q Market price in the sense of what, the price of
11 Class III milk?

12 A Right. The price of that class, which -- the
13 price of the product. The price of cheese, which in the
14 Federal Order they use the NASS. In California we use the
15 CME. That is part of your formula. You have to put that in
16 there. You divide it by the cost of production. Then that
17 gives you the adjustor.

18 Q Well, the price of cheese has already dictated
19 what the price of Class III milk is going to be, correct,
20 under the current formula?

21 A Under the current formula. You're right.

22 Q Yes, and so changes over time are being driven by
23 changes in cost of production under your adjustor formula?

24 A It takes the costs of production for milk, and it
25 takes the price of the product, whether it's cheese, butter

1 or powder.

2 Q That's already been worked into the formula
3 because that's the formula used to set the Class III price,
4 isn't it?

5 A In which formula are you discussing?

6 Q The current formula.

7 A Okay. You're right.

8 MR. ROSENBAUM: That's all I have.

9 JUDGE HUNT: Other questions? Yes, Ms. Danielson?

10 MS. DANIELSON: Nancy Danielson with the National
11 Farmers Union.

12 BY MS. DANIELSON:

13 Q Joaquin, in questions you talked about the fact
14 that California milk production has increased under the high
15 make allowance that California has. Is there a problem with
16 that from a producer standpoint?

17 A Definitely because the more production we have, if
18 the market is not dictating that production to come on by
19 higher milk prices or higher product prices, then it
20 constantly keeps our producer prices down because we're
21 based off of those product prices. We're in the end product
22 pricing system, so it's based off of the products.

23 In California, we base it right off the CME. Here
24 you're basing off the NASS reporting. Still, our prices are
25 dictated by the market. Producer prices are dictated by the

1 market.

2 Q As a dairy producer, would it benefit you to have
3 a higher or lower make allowance than the current California
4 level?

5 A A lower level would bring more accountability to
6 the industry. We as producers are accountable because we
7 are at a market, a free market condition. We have no
8 guaranteed costs of production where in the processing
9 segment of the industry they're isolated from this free
10 market condition through this make allowance that guarantees
11 them a lower price for that milk.

12 Q And how does the make allowance work to discount
13 the product price?

14 A It starts off with the product price, and then the
15 amount is the make allowance number for, you know, the NASS.
16 Well, not NASS, but in California we have the CDFA that does
17 the plant -- audits the plants for their manufacturing
18 costs, and then that particular number is used to be
19 subtracted from the value of that milk used to make that
20 particular product.

21 Q And did you state in your testimony that in times
22 when the make allowance is too high that it actually results
23 in a discounted cheese price?

24 A Of course. If a plant is efficient and it's able
25 to utilize that difference between its actual costs and what

1 it has to pay for milk, then that margin in there is used to
2 move product because we flooded our complete market in
3 California. We have to look to other alternatives for
4 markets.

5 Since we do have that margin, we're able to move
6 into the midwest and knock on those people's doors and say
7 hey, we've got a deal for you today.

8 MS. DANIELSON: No further questions. Thank you.

9 JUDGE HUNT: Mr. English?

10 MR. ENGLISH: Charles English.

11 BY MR. ENGLISH:

12 Q Mr. Contente, do you participate in hearings
13 called by CDFA?

14 A I've attended them.

15 Q Did you attend a hearing shortly after Labor Day
16 in 1997 held by CDFA with respect to make allowance issues
17 in California?

18 A I was there, but not as a participant.

19 Q Do you recall that the issues at that hearing had
20 to do with whether or not to decrease the make allowances on
21 IV-A and IV-B in California in order to account for this
22 very difference that you're referring to that existed prior
23 to the final rule going into effect between the California
24 and the Federal Order system?

25 A I don't recall exactly the --

1 Q Do you recall there were proposals heard at that
2 hearing with respect to altering, that is to say decreasing,
3 the make allowance --

4 A Oh, yes. Yes, there was. Yes.

5 Q -- for IV-A and IV-B?

6 A Yes.

7 Q Do you recall farmer organizations, cooperatives,
8 for California testifying at that hearing in opposition to
9 proposals that would lower make allowances for IV-A and
10 IV-B?

11 A I really can't say exactly who was in opposition
12 without checking some more information, but there was some
13 opposition, yes.

14 Q Okay. Would you disagree with me that some of
15 that opposition came from cooperatives in California?

16 A No, I won't disagree with you.

17 Q And the result of that hearing was essentially
18 with some modest changes basically status quo, correct?

19 A Basically, yes.

20 MR. ENGLISH: Thank you, sir?

21 JUDGE HUNT: Any other questions? Yes, Mr. Vetne?

22 MR. VETNE: Actually, I don't have a question, but
23 I do have a request, Your Honor, for official notice. This
24 is, I think, an ideal time to do it particularly following
25 Mr. English's questions.

1 California Department of Food and Agriculture
2 issued and published, released and has on the internet the
3 results of their decision on the hearing. It's called
4 Findings and Determination of the Secretary of Food and
5 Agriculture on Hearing Held September 21, 1997, and it is
6 available on the California Dairy Programs' internet site,
7 which is www.cdffa.ca.gov/dairy, and also available by simply
8 calling the Department of Agriculture.

9 I'd like to ask for official notice of that rule
10 making decision of the Secretary of Food and Agriculture of
11 California on the make allowance hearing that was described
12 and which I've identified.

13 I have several other California official notice,
14 so let me go through them unless you'd rather take them one
15 at a time.

16 JUDGE HUNT: Go ahead.

17 MR. VETNE: On a monthly basis, the Department of
18 Food and Agriculture of California issues a document called
19 California Dairy Information Bulletin. The most recent one
20 I've received I'm holding in my hand. This is actually a
21 joint publication with the joint participation of the
22 California Department of Food and Agriculture and USDA NASS.

23 That publication, the one I'm holding here, is
24 data for February issued April, 2000, and all of these
25 monthly publications actually include two years of data, so

1 there's a lot in just one month's issue, so I would ask for
2 official notice of the Dairy Information Bulletin issued
3 April, 2000, containing data for February, 2000, which may
4 or may not be available on the internet, but it is available
5 free of charge by calling Candice Gates, whose telephone
6 number I thought was in here, but she's at the Department of
7 Food and Agriculture.

8 THE WITNESS: It should be in there.

9 MR. VETNE: I was looking. Her address, in any
10 event, is 1220 N Street, Room A-224, Sacramento, California
11 95814-5621.

12 Thirdly, on an annual basis California publishes
13 California Dairy Statistics, which includes some of the
14 information in the Dairy Bulletin, but additional
15 information particularly including the production of cheese
16 by variety and that kind of thing, so I'll ask for official
17 notice of the most recent of the California market
18 statistics. I don't know if 1999 has been released yet, but
19 certainly 1998 has.

20 THE WITNESS: I think 1999 has. I think it is.

21 MR. VETNE: Okay. So the request for official
22 notice is for the most recent version, which we believe is
23 1999.

24 Three more official notice items from the
25 government publications of California. California has its

1 milk regulatory system in two sets of regulations rather
2 than one, but they function the same as a single federal
3 order. One is the handler end, and one is the producer end.

4 The handler prices are fixed under what's called a
5 stabilization plan for market milk. There are two
6 stabilization plans, one for southern California and one for
7 northern California. They're virtually identical, but I'd
8 like official notice of each. Those regulations are
9 available on the CDFA website that I've indicated, as well
10 as the pooling plan for market of milk, which is a separate
11 set of regulations and also available on the website.

12 That concludes my request for official notice of
13 California government publications.

14 JUDGE HUNT: Does anybody object to taking
15 official notice of the documents that Mr. Vetne referred to?

16 Hearing no objections, official notice is taken of
17 those documents, Mr. Vetne.

18 MR. VETNE: Thank you very much.

19 JUDGE HUNT: Any other questions of Mr. Contente
20 before he leaves? Yes, Mr. Cooper?

21 MR. COOPER: Before any further questions, has his
22 testimony been marked, or is that last --

23 JUDGE HUNT: It has not been marked.

24 MR. COOPER: -- page, the table, been marked?

25 JUDGE HUNT: Do you want it marked?

1 THE WITNESS: Yes.

2 MR. COOPER: I just want to know what he wants to
3 do. He's got a table on the last page.

4 JUDGE HUNT: Would you like to have that as part
5 of the transcript?

6 THE WITNESS: Yes. Yes.

7 JUDGE HUNT: All right. Mark that as proposed
8 Exhibit 21.

9 MR. COOPER: Is it going to be the whole document
10 or just the last page? I don't care.

11 JUDGE HUNT: I don't know. Do you want the whole
12 thing?

13 THE WITNESS: Yes.

14 JUDGE HUNT: The whole document then, including
15 the table at the end, will be marked as 21.

16 (The document referred to was
17 marked for identification as
18 Exhibit No. 21.)

19 JUDGE HUNT: Does anyone object to that being made
20 part of the record in the proceeding?

21 MR. BERDE: Are there additional copies available?

22 THE WITNESS: Yes. I've got some.

23 JUDGE HUNT: Hearing no objection, Exhibit 21 will
24 be received into evidence.

25 //

1 (The document referred to,
2 previously identified as
3 Exhibit No. 21, was received
4 in evidence.)

5 JUDGE HUNT: Thank you very much, Mr. Contente.

6 THE WITNESS: Thank you.

7 JUDGE HUNT: I hope you catch your plane.

8 MR. YALE: Your Honor? Your Honor, I had a
9 question.

10 JUDGE HUNT: I'm sorry. Go ahead.

11 MR. YALE: I was letting Mr. Cooper take care of
12 his technical question.

13 JUDGE HUNT: All right. Go ahead. He's only got
14 a couple minutes.

15 MR. YALE: I understand. I'll try to keep it to
16 one question, but sometimes --

17 JUDGE HUNT: Okay.

18 MR. YALE: -- we as lawyers lie when we say that.

19 JUDGE HUNT: Yes.

20 BY MR. YALE:

21 Q Mr. Contente, you were here yesterday.

22 A Yes.

23 Q Did you hear Mr. Yonkers' testimony?

24 A Yes.

25 Q And he testified that if the make allowance was

1 too low that processors would not be able to get that extra
2 price out of the marketplace to make up the loss of the make
3 allowance. Do you remember that?

4 A Yes.

5 Q All right. You also indicated if the make
6 allowance was too high that they would just pay it back. It
7 would end up going back to the producers. Do you recall
8 that?

9 A Yes, sir.

10 Q All right. Now, as I understand your testimony,
11 you're saying that if the make allowance is too high for
12 that processor that they will use that difference to compete
13 in the marketplace by selling the product at a cheaper
14 price.

15 A Definitely. Definitely because there's enough
16 room in there to cover all their costs plus return on
17 investment and be able to discount the product cheaper in
18 order to gain market share.

19 MR. YALE: That's all I had.

20 JUDGE HUNT: Mr. Cooper, did you have something?

21 MR. COOPER: No. I was just counting. Four
22 questions.

23 JUDGE HUNT: All right. Thank you, Mr. Contente.
24 Thank you.

25 (Witness excused.)

1 JUDGE HUNT: I did that one time at a hearing
2 where the attorney said one more question, and I kept track.
3 He had 30 more. I would probably do the same thing.

4 In any event, I will receive Exhibit 21 into
5 evidence.

6 All right. We will resume now with Dr. Barbano.

7 Whereupon,

8 DAVID BARBANO

9 having been previously duly sworn, was recalled as
10 a witness herein and was examined and testified further as
11 follows:

12 MR. VETNE: For the record I'm John Vetne resuming
13 cross-examination of Dr. Barbano.

14 I have, Your Honor, now copied Exhibit 20 and made
15 copies available for the record and extra copies in the back
16 of the room and passed them out so folks have copies.

17 CROSS-EXAMINATION RESUMED

18 BY MR. VETNE:

19 Q Going back to Exhibit 20 for one minute, someone
20 pointed out that I had neglected to bring your attention to
21 the line I attended between the separator and sweet whey,
22 and the line I added was solids drying losses. There are in
23 fact some losses of solids from the time the whey leaves the
24 vat and it ends up in bags as dry whey, correct?

25 A Yes.

1 Q And there are also fat losses from the time whey
2 leaves the vat, goes into the separator and ends up as whey
3 cream, correct?

4 A Yes.

5 Q Are there any items for which a loss of milk or
6 loss of components have been identified here that you
7 disagree with as to whether losses occur?

8 A There's none that I disagree with.

9 MR. VETNE: Your Honor, I'd like to ask Exhibit 20
10 be received.

11 JUDGE HUNT: Any objections? Hearing no
12 objections, Exhibit 20 will be received in evidence.

13 (The document referred to,
14 previously identified as
15 Exhibit No. 20, was received
16 in evidence.)

17 BY MR. VETNE:

18 Q Keep it in front of you.

19 A Okay.

20 Q We had a little bit of dialogue on what do you do
21 with the costs associated with cream or condensed that's
22 received from a different facility. We agreed in the first
23 instance that all of this much be accounted for to the
24 producer at the Class III price in our example, correct, and
25 we agreed that there were some costs, because of losses,

1 that must be recovered by someone someplace in the market
2 stream?

3 A Yes.

4 Q Okay. And your suggestion, as I recall, was that
5 the creamery operator being charged a Class III price for
6 that would pass on whatever product or component losses were
7 to the cheese buyer. Did I understand correctly?

8 A To any buyer.

9 Q To any buyer.

10 A Any buyer.

11 Q Okay. Your policy objective, and policy is my
12 word, but I think objective is your concept, in calculating
13 a make allowance as you describe it on page 14 of your
14 testimony is that a processor who procures producer milk
15 without including in the mix added condensed or added fat,
16 but just from the producer milk supply after allowing for
17 make whatever the amount and identity of the make factors
18 are, end up with a net revenue of zero. Do I read that
19 correctly? I mean, that's what I read. Is that --

20 A At the point where you calculate the value of
21 protein per pound, fat per pound, other solids per pound.
22 It will not be zero once you go to other milk composition.

23 Q Right. We're looking at I guess standardized or
24 ideal milk and standardized or ideal cheddar, --

25 A Right.

1 Q -- and if the net revenue is not going to be zero,
2 it's going to be milk that is used in some other composition
3 or milk that's received that has a different composition,
4 what in your scenario would change the net revenue from zero
5 to something other than zero?

6 A For a cheese maker, if the composition of the milk
7 in terms of its fat and protein content is higher than the
8 base point calculation in terms of concentration of fat and
9 true protein and if the ratio of fat to true protein is
10 higher than the ratio assumed in the base calculation, then
11 there will be a positive net revenue to the cheese maker.

12 Q And the converse is true?

13 A The converse is true --

14 Q Okay.

15 A -- in my scenario.

16 Q And for a manufacturer that engages in the process
17 of receiving intermediate step milk illustrated a bit in
18 Exhibit 20, if the incoming producer milk starts at the
19 ideal ratio, whatever is assumed, after that charge from the
20 condensory at the accountant's office in the cheese plant if
21 you start out at net zero revenue and are paying for that
22 then it's a negative net revenue?

23 It's not a California formula, so if you start at
24 zero and have a cost it's something less than zero, or am I
25 missing this?

1 A That net zero is at the point where you establish
2 protein, fat and other solids value in terms of price per
3 pound or then use in calculation of the price of milks of
4 other compositions.

5 In terms of the product coming from the creamery
6 to the cheese plant, the cheese plant is now choosing to buy
7 other ingredients besides producer raw milk --

8 Q Yes.

9 A -- and would make that decision based on the cost
10 of those ingredients, which may include other than the raw
11 milk cost because there's some processing costs to do the
12 separation, the condensing and so on, and there's some
13 losses that are incurred there.

14 Q Right.

15 A So you would consider that as an alternative
16 against the alternative of bringing in more milk solids from
17 the farm unmodified.

18 Q Yes. I understand that the manufacturer would
19 consider it as a business decision, --

20 A Yes.

21 Q -- but a business decision if exercised has no
22 adjustment in your formula to account for the difference
23 between the amount paid by the manufacturer and the amount
24 received by the producer.

25 A The amount paid by the manufacturer for what?

1 Q For condensed -- for solids and condensed milk and
2 for fat and cream.

3 A But that's not a factor that's being considered in
4 the establishment of the Class III price. That's an
5 alternative way of handling the milk that's at the choice of
6 the processor, and it's a business management decision.
7 Does it make sense?

8 Q Are we not including handler costs to get milk
9 from the farm into the cheese package as part of the make,
10 and if this is a cost it is a cost that's not factored into
11 your formula, correct?

12 A Right, and it's not factored into the current
13 situation either in terms of the current system.

14 Q I understand that is the case, but if the current
15 situation is, if I can paraphrase, less sensitive to
16 differences in value of protein in milk and your scenario
17 would make it more sensitive, it becomes more important to
18 account for someplace, either in costs, make allowance or
19 price, for now what is a more sensitive economic factor in
20 losses between the farm through the condensatory to the
21 cheese plant. Did I lose you, because I almost lost myself.

22 A Yes. I lost you there.

23 Q Okay. Let me just think about that because that
24 may simply be argument that I can do better on paper.

25 The make allowances that you suggest ought to be

1 in the system are allowances -- see if you agree with me.

2 Are allowances which are reasonably achievable, A, and, B,
3 if plants aren't achieving that they should.

4 A I think that's the assumption. There's some
5 average value that should be reasonably achievable.

6 Q Okay. Your testimony doesn't address as a policy
7 question whether, or maybe it does; whether the price or the
8 make allowance in the federal system should seek to alter
9 handler market behavior rather than reflect it. I guess you
10 are addressing that because it sounds like you want to alter
11 it.

12 A The only -- I've used the make allowance the way
13 it's given or used currently. I haven't done anything to
14 change the make allowance, but I'm saying that when you
15 credit the make allowance, and that was in one of the
16 scenarios particularly on that moisture adjustment side,
17 that the make allowance as used currently is per pound of
18 cheese.

19 If I'm going to take a make allowance and credit
20 properly the cheese maker for the amount of cheese made,
21 then the amount of cheese made is the amount of cheese at
22 the moisture test that it was recorded, not at 38 or 39.

23 Q Would you agree with me that it is likely that at
24 least some plants in the system, in order to achieve an
25 efficiency and a recovery of fat and casein that you think

1 ought to be in the formula, some plants at least would have
2 to make investment into equipment?

3 A In terms of making what's in the formula, which on
4 fat recovery would be 90 percent -- that's what we're
5 talking about in terms of achieving 90 percent fat
6 recovery -- that in the study that I did in 1978 there was
7 one of the factories, as I recall, that was achieving
8 between 89 and 90 percent at that time with the status of
9 the best equipment available of large size capacity at that
10 time, so I think that there's a lot of equipment that's been
11 produced within the last 15 years that can achieve -- can be
12 operated to achieve 90 percent fat recovery.

13 Q That wasn't quite my question. My question was
14 whether, and maybe you don't know, but whether you would
15 expect some plants to achieve the efficiency assumed in the
16 formula that you propose, some plants would have to make
17 investment into equipment because they do not know achieve
18 that efficiency.

19 A If they do not achieve that efficiency now, the
20 first question I ask is is it a problem with the equipment
21 or a problem with the way they're operating the equipment.
22 I would have to eliminate first the issue of how they
23 operate the equipment. That can always be a problem.

24 Q Okay. Let's assume you've done that.

25 A Okay. I would say most of the time I'd find that

1 it was in their operation of the equipment unless there was
2 physical damage to the equipment because of its age and you
3 need to replace it.

4 Q Okay. It would be fair to say, wouldn't it, that
5 you don't know the extent to which there's old equipment out
6 there that needs to be replaced to achieve this optimal
7 efficiency?

8 A Yes. I don't have any exact numbers.

9 Q And it's also fair to say that you don't know and
10 haven't analyzed the extent to which if manufacturers change
11 their operation, either the way they exploit the labor and
12 equipment available or new equipment, you don't know the
13 extent to which that would cause additional depreciation to
14 be reflected in the aggregate make allowance of plants?

15 A No, I don't know that.

16 Q Finally, and I don't promise one question, but,
17 finally, are you familiar with the use of milk from the farm
18 from which water has been removed through a reverse osmosis
19 process, which is then shipped and used in cheese making?

20 A I'm familiar with that process and that it can be
21 done, and I've worked with that.

22 Q Okay. Would you agree with me that that process
23 has additional elements of loss of components between the
24 tank at the farm and receipt at the silo of the plant?

25 A I think in all of this loss when you're doing

1 processing such as reverse osmosis on the farm, and I think
2 even going back to what we talked about in terms of the farm
3 bulk tanks on Exhibit 20, that admittedly whether we're
4 doing your own processing or whether we're not that the loss
5 from the farm tank to the plant can be a big loss and that
6 one of the things that tends in terms of changing the
7 structure of our industry that's tended to reduce that is
8 that we have fewer small units. It's really a function of
9 the surface area of equipment to the volume of milk
10 contained.

11 In a farm where you're running an RO, it's very
12 unlikely that that's going to be a small farm. Generally
13 the losses in terms of shrinkage will be a higher percentage
14 of the milk the smaller the unit gets, the farm unit, so
15 that I would say on a farm using an RO if you took that farm
16 with and without the RO, yes, the RO is probably going to
17 induce some additional losses, but this is probably a farm
18 unit that's fairly large, so in the scheme of things of how
19 much is lost at that farm versus others, it's likely that
20 that has a lower than average percent of shrink because it's
21 a big farm unit.

22 Q I see. Okay. A handler then that has to account
23 to the Market Administrator at a cheese price in order to
24 minimize the components that he has to account for that are
25 lost --

1 A Right.

2 Q -- before it gets into a silo would have some
3 incentive to select as his suppliers larger plants, larger
4 farms, that come in a 50,000 gallon truck rather than
5 smaller farms that have a lot of pickup points and more I
6 guess surface because --

7 A That's right.

8 Q -- there's more trucks, smaller units. Is that
9 correct?

10 A That's right. That's correct.

11 Q Milk that's gone through ultra filtration, how is
12 that different from what I described as RO milk?

13 A The difference is that the part of the solids, the
14 other solids, are in the permeate, the stuff that -- the
15 material that goes through the filter and remains on the
16 farm, where in RO very little, if any, of the solids go
17 through in the permeate and are left on the farm, so the
18 difference would be if I'm shipping a truckload of RO
19 concentrated milk I have pretty much concentrated all of the
20 solids, the other solids, the fat, the protein.

21 In the UF, I have left at the farm part of the
22 lactose and part of the non-protein nitrogen, part of the
23 minerals, things that are in the other solids fraction in
24 the payment system.

25 Q Okay. Again, the buying handler -- I don't know.

1 What does a producer do with the lactose and water that is
2 kept at the farm?

3 A The best thing is to try to recover value out of
4 that by using it as a feed material for the cows. The
5 lactose is a carbohydrate, the milk sugar, and at some ratio
6 with proper balancing of a dairy cattle ration will allow
7 you to substitute that for other sources of carbohydrate.

8 Q And the handler would account to the Market
9 Administrator or the system on RO milk -- quite frankly, I'm
10 not sure -- on what was in the tank before it was filtered
11 or after? Do you know?

12 A I'm not sure exactly how they're handling it, but
13 I know that there are instances where they've having to deal
14 with it, and I think they'd be better at answering that than
15 me.

16 Q Okay. If I asked this before, I apologize. Do
17 you know the proportion of plants, not volume, cheese
18 plants, that do not handle whey at their own plant, but ship
19 it someplace else?

20 A In my experience -- now, when you say cheese
21 plants, are we talking of cheddar cheese plants?

22 Q All cheese --

23 A Every cheese?

24 Q We're pricing every cheese from this hearing to
25 the current Class III price, --

1 A Okay.

2 Q -- and the proposed one prices all cheese and
3 other solids as well.

4 A In my experience, most plants, because of economic
5 decisions, are usually -- it's to their advantage to process
6 the whey on site to a product where they've recovered a
7 concentrate of the other solids in various forms, whether it
8 be whey protein concentrate, lactose, and not haul whole
9 unconcentrated whey to another site. That's usually the
10 best case scenario for a plant.

11 Q Okay. The intermediate scenario --

12 A The intermediate --

13 Q -- like concentrating the whey before it's sold to
14 another plant for further processing?

15 A I think that would be a situation of is there
16 another plant close enough that has the capacity and would
17 you concentrate it enough to get the hauling costs
18 reasonable and then does the other plant have the capacity
19 to process those solids. It's just a question of an
20 individual circumstance then.

21 Q Do you know the proportion of plants that either
22 don't process whey or simply concentrate it and let somebody
23 else process it?

24 A No, I do not.

25 MR. VETNE: Thank you.

1 JUDGE HUNT: Other questions of Dr. Barbano?

2 Mr. Beshore? Oh, I'm sorry. Mr. Berde?

3 MR. BERDE: Before he leaves, I just want to ask
4 him a question.

5 JUDGE HUNT: We're not finished yet. There are a
6 couple others. Go right ahead, Mr. Berde.

7 MR. BERDE: Okay.

8 BY MR. BERDE:

9 Q Dr. Barbano, I'd like to read you some language
10 from the notice of hearing and then ask you a question about
11 it.

12 A Okay.

13 Q I'm directing your attention to Proposal No. 32,
14 which is proposed by the AMS, Agriculture Marketing Service,
15 and I'll quote from the proposal or from the notice of
16 hearing.

17 It says, "Proposals to change the Class IV
18 butterfat price that would not also result in changes to the
19 Class III butterfat price raise the issue of whether the
20 butterfat price for milk used in Class III should be based
21 directly on the value of butterfat in cheese instead of the
22 value of butterfat in butter."

23 Then I'll omit some language, and it continues.
24 "Data and testimony concerning yield factors specific to
25 butterfat in cheese would be appropriate additions to the

1 hearing record."

2 Would it be fair to say that your direct testimony
3 and the exhibits that you've offered and which have been
4 received in evidence are responsive to the concerns
5 indicated in Proposal No. 32?

6 A I think that what I've presented does respond to
7 that, yes.

8 MR. BERDE: Thank you.

9 JUDGE HUNT: Mr. Beshore?

10 BY MR. BESHORE:

11 Q Dr. Barbano, the assumptions for milk content that
12 go into the spreadsheet, which is page --

13 A Yes.

14 Q Pages 15 and 16.

15 A Yes.

16 Q I think if I understood one of Mr. Vetne's
17 questions correctly, he referred to those as ideal contents
18 of milk. Wouldn't it be more correct, if I understand your
19 testimony, that you attempted to input average producer milk
20 component values?

21 A Okay. On the skim portion values, that is
22 supposed to reflect an average skim portion. The fat value
23 at 3.5 is chosen because that's where people like to compare
24 prices at 3.5, so the last column I attempted to use an
25 average.

1 Column No. 5 to the right is where I used a 3.67
2 fat to reflect a fat value that might be more close to what
3 a plant would receive, but whatever. If you had data that
4 quantitatively said this is the average of milk received,
5 that would be an appropriate number to use.

6 Q Okay. And the average is being the ratios of true
7 protein to crude protein and things of that nature?

8 A Well, that's correct. The fat content, the true
9 protein content, the ratio of casein to true protein.

10 Q One other question. Is one of the ways that
11 cheese manufacturers seek to utilize most efficiently the
12 ingredients in terms of butterfat now that they receive in
13 their plants the addition of skim solids in the form of
14 nonfat dry milk to increase the yields of cheese and
15 incorporate more of what would otherwise -- what might
16 otherwise be whey cream into their end product?

17 A That's not quite technically correct.

18 Q Okay.

19 A What they do is use additional solids, but what
20 they will look at very carefully if they're going to be
21 doing that is usually using some sort of analytical system
22 that may be an on-line standardization controller that
23 measures or senses the fat content of the milk and the
24 protein content of the milk going to the vats.

25 They don't just want to add nonfat solids. At the

1 same time they want to control the ratio of fat to the true
2 protein or casein to control and maintain as high as they
3 can the fat on a dry basis or the composition of cheese that
4 will return them the most for the added investment they've
5 made in ingredients in terms of condensed or nonfat dry milk
6 and adding fat if they need to add fat to balance that ratio
7 to get the maximum amount of cheese from the ingredients in
8 the vat.

9 MR. BESHORE: Thank you.

10 JUDGE HUNT: Mr. Olson?

11 BY MR. OLSON:

12 Q I just wanted to get a little perspective here.
13 You indicated that the ratio as you calculated it of casein
14 to protein that's used currently in the pricing system is 75
15 percent, and that would convert to a casein to true protein
16 of 79.7635 percent --

17 A Yes. That's correct.

18 Q -- and that the actual ratio as you see it of
19 casein to true protein is probably more like 82.2 percent?

20 A Correct. That is some data from some factories in
21 New York state that I've done some long-term analysis on.
22 Yes.

23 Q Do you have any perspective relative to the
24 magnitude of variation from season to season or region to
25 region of the country of this ratio of casein to true

1 protein?

2 A I think the seasonal variation, because I have
3 that data in the numbers that are reported in the
4 publication referenced, and I think it actually shows the
5 seasonal variation, is probably, and I'd have to go back and
6 look specifically, but I would guess that it's probably
7 about one percent. In other words, from 82 to 83 centered
8 around some mean that there's probably that type of
9 variation seasonally.

10 When you talk about regional differences, I think
11 the thing that you have to look at is other than somatic
12 cell count, which there's something in the system to adjust
13 for that. Then the next thing I would consider if I had a
14 plant or a region being different is I'd look at the makeup
15 in terms of the breed of cattle and that there are -- given
16 low somatic cell count, there's probably some differences
17 from one breed to another.

18 I think again there's a lot of variation within
19 each breed, but there may be some average differences
20 between breeds.

21 Q Do you have a perspective if the difference
22 between regions would be similar to what you found as far as
23 the difference between seasons or have any basis for --

24 A I'd have to go back to the 1984 study that I did
25 with 50 cheese plants across the United States and look at

1 that data. There would be some indication of the data
2 there, and I don't recall it right at the moment.

3 MR. OLSON: Thank you.

4 JUDGE HUNT: Mr. Galarno?

5 BY MR. GALARNO:

6 Q Good morning, Dr. Barbano. My name is Clay
7 Galarno with Michigan Milk. I just have one point I'd like
8 to get some more clarification on in your conclusion, No. 3.
9 You said in your opinion, the cheese price used in
10 the Class III price should be the price per pound of cheese
11 at moisture test that more closely represents the actual
12 moisture at which cheese was produced and that the same
13 moisture assumption should be used in the cheese yield
14 formula.

15 Are you suggesting that each month we should
16 calculate this average and change our cheese yield formulas
17 based on that variable moisture percentage?

18 A I think that would be a bit of an overkill, and I
19 think that if there -- if the real average if we had
20 moisture content for the blocks in the survey and the actual
21 moisture test for the barrels in the survey, that if you
22 took an average over a year's worth of time my expectation
23 is that that would probably be fairly stable across from one
24 year to the next, and you would look at some value that
25 would be a reasonable average and choose that value, not

1 vary it each month.

2 Q Do you know anyone that has performed that study?

3 A The problem is there is no data on the block
4 moisture content. There is data on the barrel. That's
5 published in the survey, so that already exists, and
6 typically I think the numbers run in the 34 to 35 percent
7 moisture range on barrel cheese as it's made.

8 Q Thanks. Maybe along that same line, are you
9 recommending that any additional cheeses be included in this
10 study other than the current 40 pound block and the barrels?

11 A I've made no recommendation on that at all. I've
12 just taken it as it is with the current 40 pound block and
13 the barrels.

14 MR. GALARNO: Thanks. That's all I have.

15 JUDGE HUNT: Anyone else? I'll give you a second.
16 Mr. Yale?

17 MR. YALE: Did you have someone else?

18 JUDGE HUNT: No. Ms. Brenner is going to ask a
19 question, but you go ahead. She wants to wrap it up, I
20 hope.

21 BY MR. YALE:

22 Q I'm going to try to hit some topics on here
23 because everybody else kind of set the tone of what's said.

24 Let's talk a minute about cost. There's been a
25 lot of questions, you know, asking you about is this a cost

1 and should it be included and so on and so forth. As I
2 understand, your testimony is that you want to account for
3 all the value that comes out of the milk that goes into the
4 cheese, so in a sense being that the plant is going to
5 utilize fully its raw product. Is that correct?

6 A Yes.

7 Q And then what it costs to do that comes out, and
8 what's left goes to the producers, right?

9 A (Non-verbal response.)

10 Q Okay. But it's your understanding, though, that
11 the plants should pay for that cost of the milk to get the
12 milk? The cheese plants should pay to get that cost from
13 the producer to the plant, not the Class I handlers?

14 JUDGE HUNT: Aren't we kind of replowing a lot of
15 what has been covered before, Mr. Yale, with that question?

16 MR. YALE: I don't know that he asked -- this
17 question I don't believe was asked.

18 JUDGE HUNT: All right. Go ahead.

19 MR. YALE: Yes, and there's only one topic on this
20 question.

21 THE WITNESS: There are real costs there. The
22 question of who should pay them is not anything that I've
23 addressed or really analyzed to come to some conclusion, but
24 there are real costs there.

25 //

1 BY MR. YALE:

2 Q Mr. Vetne asked you some questions about ultra
3 filtration and RO, and I want to add some things to the
4 record on that issue.

5 By and large there's two factors involved in this
6 shrink, one of which is the handling. You know, when it
7 goes from one vessel or one thing to another there seems to
8 be a loss, a spillage or something, right?

9 A Yes.

10 Q And then sometimes there is some surface loss? In
11 other words, the product attaches to the surface of the pipe
12 or what other item it goes through. Is that right?

13 A Yes.

14 Q Okay. Now, you are familiar with the UF and the
15 RO process, right?

16 A Yes.

17 Q Now, in the on farm UF process this goes from --
18 the farmer puts it in the bulk tank like any other farmer.
19 Is that right?

20 A Correct.

21 Q Okay. And then that milk is transported from that
22 bulk tank to a storage tank at the UF facility, right?

23 A Yes.

24 Q And that's pretty well like what happens in a
25 cheese plant operation going from the farm to the plant?

1 A Although many times the two of those tanks are in
2 adjacent buildings, so it's not like it's going onto a truck
3 and --

4 Q Okay.

5 A -- all of that.

6 Q Fair enough. Fair enough. Okay. And then when
7 it goes from that silo or storage at the UF plant, what
8 happens to the milk? How does it transport through the
9 system?

10 A The milk from the silo at the site where they're
11 running the UF would go into the UF system, and the FDA
12 requirements on UF systems for on farm, as I'm aware,
13 require a straight through type of a process instead of a
14 recirculation process, so it would go through one pass on
15 the UF system, and it would split the milk into two streams,
16 a retentate stream and a permeate stream.

17 In that process you have equipment with surface
18 area where there can be some losses, and that retentate
19 would go into either a storage tank or truck. Ultimately
20 it's got to go into a truck to be shipped out to a cheese
21 factory. The permeate would be taken out of that building
22 and probably be -- it could be concentrated by an RO, and
23 then it can be utilized in the farm in terms of being a feed
24 supplement.

25 Q But let's talk about the milk as it goes through

1 the retentate. The retentate goes through -- this milk, as
2 it gets split, it keeps going through subsequent passes,
3 does it not? I mean, it goes through one set of membranes,
4 and what's left goes through another set until you've --

5 A This is an important point from a regulatory point
6 of view is that it's in a series. It's going continuously
7 through. It's never looping around in a circle.

8 Q Right.

9 A That's what happens typically in a plant at the
10 farm. It's a straight through from one module to another.

11 Q But it goes through a number of pumps through the
12 process?

13 A Yes.

14 Q Do you know the number of pumps?

15 A You can figure it. Usually you have different
16 stages. There will be several pumps. I don't know the
17 exact number.

18 Q Maybe as many as 24 pumps?

19 A I don't know specifically, but there's many pumps.

20 Q And then it goes into a vessel that has membranes
21 in it, right, at each stage?

22 A Well, at each stage, yes.

23 Q Right.

24 A There's usually a pump for each stage.

25 Q And how many membranes are in each vessel?

1 A It's different for different membrane suppliers,
2 so I don't know on a farm exactly how they've configured it
3 in terms of how many membranes are within one stainless
4 steel model.

5 Q But there are several or more, right?

6 A Yes.

7 Q All right. And each one of those has surfaces on
8 which this stuff can -- things can stick to, right?

9 A Yes.

10 Q So in the end it comes down, and it goes into
11 another tank, right?

12 A The retentate, yes.

13 Q The retentate, and then that is pumped onto a
14 truck?

15 A Correct.

16 Q And that's sent to a creamery, right?

17 A Yes.

18 Q Now, in terms of the number of vessels and pumps
19 and the like that goes on at this UF facility, how does that
20 compare to the cheddar process from the time it goes into
21 the silo at the farm until it goes to the vat in terms of
22 the number of vessels?

23 A Goes into the silo at the --

24 Q From the silo at the cheese plant --

25 A At the cheese plant. Okay.

1 Q -- to the vat.

2 A There are different processes, but both represent
3 a substantial number of manipulations in that process in
4 surface area.

5 Q Okay. Now, in this you had some involvement or
6 consulting in some way, did you not, in the developing of
7 some of this UF technology?

8 A I've been working with analysis of some of the
9 products of the UF, the UF concentrates and evaluating
10 losses of solids into permeate from those processes, yes.

11 Q And one of the important issues in developing this
12 wasn't just the regulatory with the FDA in terms of the
13 health issue. It was also how to deal with it in terms of
14 the Federal Order, was it not?

15 A Yes. There's some work on that, too.

16 Q Right. And there was a lot of work done to
17 determine what kind of shrinkage happened from the time it
18 left the farm or the bulk tank until the time it went onto
19 the truck to the creamery with the retentate, right?

20 A I'm aware that in the Federal Orders they've done
21 quite a bit of work on that.

22 Q Do you know what that shrinkage was?

23 A I don't have access to specific data, but my
24 awareness was that it was less than one percent is what they
25 were looking at, but again this is typical of a large unit.

1 If I had a small farm with a small UF unit, the
2 surface area would be a bigger issue relative to the total
3 volume of milk I'm processing, so in that whether I'm
4 running a UF or not, when I run that UF the more milk I
5 process through it in a session the lower percentage of
6 solids will be lost as a percentage of the total, and these
7 tend to be processing a large volume of milk.

8 Q Now, there was talk about loss after the vat, but,
9 as I understand, your formulas, the formulas you discussed
10 and the VanSlyke, talk about the recovery of the product
11 from the vat on and that the shrinkage is built into those
12 formulas?

13 A In terms of estimating the amount of cheese that
14 will be obtained, the non-recovery of fat in cheese is that
15 factor right in the VanSlyke formula, .9, and an estimate of
16 the non-recovery of casein as cheese is that minus .1
17 factor.

18 Q Okay. I want to talk a moment here about the
19 butterfat and make sure I understand this. You're
20 indicating that somewhere between 91 and 93 percent of the
21 butterfat is recovered in the cheddaring process?

22 A Somewhere -- in the cheddar cheese making, most
23 processors should be able to achieve between 90 and 93.

24 Q Okay. So 92 percent is not inappropriate?

25 A In my opinion, it's not inappropriate.

1 Q Okay. Of the remaining -- let's say we use 92.
2 Of the remaining eight percent, how much of that is
3 recovered in the whey cream?

4 A I would assume if -- this varies depending on
5 whether you're making 640s, 40 pound blocks or barrels.
6 There's a certain amount of fat that is recovered as whey
7 that comes off from the curd when we separate the curd from
8 the whey, and that's a large volume of whey, and that's the
9 bulk of the fat that's not recovered in the cheese is there.
10 When you say 92 percent recovery and we're
11 starting from the amount of fat in the vat, not back at the
12 farm, that of that eight percent that didn't stay in the
13 cheese I'd say that it's pretty typical that about five and
14 a half to six out of that eight is in the whey that comes
15 off the vat and goes right over to a holding tank to go to a
16 cream separator.

17 Additional fat comes out of the cheese curd during
18 the manipulations of the curd after the big volume of whey
19 has come out in the cheddaring and in the pressing steps,
20 the salting steps of that cheese. Typically in a good
21 operation I'd like for that to be one and a half to two and
22 a half percent of that eight let's say that's lost, and that
23 fat is not as easily recovered in whey cream and may not go
24 into whey cream, depending on whether it's 640s and you have
25 wooden boxes and all those issues.

1 Q So you've got 92 percent in this example in the
2 fat recovery in the cheese, six percent into the whey cream,
3 and the rest of it is lost?

4 A The rest of it will be at some lower value. You'd
5 like to get it all in the whey cream. Depending on how you
6 do things, you can get more of it there, but it's dependent
7 on how you're making your cheese.

8 Q Following up on Mr. Berde's question, there was
9 the question about proposals; that your proposal was
10 consistent with what he just read to you. The government
11 was suggesting some alternative to pricing butterfat.

12 If in the wisdom of the Secretary they determine
13 they don't want to change the policy of having a same class
14 or a butterfat price for each of Class III and IV, which at
15 that point would effectively make your proposal not doable
16 at this point, right?

17 A That's correct.

18 Q Okay. But there are ways to solve some of the
19 concerns that you addressed in your proposal, are there not,
20 within the limitations of the existing formulation for the
21 protein value in the cheese?

22 A I think if I looked at the current system, there
23 are ways to adjust the system that I think improve it, but
24 don't address some of the other fundamental issues that I
25 think are problems with it, but there are opportunities to

1 improve it.

2 Q And what would those be?

3 A Specifically assuming we're leaving the fat value
4 just the way it is as the Class IV fat price --

5 Q Right.

6 A -- that then it comes down to the calculation of
7 the protein price per pound.

8 The changes that I would make, and actually I went
9 through and I looked at that more carefully, and I prepared
10 sort of a calculation. I have it on the computer.

11 What I would do is use what I said in my testimony
12 in No. 16 where I've calculated a difference in yield, an
13 incremental difference in yield as it says on page 183 of
14 the final rule, to be a 1.371 by the VanSlyke formula and
15 then adjusted it from a crude protein basis to a true
16 protein basis. I would utilize that as the factor in the
17 protein calculation.

18 I have that. Can I display it on the screen?

19 MR. YALE: Can he show it? He has the numbers
20 that show the numbers of the calculation.

21 JUDGE HUNT: All right. Go ahead.

22 Did you cover this yesterday, Dr. Barbano?

23 THE WITNESS: Did I cover this? No, I did not. I
24 did not.

25 JUDGE HUNT: Maybe you'd like to dim the lights.

1 That's good.

2 THE WITNESS: This is the current calculation
3 using the March data using the NASS cheese price, the make
4 allowance, the current protein factor and the current fat
5 factor that comes up with the value of protein per pound of
6 \$2.428.

7 As I said, if I look at this and given the fact
8 that we're not changing the fat price, we're leaving the
9 system the way it is, how would I adjust the current
10 calculation? First, I would change the factor from the
11 1.405 to the 1.456, which I feel more correctly represents
12 the incremental change in cheese yield due to protein.

13 Secondly, when I look more carefully at how this
14 calculation is done, so what I've done in this section is
15 simply changed that one value right here, so the only
16 difference is that value, the factor, and it produces a
17 value per pound of protein of \$2.1007.

18 Also as I look more closely at this method of
19 calculation, one of the things that I see here is where it
20 has valued the fat at \$1.4487, which is the butter price for
21 fat, that that really is reflecting that the value of one
22 pound of fat is being included here in the cheese -- the
23 protein value calculation.

24 Really of every pound of fat that's received, not
25 all of that pound of fat is retained in the cheese, only 90

1 percent of that, so in an adjustment for that really the
2 correct amount of fat value that is retained in the cheese
3 is only .9 times the 1.487 subtracted from this value of the
4 1.79. I hope it's clear here. This is exactly what happens
5 now that they're in.

6 Step 2 of this protein price calculation takes the
7 NASS cheese price minus the make allowance times the 1.582,
8 so this is calculating the value of fat in the cheese and
9 putting it to the protein value; that then the adjustment to
10 reflect the correct amount of fat that's retained in the
11 cheese will be .9 times the 1.44, and then I have left the
12 1.28 the way it is. I've said that that's one of the things
13 that I feel creates a problem in the system, but it's very
14 hard without changing the whole system to eliminate that.

15 This produces a price per pound of protein of
16 \$2.2862, and if looking at the current system without
17 changing the fat price to correct some technical issues on
18 the protein side and the protein factor and the protein
19 value, these two things to me seem to be technically correct
20 steps to modify what I would call an imperfect system.

21 That's my view in terms of being asked the
22 question of how would I change the current system to be more
23 technically correct on those issues that this is the answer.

24 BY MR. YALE:

25 Q Would it still be appropriate to consider -- that

1 1.582 is based upon a 90 percent butterfat yield?

2 A That's correct.

3 Q Would it be appropriate if you changed that; that
4 that could be considered if you looked at say a 92 percent
5 yield that would change that number, and then you would have
6 to change your multiplier there to .92? Let me back up.

7 A Okay. If you were going to change fat recovery,
8 propose a changed fat recovery assumption to .92, yes, you
9 would have to modify the 1.582, and you'd also instead of
10 multiplying the \$1.4487 times .9 you'd multiply that by .92.

11 JUDGE HUNT: Let me interrupt for a moment. What
12 specific proposal does this relate to?

13 MR. YALE: This goes to Proposal No. -- the one
14 dealing with western states' proposal on cheese on the
15 yield. We are going to have testimony that develops this.

16 JUDGE HUNT: And the changing in the system that
17 Dr. Barbano just described?

18 MR. YALE: Yes. I mean, this is just a slight
19 tweaking of the existing formula, Your Honor.

20 JUDGE HUNT: All right. Okay.

21 MR. YALE: You see, his other was a wholesale
22 change.

23 JUDGE HUNT: All right.

24 MR. YALE: And this is just a tweaking of the
25 program, the number that's in there. We're showing where

1 those numbers, instead of -- for example, Your Honor, where
2 it says 1.456 up here, the Department had 1.405.

3 JUDGE HUNT: Okay. Okay. Proceed.

4 MR. YALE: Okay. I'm done proceeding. I have no
5 further questions.

6 JUDGE HUNT: Ms. Brenner?

7 BY MS. BRENNER:

8 Q Mostly just for clarification, Dr. Barbano.
9 There's been a lot of discussion about the relationships of
10 crude protein to true protein and casein. Would you for the
11 record just make a distinction between those three
12 components, which I guess are the casein is the smallest
13 part of the crude protein that we're breaking down there in
14 relation to the use of milk and cheese?

15 A Okay. We have, as you mentioned, crude protein,
16 true protein and casein. The crude protein and the
17 measurement of all three of these in terms of the analysis
18 and determination of their concentration in milk is done by
19 measuring the nitrogen content of milk and calculating the
20 protein content from that.

21 Assuming that all of the nitrogen in milk is due
22 to protein, that total nitrogen value times a factor to
23 convert to protein is the crude protein. Therefore, the
24 relationship of true protein to crude protein, the true
25 protein does not include the nitrogen that would be in milk

1 that's from non-protein nitrogen that has nothing to do with
2 protein, and in general expressed on a protein basis an
3 average value for that is about .19 on a protein basis.

4 The numbers I stated in my testimony yesterday on
5 that multiple year testing of milk in New York state was
6 coming out with a .192, so my observations would indicate
7 that that's a very reasonable number on average in
8 aggregate.

9 The casein is a portion of the true protein, and
10 the casein is the protein that typically in cheese making
11 will be recovered in the cheese, and on a true protein basis
12 the numbers that I see in terms of milk analysis, as I
13 stated in my testimony, probably for bulk milk supplies
14 average between 82.2 and 82.4 percent of the true protein.

15 Does that completely answer --

16 Q And the effect of the casein in the milk is to
17 increase cheese yield?

18 A The more casein you have, the higher the yield of
19 cheese. The more cheese you will attain.

20 Q Okay. On several different occasions you've used
21 the initials FDB. Does that mean fat on a dry basis?

22 A That is correct.

23 Q Okay. On page 22, in the last sentence in the
24 paragraph that ends at the top of the page --

25 A Yes.

1 Q -- dealing with the 39 percent moisture adjustment
2 I really wasn't very clear on how that affects the make
3 allowance.

4 A In the current system, at 39 percent the barrel
5 cheese as reported is at 34, 35, whatever percent moisture,
6 and, as I understand in the NASS survey, the respondents in
7 the survey would report the price per pound of cheese at
8 that test, or they would report the total pounds of cheese
9 sold and the total value of that.

10 When you convert from some low moisture value such
11 as 35, 36 to a 39 percent basis, as the moisture goes up the
12 mathematical adjustment is to lower the price per pound of
13 the cheese; that you're really reflecting the value per
14 pound of solids.

15 The issue that I have is that when that's done it
16 lowers the price per pound of cheese and then the fixed make
17 allowance, the 17.02 in the example that I used, is
18 subtracted from a smaller number, so in effect it's as if
19 you made the cheese at the higher moisture content. You're
20 being credited for a make allowance against that higher
21 moisture and yield.

22 It gives a bit more credit for total make
23 allowance, not the amount per pound, than really was
24 incurred in terms of the cheese manufacturing. They didn't
25 make cheese at 39 percent moisture and didn't have the

1 additional cost that would be there making cheese at 39
2 percent moisture.

3 Q Okay. Thank you. In referring to the milk price
4 calculator, you indicated that that was on page 15, and I
5 was wondering if you didn't mean page 16?

6 A In my copy it is on page 15, and it's to the
7 right-hand side of the page. There are five columns of
8 data, and above the first of those five columns on the right
9 it says Milk Price Calculator.

10 Q Is this the first or second page after the text?

11 A This is the first page, page number 15.

12 JUDGE HUNT: Yes. You can show it to her

13 THE WITNESS: See, the copy you have --

14 MS. BRENNER: I've got it split onto two pages.

15 MALE VOICE: That's page 15. Here's a different
16 one.

17 MS. BRENNER: Okay. I need to get a new copy.

18 BY MS. BRENNER:

19 Q One of the people who was cross-examining you
20 referred consistently to cheese makers using condensed to
21 fortify the solids in milk to use cheese. Do they
22 customarily use condensed rather than nonfat dry milk? What
23 is the --

24 A It really depends on the price of condensed and
25 the price of powder. It's my understanding that in most of

1 the time recently they have used nonfat dry milk powder for
2 the most part, but it depends on the cost of condensed at
3 the current time versus the cost of powder.

4 Q Okay. In looking at the flow chart that Mr.
5 Rosenbaum constructed and the embellishments supplied by Mr.
6 Vetne, it's kind of astonishing that there's ever any actual
7 cheese that ends up on a shelf in a grocery store.

8 I know you did respond to a question from Mr.
9 Beshore that you haven't done any specific work on how much
10 loss there is in the plant, but I don't think we have any
11 clear picture at this point about whether 50 percent of the
12 milk that comes into the plant is lost or 70 percent or 90.
13 I meant to go down.

14 A Right

15 Q Twenty percent or ten percent. I was wondering if
16 you had any information or sense of that kind of loss.

17 ^\ ^Y peak of loss, I guess I'd define it as if I analyze the milk in the
vats,
18 if we're starting there, and look at the fat and protein
19 content and then look at the amount, the weight of cheese,
20 the composition of that, the weight of whey cream, the
21 weight of sweet whey powder if we're making whey powder and
22 so on, that particularly on fat if I was working with a
23 plant if we weren't accounting for better than 98 percent or
24 approximately 98 percent of the fat I'd be really looking
25 for something that is identifiable in terms of it may be in

1 something that's of low value, but I know where it is in
2 terms of versus disappearance totally.

3 Q And that's from the vat on to the --

4 A From the vat on through --

5 Q -- final product?

6 A -- the system. There's fat that's present. One
7 of the things that can be a little bit deceptive is that in
8 the whey and then when you make the whey powder there's some
9 fat that winds up in the whey powder or the whey products.
10 It's not that it disappeared. If you never measure it you
11 think it disappeared. It's over in the whey product side.

12 Q These other places along the way like the loss of
13 milk between the silo and the pasteurizer, would that amount
14 to something like a half a percent? Five percent?

15 A No. Those are -- in my estimation, they would be
16 very small amounts as a percentage because what you're
17 doing, if you envision a factory running a million, two
18 million pounds a day through the pipeline from the silos
19 through the pasteurizers to the vat, that the total volume
20 contained in that pipeline is a pretty small percentage.

21 If it were full, a pretty small percentage of the
22 total volume of milk processed in that 18 or 20 hour period,
23 so the loss only occurs each time you stop, and usually
24 you'd be -- under good operating conditions you'd be running
25 for 18 to 20 hours and then breaking down to clean, so you'd

1 look at it from that perspective.

2 I think it would be on a percentage basis a pretty
3 small number. You know, I don't have any absolute number.
4 It depends on the size of the plant. If I run twice as much
5 milk today, if I run my plant at full capacity at two
6 million pounds versus running it yesterday at one million
7 pounds, on a percentage basis with the same loss it would be
8 a higher percentage of the one million pounds.

9 MS. BRENNER: Thank you. That's all I have.

10 JUDGE HUNT: Very brief, Mr. Rosenbaum.

11 MR. ROSENBAUM: I will be brief, Your Honor.

12 BY MR. ROSENBAUM:

13 Q Am I right that you just said that you would
14 expect a two percent loss in fat comparing what was in the
15 vat to what's in the cheese and the sweet whey and the whey
16 cream?

17 A Whey cream. You could have that kind of loss.
18 It's hard. There's equipment surfaces particularly in the
19 pressing, and that's probably one of the key places in
20 pressing the cheese that if the temperatures aren't right in
21 the system you can have a lot of fat loss there that you're
22 not going to recover.

23 Q Okay. But you've paid for that milk.

24 A That's correct.

25 Q But you never recover the fat, right?

1 A You paid for that fat, and it's part of making
2 cheese.

3 Q Okay.

4 A There's a certain amount that's going to
5 disappear.

6 Q All right. If you're buying milk at \$11.50 a
7 hundredweight -- well, somewhere in the system, to put it a
8 little differently, if the farmer is being paid what you get
9 for the cheese minus what it cost to make the product, one
10 of the costs of making the product includes the loss of that
11 much milk necessarily in the process, correct?

12 A Yes. There's a cost, and on the fat, as I've
13 mentioned the fat and that loss, fat is relatively unique
14 compared to protein and other solids in that it comes out,
15 particularly at the pressing comes out of the structure of
16 the cheese as free fat, and that loss tends to be higher
17 than what you'd have on other components. It's a little bit
18 different.

19 Q Whatever you've lost up to the point of the vat is
20 in addition to the two percent you lose thereafter?

21 A Of fat. Not of volume. Not of protein. It's a
22 fat protein, and fat sticks to surfaces. That's the
23 problem.

24 MR. ROSENBAUM: That's the problem. Okay. Thank
25 you.

1 JUDGE HUNT: All right. Thank you, Dr. Barbano.

2 (Witness excused.)

3 JUDGE HUNT: Mr. English, I hope it's not going to
4 repeat anything that's been said before or reinforce a
5 point.

6 MR. ENGLISH: No, Your Honor. If you're
7 dismissing the witness, I think now is the appropriate time
8 to reconsider or to look at or to examine your reserved
9 motion, and I'd like to be heard on that issue.

10 JUDGE HUNT: You've made your motions. I will
11 rule on it at this time.

12 MR. ENGLISH: Well, I'd like to add, Your Honor,
13 especially because I believe Mr. Berde made an argument that
14 somehow the provision within Proposal 32 somehow saved the
15 testimony of this witness.

16 JUDGE HUNT: I'm going to rule that Dr. Barbano's
17 pricing formula is not one of the proposals being considered
18 at this hearing. Although there's a lot of testimony and
19 comments on it, that is not a proposal being considered.

20 However, he has provided information in his
21 testimony that's germane to the proposals being considered,
22 and so I will allow Dr. Barbano's testimony to remain in the
23 record and, as Mr. Cooper suggested earlier, leave it to the
24 Secretary's representatives who will make the determination
25 on the final rule to disregard that part of Dr. Barbano's

1 testimony that's not pertinent to the proposals under
2 consideration.

3 MR. ENGLISH: Thank you, Your Honor.

4 MR. COOPER: And that would be receiving Exhibits
5 15, 16 and 17?

6 JUDGE HUNT: I haven't accepted anything. They
7 haven't been offered.

8 MR. COOPER: Well, his testimony is Exhibit 15.

9 JUDGE HUNT: But the proposals have not been
10 offered, or those exhibits have not been offered.

11 MR. YALE: Your Honor, I'll offer Dr. Barbano's
12 exhibit. Now, 19 and 20 I didn't concoct, but --

13 JUDGE HUNT: Nineteen and 20 have been received.

14 MR. YALE: Okay, but the others I would.

15 JUDGE HUNT: Dr. Barbano's testimony and exhibits
16 are 15, 16 and 17.

17 MR. YALE: Right. I would move that they be
18 admitted.

19 JUDGE HUNT: Does anyone object to their being
20 part of the record in the proceeding?

21 Hearing no objections, Exhibits 15, 16 and 17 will
22 be received into evidence.

23 //

24 //

25 //

1 (The documents referred to,
2 previously identified as
3 Exhibit Nos. 15 through 17,
4 were received in evidence.)

5 MR. COOPER: Just a clarification.

6 JUDGE HUNT: Yes, sir?

7 MR. COOPER: Leprino had an Exhibit 18. I don't
8 have it as received on my list. I don't know whether it was
9 or not. It was marked certainly.

10 MR. OLSEN: Your Honor, I believe that was
11 received into evidence yesterday.

12 JUDGE HUNT: I have it indicated as received in
13 evidence.

14 MR. OLSEN: I believe it was.

15 JUDGE HUNT: All right, Mr. Olsen.

16 MR. COOPER: Okay. I just wanted to make sure.

17 MR. OLSEN: I believe it was received in evidence
18 yesterday.

19 JUDGE HUNT: Pardon?

20 MR. OLSEN: I believe it was received in evidence
21 yesterday.

22 JUDGE HUNT: I have it indicated here as received
23 in evidence.

24 MR. COOPER: Okay. That's fine.

25 JUDGE HUNT: It was offered as official notice and

1 also offered as an exhibit. I have it down that it was
2 received. It's received. Exhibit 18 is received in
3 evidence.

4 MR. OLSEN: Thank you, Your Honor.

5 JUDGE HUNT: Before we break for lunch, we'll go
6 off the record.

7 (Whereupon, at 12:10 p.m. the hearing in the
8 above-entitled matter was recessed, to reconvene at
9 1:20 p.m. this same day, Wednesday, May 10, 2000.)

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1 part of the record?

2 No objection. Exhibit 22 will be received in
3 evidence.

4 (The document referred to,
5 previously identified as
6 Exhibit No. 22, was received
7 in evidence.)

8 JUDGE HUNT: Mr. Pacheco, are you here, sir? Mr.
9 Pacheco?

10 MALE VOICE: He said he's not ready.

11 JUDGE HUNT: You're not ready?

12 MR. PACHECO: That's fine. I can wait.

13 JUDGE HUNT: You can wait?

14 MR. PACHECO: Yes, if that's all right.

15 JUDGE HUNT: Okay. Okay. Sure.

16 Mr. English?

17 MR. ENGLISH: Yes, Your Honor. Thank you. My
18 first witness, Your Honor -- again, Charles English for
19 Suiza Foods Corporation and also Master Dairies. I have two
20 witnesses this afternoon. There will be another witness
21 later in the hearing. The first witness is Mr. Ernie Yates.

22 JUDGE HUNT: Good afternoon, sir.

23 //

24 //

25 //

1 Whereupon,

2 ERNEST YATES

3 having been duly sworn, was called as a witness
4 and was examined and testified as follows:

5 JUDGE HUNT: Would you state and spell your name
6 and the organization you represent?

7 THE WITNESS: My name is Ernest Yates,
8 E-R-N-E-S-T, Y-A-T-E-S, and I am the director of dairy
9 procurement for Suiza Foods Corporation.

10 MR. ENGLISH: Your Honor, Mr. Yates has a prepared
11 statement that he'll read for the record. He also has one
12 document that I've already distributed to the court reporter
13 and to yourself and is being distributed that I'd like to
14 have marked as an exhibit.

15 It is a document entitled American Butter
16 Institute Market Situation and Outlook, Author, Chris
17 Newburn, Third Quarter, 1999, Volume 2, No. 3. I'd like to
18 have that marked as I believe Exhibit 23, Your Honor.

19 JUDGE HUNT: Yes, sir. That will be 23.

20 (The document referred to was
21 marked for identification as
22 Exhibit No. 23.)

23 MR. ENGLISH: In addition, Your Honor, the witness
24 will make reference to a decision of the United States
25 Department of Agriculture, Agricultural Marketing Service,

1 dated June 30, 1998, with respect to the determination of an
2 equivalent Grade A butter price series. I'd like official
3 notice taken of 63 F.R., page 35564. Again, the date is
4 Tuesday, June 30, 1998.

5 MR. YALE: What was the number again?

6 MR. ENGLISH: It will be handed out, Mr. Yale, but
7 it's 63 F.R., page 35564, date June 30, 1998. For the
8 convenience of the parties, we are providing a copy of that
9 page of the Federal Register, and we will request official
10 notice be taken of that particular federal register page.

11 JUDGE HUNT: Does anyone have any objection to
12 taking official notice of the Federal Register referred to
13 by Mr. English?

14 Hearing no objections, I'll take official notice
15 of that document.

16 MR. ENGLISH: The witness will now provide his
17 statement.

18 DIRECT EXAMINATION

19 THE WITNESS: Suiza operates Class I and II
20 processing facilities in many regions of the country. I am
21 testifying on behalf of Suiza in support of Proposal No. 3.
22 I'm also here to express my support for the philosophy
23 underlying Proposal No. 8's request to correct the butterfat
24 value to reflect a historical Grade A butter price, but,
25 more importantly, to express my objection to limiting

1 Proposal No. 8's correction to adjust the Class IV butterfat
2 value.

3 In addition, I oppose Proposal No. 1, which
4 suggests the use of the Chicago Mercantile Exchange, CME,
5 product prices in lieu of National Agricultural Statistical
6 Survey, NASS, product prices.

7 Proposal No. 3 is consistent with the broad
8 recognition within the industry that the final rule in
9 transitioning from the use of the CME butter price minus
10 nine cents to the NASS butter price with no Grade A
11 adjustment failed to reflect an equivalent Grade A butter
12 price.

13 The industry, with the support of USDA, has long
14 recognized the core concept that market clearing minimum
15 prices should be based on manufacturing values. In fact, it
16 is my understanding that in 1998 USDA went so far as to
17 assert that establishing an equivalent Grade A butter price
18 in the absence of announced Grade A butter prices was
19 "essential to the continuing operation of the Federal Order
20 program," Determination of Equivalent Price Series, 63 F.R.,
21 35564, June 30, 1998.

22 Thus, when the Grade A butter market became too
23 thin to continue trading on the CME, USDA established an
24 equivalent Grade A price series by discounting the Grade AA
25 butter price by nine cents. It is my understanding the nine

1 cent adjustment reflected the historical difference between
2 Grade A and Grade AA prices.

3 Since January, 1999, NASS Grade AA butter prices
4 have averaged slightly less than two cents per pound below
5 CME grade AA prices. After reviewing butterfat values
6 discussed in the American Butter Institute's 1999 third
7 quarter report, I would agree with the proposals that adjust
8 the NASS Grade AA butter price by six cents to establish an
9 equivalent Grade A butter price. See Exhibit 23, the
10 American Butter Institute's third quarter report, Volume 2,
11 No. 3.

12 My understanding of the need to base the butterfat
13 values for Classes II, III and IV minimum price formulas off
14 the manufacturing value for butter is more anecdotal than
15 technical. As a result, another witness with technical
16 expertise will follow me.

17 Anecdotally, though, I am learning firsthand the
18 importance of an equivalent Grade A price. Suiza buys raw
19 milk from dairy farmers and/or their cooperatives, which
20 typically contain about 3.6 percent butterfat. Our Class I
21 finished products generally contain less than 2.5 percent
22 butterfat. Therefore, we have cream left over which is
23 typically sold in 5,800 gallon bulk tankers. It's my job to
24 market this bulk cream.

25 My goal is to market this bulk cream to at least

1 cover all related costs, which include the raw product cost
2 of sale, the cost of pasteurizing/processing the cream, the
3 cost of pumping the cream in and out of storage tanks,
4 shrinkage, transportation cost and related administrative
5 costs, which would increase dramatically if Proposal No. 8
6 is adopted.

7 Suiza, like other industry cream sellers, has
8 historically sold bulk cream to combinations of Class II,
9 III and IV processors at prices based off the former Grade A
10 butter price and later the equivalent Grade A butter price.
11 Prior to the final rule, butterfat prices for Class II, III
12 and IV were practically identical, and, therefore, the cost
13 of transportation between shipping and receiving plants was
14 the largest decision factor for cream sellers.

15 Proposal 8 would create a large cost wedge between
16 Class IV and II, which would immediately complicate and
17 increase the cost of marketing bulk cream. Thus, we are in
18 agreement with National Milk Producers Federation that there
19 is a need to adjust the butterfat value to reflect an
20 equivalent Grade A butter price.

21 It is obvious from the number of proposals in the
22 hearing notice that many producers and processors agree that
23 the failure to reflect an equivalent Grade A butter price
24 was an oversight that needs to be corrected. We believe the
25 need to correct this oversight obviously goes beyond just

1 Class IV, and such a correction should include Classes II,
2 III and IV.

3 Our position is supported by USDA's decision in
4 the final rule that established a fixed differential of 70
5 cents between Class II and IV allocated among the skim and
6 fat values. Correcting the butterfat value for Class IV but
7 not for Class II would have the unintended consequence of
8 undermining this essential relationship. Thus, the only
9 debate between proponents of Proposal No. 3 and No. 8 seem
10 to be the extent to which this oversight should be
11 corrected.

12 Beyond our concern that Proposal No. 8 would
13 distort the Class II and IV price relationship, we believe
14 Proposal No. 8, if adopted, would force me to move cream in
15 inefficient ways. The experts would call this disorderly
16 marketing.

17 In particular, if the butterfat adjustment is
18 simply limited to Class IV, you can bet that I and other
19 cream sellers are going to compete to sell as much cream as
20 possible to Class IV processors. I think it's logical to
21 conclude that as more cream is offered to Class IV
22 processors that Class IV processors will react by lowering
23 the price they pay for bulk cream, so instead of Proposal
24 No. 8 correcting the problem fluid processors have been
25 facing since January, 2000, Proposal 8 would only put Class

1 IV processors in a superior negotiating position to procure
2 bulk cream from fluid processors.

3 Accordingly, the problem for my company, which was
4 created by the final decision's butterfat formula, will only
5 be worse if Proposal 8 is adopted in lieu of Proposal 3. In
6 fact, Proposal 8 could lead to fluid processors being forced
7 to avoid generating bulk cream by purchasing raw milk from
8 dairy producers with butterfat contents that match fluid
9 processors' finished products, e.g., 2.5 percent butterfat.

10 In conclusion, since there is general agreement
11 that the butterfat value should be adjusted to reflect
12 manufacturing values and since limiting the adjustment to
13 Class IV only would distort the Class II and IV price
14 relationship and create adverse consequences for Class I
15 processors, I urge the adoption of Proposal No. 3.

16 Thank you.

17 MR. ENGLISH: Thank you, Mr. Yates.

18 Your Honor, I move the admission of Exhibit 23,
19 and as I make the witness available for cross-examination I
20 would note that both with respect to this witness and the
21 witness who will follow for Master Dairies, Inc., that there
22 will be a third witness later in the hearing to provide
23 greater technical expertise in order to speed this process.

24 JUDGE HUNT: All right.

25 MR. ENGLISH: Thank you.

1 JUDGE HUNT: Any objections to Exhibit 23?

2 Hearing no objections, Exhibit 23 will be received
3 in evidence.

4 (The document referred to,
5 previously identified as
6 Exhibit No. 23, was received
7 in evidence.)

8 JUDGE HUNT: Any questions of Mr. Yates?

9 Mr. Yale?

10 MR. YALE: Ben Yale on behalf of the proponents on
11 Proposal 1 and others.

12 CROSS-EXAMINATION

13 BY MR. YALE:

14 Q Good afternoon, Mr. Yates.

15 A Good afternoon.

16 Q Your proposal and your testimony seems to suggest
17 that if there is no adjustment to the Class IV butter price,
18 you no longer have a problem in moving your milk or your
19 cream. Is that correct?

20 A I don't think we quite follow with no longer
21 having a problem. The problem was created January 1 when we
22 went with the new butterfat values, which increased the
23 value of butterfat in a load of cream by approximately six
24 cents a pound.

25 If there's 20,000 pounds of fat on a load, that's

1 \$1,200 a load. It's my experience that that added cost was
2 not passed on. It was not able to be passed on.

3 Q But one situation to discuss is that there's this
4 implied increase in the cost of butterfat, which you just
5 mentioned, right, for all classes?

6 A There was a real increase, yes.

7 Q All right. And then the other part of your
8 proposal addresses the fact that if you only adjust it for
9 Class IV but not the other classes, then you create the
10 potential by having two different butterfat prices, the
11 potential for some disorderly marketing of cream?

12 A That's correct.

13 Q All right. I just want to talk about that. Let's
14 just talk about the first part then. How much Grade A
15 butter is sold today?

16 A I don't know.

17 Q Isn't it true that in 1998 that the CME decided
18 there was so little trading that they discontinued Grade A
19 and Grade B butter on their --

20 A They did discontinue it.

21 Q Do you sell Grade A butter as Grade A butter?

22 A As far as know, Suiza does not sell. I'm not
23 aware of that.

24 Q Okay. How do you label the cream that you sell?

25 A As Grade A bulk cream.

1 Q Is there a Grade AA bulk cream?

2 A No. The Grade A is referred to the interstate
3 milk shippers' listing and tied back to that.

4 Q Right. There's no higher quality than Grade A
5 cream that's sold to your knowledge. Am I correct?

6 A Right.

7 Q And the source of this cream that you have comes
8 from a Class I handler, right?

9 A Correct.

10 Q I indicated that I think you suggested 2.5 percent
11 is your average butterfat content of the product that you
12 sell?

13 A No more than that.

14 Q No more than that.

15 A That or less. It varies.

16 Q And that is because you sell a lot of products of
17 just skim, lowfat and nonfat milk, right?

18 A Sure.

19 Q Now, are those products sold at approximately the
20 same price per gallon as the whole milk?

21 A You know, it varies, but typically there's a
22 difference.

23 Q But isn't it true that if you did it on a skim
24 basis that you'd get more for skim milk that you sell than
25 the skim that you sell in whole milk?

1 A I'm not prepared to -- I'd have to think about
2 that.

3 Q Let's ask it this way. You sell skim milk and
4 lowfat milk because the consuming public demands it, right?

5 A Right.

6 Q And in fact the process of removing that cream
7 creates an added value product to the health conscious
8 consumer, right?

9 A Well, yes. I like that.

10 Q I'm sure you do. We all do. What your proposal
11 is asking -- your complaint is that as you make this added
12 value product that you have a byproduct of cream that you
13 want to have discounted in price in the Federal Order
14 program. Isn't that what you're requesting?

15 A Well, maybe. Are you suggesting also that the
16 homo, the 3.25, is added value since the farm milk comes in
17 at 3.6?

18 Q Sure. Sure. Anything. I mean, you're reducing
19 it. You're making it all added value because you're
20 standardizing it to the levels that consumers wish to
21 purchase it at, right?

22 A Okay.

23 Q As a result of creating this added value product,
24 you now have an additional byproduct of Grade A cream,
25 right?

1 A Okay.

2 Q And the cost to create that Grade A cream is all
3 part of your manufacturing cost in the bottling plant,
4 right?

5 A Well, that's not typically the way it has worked
6 in the past.

7 Q How does it work? How do you get it?

8 A You buy raw milk. You know, when you sell cream
9 it's 40 percent Class II milk. You really don't, you know,
10 need all that, but because the farmers produce milk with 3.6
11 or so percent fat you end up with Class II, 40 percent --

12 Q Right.

13 A -- Class II milk left over so you market that to
14 other processors that need 40 percent Class II milk.

15 Q Right. And you repay to the Federal Order for the
16 Class II price for that?

17 A Or ever how it's allocated --

18 Q However it's allocated.

19 A -- or classified. Yes.

20 Q Right. If you sold it as Class IV product, it
21 would be classified as a Class IV product, right?

22 A Right.

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

24 JUDGE HUNT: Mr. Christ?

25 MR. CHRIST: Thank you, Your Honor. I'm Paul

1 Christ from Land O'Lakes.

2 BY MR. CHRIST:

3 Q Mr. Yates, one of your arguments was that it would
4 be difficult for or that Class IV processors would now have
5 a competitive advantage in buying cream from your
6 organization. Is that not correct?

7 A Correct.

8 Q Okay. Is there today a difference in the
9 butterfat price for Class II milk and the butterfat price
10 for Class IV milk?

11 A Well, it varies constantly as, you know, you're
12 probably aware of, but typically there is a difference.

13 Q No. I mean the regulated minimums.

14 A The regulated minimum? Just the 70 cents.

15 Q Okay. So there is a difference?

16 A Yes.

17 Q Does there exist a so-called competitive
18 advantage?

19 A It's a small difference at the 40 percent.

20 Q Okay. But a difference does exist?

21 A Yes.

22 Q Okay. Do you now sell cream to Class II buyers?

23 A Yes, we do.

24 Q Why would you sell cream to a Class II buyer when
25 your cost is higher for the butterfat?

1 A Transportation would be a big factor in that.

2 Q Do you pay the transportation cost on the --

3 A Sometimes we do. Sometimes we don't.

4 Q Okay. The transportation cost would be an
5 offsetting factor relative to the difference in the raw
6 butterfat costs?

7 A Right. Right.

8 Q Does it ever occur that a Class II buyer offers a
9 higher multiple or a higher price for cream than is offered
10 by a butter manufacturer?

11 A Sure.

12 Q Okay. And that would be a reason for selling
13 cream to a Class II manufacturer?

14 A Right.

15 Q In the future, if a Class II manufacturer were to
16 offer you a higher price for cream than a Class IV
17 manufacturer, would that also be a reason for selling cream
18 to a Class II manufacturer?

19 A Yes. We try to maximize our sales to the extent
20 that we can.

21 Q You try to maximize your sales to --

22 A Sure.

23 Q -- Class II buyers?

24 A Or whoever.

25 Q To whomever --

1 A Yes.

2 Q -- offers the highest price?

3 A That's exactly right.

4 Q Highest net return?

5 A That's exactly right.

6 Q And there are differences in the offers made by
7 different potential buyers?

8 A Yes. One of the disadvantages that we have is
9 that Class IV manufacturers and III and II, they seem to
10 have the ability if it's a perception in the market that the
11 butter market is moving down like we've had in the last
12 couple of years where hey, it's going to drop 50 cents,
13 they'll almost just stop buying.

14 They have enough inventory to get them through or
15 they'll cut back, so the Class I processors having this bulk
16 cream, we have to go somewhere with it. It's very
17 perishable. It seems like -- it feels like -- we're at the
18 mercy of these guys.

19 Q Okay. But even in those events where prices are
20 coming down, you still choose to sell to the buyer who
21 offers the highest net return for cream?

22 A Yes.

23 Q Now, you seem to believe that a greater percentage
24 of the surplus cream would now go to Class IV processors
25 than Class II or Class III processors?

1 A Yes.

2 Q Does your organization manufacture ice cream?

3 A Yes.

4 Q Do you expect that your ice cream sales will
5 decline because of this change?

6 A Which change?

7 Q Because of the reduction in the butterfat price
8 for Class IV milk?

9 A No.

10 Q Okay. If your sales, ice cream sales, are not
11 likely to decrease, your requirement for milk fat in ice
12 cream is not likely to decrease?

13 A That's correct.

14 Q Would you be willing to generalize that to the ice
15 cream industry?

16 A That's correct.

17 Q Okay. So if the requirements for fat in ice cream
18 are not likely to decrease then there would be no more
19 butterfat available for sale to the Class IV buyer than is
20 now available?

21 A It's the timeliness of it and the negotiation of
22 prices. You would think that with the cost of a load of
23 bulk cream moving up \$1,200 January 1 it would be very easy
24 and simple for fluid processors to just pass that on
25 through.

1 I mean, that's the logical conclusion, and that's
2 what we were hoping for. We're in May, and that has not
3 happened yet, so, yes, there's a demand for fat, but the
4 supply for fat seems to be more than adequate.

5 Q Okay. Another line of questions relating to the
6 offers made by Class IV buyers, butter manufacturers in
7 effect. This change in the cost of butterfat under Federal
8 Orders that occurred on January 1, did you detect any change
9 in the buying practices of butter manufacturers as a result?

10 A Buying practices of fluid --

11 Q For example, the multiples that were offered or
12 other behavior.

13 A Well, not as a result of that.

14 Q Okay. That's --

15 A Actually, some of them moved down because of the
16 supply of cream at the time, but I don't think -- that was
17 seasonal and not due to the higher butterfat cost.

18 Q Those are two separate determinants. They may
19 have gone down because of the butterfat supply, but they did
20 not go down because of the increase in the price of
21 butterfat under Federal Orders, so your terms of trade
22 between your bottling facilities and the Class IV buyer
23 deteriorated as a result of this change?

24 A Yes.

25 MR. CHRIST: Thank you.

1 JUDGE HUNT: Next question? Mr. Beshore?

2 BY MR. BESHORE:

3 Q Mr. Yates, Proposal 3, which you support, does not
4 change the value of butterfat in Class II. Is that correct?

5 A That's correct.

6 Q And that's your position here today on behalf of
7 Suiza that the value of butterfat in Class I should not be
8 changed?

9 A Well, we're not opposed to the proposal that
10 changes that, but we're in support of our Proposal No. 3.

11 Q Okay. So you don't think it's necessary to change
12 that price then?

13 A Again, we're going to support Proposal No. 3, and
14 we're not opposed to what was it, Proposal No. 4 that
15 suggests that?

16 Q Okay. Whatever proposal it was. Isn't it correct
17 that you refer to having cream left over after processing
18 your Class I finished products? Cream for Class IV is the
19 cream that's left over from all of the higher value uses in
20 the Federal Order system. Wouldn't you agree with that?

21 A Well, I guess so. Butter sometimes is a higher
22 value product also. It's --

23 Q That's the exception rather --

24 A Yes.

25 Q -- than the rule, however?

1 A The ability to store butter I think allows those
2 manufacturers to buy when it's in surplus more and then not
3 buy when cream is not so much in surplus, milk and cream is
4 not so much in surplus.

5 Q Okay. If Proposal No. 8 is adopted, you would
6 obtain the very similar price relief to what you have
7 requested with respect to the sales of surplus cream for
8 Class IV butter makers. Would you agree with that?

9 Proposal 8, which just changes the Class IV butter
10 price, would give you a very similar -- give fluid handlers
11 who are selling surplus cream for Class IV uses very similar
12 price relief to that part of your proposal?

13 A No. I'm saying that would not happen. I don't
14 think that would happen.

15 Q It would reduce the price of all the cream that
16 you're selling for Class IV, would it not?

17 A Yes, but these Class IV guys that procure cream,
18 they do a very good job of procuring cream. When you go to
19 a butter plant, you can be assured that you're getting the
20 lowest possible multiple for that particular day that
21 anybody is willing to pay, so if they discover --

22 Q That's their job, right?

23 A Yes, and they will discover -- some of them are in
24 the room today -- that even though my cost went up January 1
25 that next January 1 my cost goes down the \$1,200 a load to

1 get back to where we were prior to January, 2000.

2 It would be my opinion that they will try to
3 squeeze the multiples down because they know my alternative
4 going to a Class II plant would be worse, and they'll keep
5 lowering the multiples until they find that break even point
6 of where there's maybe no difference, you know, between IV
7 and II.

8 Q Well, they know that they're the market clearing
9 outlet, the final outlet for surplus cream because they make
10 the product that can be stored and, therefore, they know
11 that, you know, they're going to be able to acquire their
12 product at the market clearing price.

13 A Yes. They sit back and wait for the price to get
14 as low as they think it's going to get and then buy and make
15 butter, and then if it moves they seem like they wait.

16 Q So it's got the lowest value in Class IV of any
17 other uses, and that's what the market tells you every day?

18 A Well, because of their ability to store butter, it
19 just seems to me.

20 Q Because of supply and demand?

21 A Yes. They have the option on when to produce,
22 where a lot of the other items, even Class II and III, have
23 that option to some degree, but not to the extent that
24 butter does.

25 Q So if I understand you, the lowest use value for

1 your cream is consistently in Class IV? That's where you
2 get the lowest returns for your cream?

3 A Yes.

4 MR. BESHORE: Thank you.

5 JUDGE HUNT: Any other questions?

6 Mr. English?

7 BY MR. ENGLISH:

8 Q Mr. Yates, with respect to a couple questions
9 asked by Mr. Yale, if you were to hold the NASS price
10 constant with reference to comparing what was going on in
11 December, 1999, to January, 2000, would you receive more,
12 the same or less revenue from the person to whom you're
13 selling your load of cream in January, 2000, versus December
14 of 1999? This is the gross amount now, how much you receive
15 in payment if you hold the NASS price constant.

16 A Yes. We sell over the CME price, so it's --

17 Q Okay. It's over the CME price?

18 A Yes.

19 Q So hold the CME price constant.

20 A Yes. If the CME price is constant, then we would
21 have the same gross.

22 Q But did your cost basis, what you have to account
23 to the Federal Order, change, again holding everything else
24 constant?

25 A Yes, it did.

1 Q And Mr. Christ asked you a couple of questions
2 with respect to the impact of the six cents going down. If
3 the six cents went down on Class IV but didn't go down in
4 ice cream relative to the cost of the ice cream, he also
5 asked you wouldn't that necessarily suggest the ice cream
6 makers might pay you more in order to adjust. That would
7 increase, however, the cost of making ice cream, correct?

8 A That's correct. It would.

9 Q Which would increase the price, assuming what the
10 ice cream is going to sell out in the marketplace, which
11 would lower the demand, correct?

12 A Yes, sir. That's correct.

13 Q And with respect to the terms of trade that were
14 referenced as becoming unfavorable as to Class IV as a
15 result of this change, isn't that also true as to Class II
16 and III?

17 A Yes, it would be.

18 MR. ENGLISH: That's all the questions I have.

19 JUDGE HUNT: All right. Thank you very much, Mr.
20 Yates.

21 MS. BRENNER: Your Honor?

22 JUDGE HUNT: Oh, I'm sorry. Ms. Brenner?

23 BY MS. BRENNER:

24 Q Mr. Yates, several times in I believe your
25 conversation with Mr. Christ you used the word multiples.

1 Would you mind explaining what you mean by that?

2 A Cream is typically sold over the CME price times a
3 factor, and that factor is I don't want to -- you know, it's
4 100 and some percent or a percent of the CME. That factor
5 is multiplied times the pounds of fat on the load, not by
6 the product pounds on the load.

7 If there's 50,000 pounds of cream at 40 percent
8 fat with a 40 percent butterfat test, then there's 20,000
9 pounds of fat, and you only price that fat. That's the
10 industry standard that I understand. It's been that way for
11 many years.

12 Q Do you keep track of what products your surplus
13 cream is used in when you sell it to like an ice cream
14 plant, for instance? That would be Class II.

15 A In the past, before January, 2000, it really
16 didn't matter, you know. There was a little difference in
17 price, and depending on the months there could be some
18 significant difference in price, but for the most part the
19 fat values were identical whether it went to ice cream,
20 cheese or butter, but since January 1, yes, we've had to
21 keep track of it.

22 If someone calls me and asks me well, do you have
23 a load of cream for sale, the first question I'll ask him is
24 what are you going to use it for because the new formulas --
25 well, I'm getting ahead of myself here. The 70 cents. We

1 do consider the 70 cents, so if it's Class II I do try to
2 get more for the Class II sales than the Class IV.

3 If Proposal 8 would be adopted, well, then it
4 would be a tremendous difference between II, III and Class
5 IV, so it would be really important at that time, and, yes,
6 we would.

7 Q In keeping track, do you have some idea of whether
8 most of your surplus cream goes to Class II, III or IV uses?

9 A I'm really not prepared to answer that, but I
10 would say it's probably more in II.

11 Q In Class II?

12 A Yes.

13 Q Okay. Are you aware of having sold any cream for
14 use in anhydrous milk fat?

15 A Some of the plants that we sell to I understand
16 they do make that product.

17 Q Is that right?

18 A Yes.

19 MS. BRENNER: Okay. Thank you. That's all I
20 have.

21 JUDGE HUNT: Anyone else? All right. I guess
22 that's it, Mr. Yates.

23 THE WITNESS: Thank you.

24 JUDGE HUNT: Thank you.

25 (Witness excused.)

1 MR. ENGLISH: Your Honor, the next witness will be
2 Mr. William Tinklepaugh, and he has a statement and one
3 exhibit, which we will get six copies of to the court
4 reporter.

5 Whereupon,

6 WILLIAM TINKLEPAUGH

7 having been duly sworn, was called as a witness
8 and was examined and testified as follows:

9 JUDGE HUNT: Would you state your name for the
10 record, please?

11 THE WITNESS: My name is Bill Tinklepaugh, and I'm
12 the president and CEO of Master Dairies, Inc.

13 MR. ENGLISH: Before Mr. Tinklepaugh gives a
14 statement, Your Honor, we have a two page exhibit, the cover
15 sheet of which reads Federal Milk Marketing Order Reform, Ne
16 England, et al., Final Decision, Regulatory Impact Analysis,
17 March, 1999. The second page is page 66, Appendix Table 17.

18 I'd like to have this document marked as an
19 exhibit for convenience of this witness. It may be more
20 appropriate at a later time to take official notice of the
21 entire document, but we can address that at a later time,
22 Your Honor.

23 JUDGE HUNT: Okay.

24 MR. ENGLISH: I certainly do not mean to exclude
25 any other page by selecting this particular page.

1 JUDGE HUNT: All right.

2 MR. ENGLISH: If I could have this marked, Your
3 Honor?

4 JUDGE HUNT: We will mark that as proposed Exhibit
5 No. 24.

6 (The document referred to was
7 marked for identification as
8 Exhibit No. 24.)

9 MR. ENGLISH: Then Mr. Tinklepaugh may begin his
10 statement.

11 DIRECT EXAMINATION

12 THE WITNESS: Thank you. Master Dairies is a
13 purchasing association owned by ten dairy processing
14 companies who operate 30 dairy plants, mostly fluid milk
15 processing operations, in 12 states covered by Federal Milk
16 Orders and with distribution in about 30 states.

17 We estimate that our U.S. member companies' dairy
18 product sales exceed \$2 billion annually. While Class I
19 sales represent the bulk of our member companies' business,
20 a number of our members also produce a variety of Class II
21 products, including ice cream, cottage cheese, yogurt and
22 sour cream.

23 I'm appearing today on behalf of our member
24 companies in support of Proposal No. 3 concerning the
25 Federal Milk Order cost of butterfat used to produce Class

1 II, III and IV products. I also appear in opposition to
2 several other proposals which we feel would unjustifiably
3 increase the cost of Class I milk while decreasing the cost
4 of Class IV. These latter proposals fail to reflect supply
5 and demand market conditions for fluid milk use and should
6 be denied.

7 There appears to be general agreement among all
8 segments of the industry that the final rule's butterfat
9 price incorrectly valued bulk fluid cream. Simply put, in
10 the transition from using the Chicago Mercantile Exchange
11 Grade AA price less nine cents to the use of the NASS price
12 series, USDA failed to carry forward the downward price
13 adjustment. This conversion factor was and is necessary in
14 order to adjust the Grade AA price to the old, no longer
15 traded Grade AA price.

16 The historic relationship between AA and Grade A
17 price was approximately nine cents, thus leading to the
18 establishment of an equivalent price series for Grade A
19 using the Grade AA price minus nine cents. Since the NASS
20 AA price historically has been two to three cents lower than
21 the CME price, the relationship conversion factor for NASS
22 should be approximately six cents.

23 However, in the final rule, which was implemented
24 January 1 of this year, USDA omitted any adjustment to the
25 NASS price. The proponents of the Class IV only proposal

1 regarding butterfat tacitly acknowledged this oversight with
2 their proposal. The only debate by the industry appears to
3 be the extent to which this oversight should now be
4 corrected.

5 We believe that Proposal No. 3 should be adopted.
6 USDA went to great pains to link the Class IV price and the
7 Class II price and then established a 70 cent differential
8 between the two. There is no need to increase this
9 differential through the back door by decreasing the Class
10 IV cost while leaving the Class II cost six cents higher on
11 butterfat. The old CME price less nine cents was
12 recognized. It's good enough for Class II and III, as well
13 as Class IV. The change adjusted for the two to three cent
14 CME to NASS difference should also apply to all three
15 classes.

16 As to the alleged need to change or lower the make
17 allowances, these changes will likely have an elevating
18 impact on Class I prices. However, we need to remember that
19 USDA made a finding in the final rule that a sufficient
20 quantity of fluid milk would be available under final rule
21 prices.

22 Congress chose to further increase the Class I
23 differentials in many markets, leading to an overall
24 increase in the all milk price. While there were some
25 relatively modest changes to USDA's modified 1-A, the

1 regulatory impact analysis, Appendix Table 17 on page 66,
2 provides the best evidence of the price enhancing impact,
3 approximately a nine cent increase in the all milk price
4 over that which was thought by USDA to generate a sufficient
5 quantity of milk for fluid use, which was the modified
6 Option 1-B.

7 Hearing proposals which would further increase the
8 all milk price, therefore, are not justified. Indeed, none
9 of the Master Dairies U.S. member companies are having
10 difficulty procuring a raw milk supply for fluid use
11 precisely because there is more than a sufficient supply of
12 milk for fluid use nationwide. While there may be isolated
13 and limited time wise and geographically limited needs to
14 import milk into the southeast, it is impossible for anyone
15 to argue that there is not a sufficient supply of milk in
16 the United States today.

17 U.S. milk production is up 5.1 percent for the
18 period January through March, 2000, over the same period a
19 year ago. In addition, the number of milk cows and
20 production are higher than for the years 1998 and 1999,
21 58,000 in March, 2,000 over March, 1998, reversing a
22 long-term trend in the other direction.

23 Many of the proposals in this hearing would
24 increase milk prices despite these increases in production
25 and cow numbers. The result of such higher prices logically

1 will be decreased consumption of fluid milk by consumers and
2 increased production of milk by dairy farmers. The
3 cumulative effect will be to depress manufacturing milk
4 values, further complicating the dairy industry's need to
5 transition to a more market oriented approach.

6 Master Dairies urges adoption of Proposal No. 3
7 and rejection of all other price enhancing proposals. We
8 strongly urge the Department to adopt market oriented
9 policies, which will benefit the entire industry as we
10 continue into the increasingly competitive twenty-first
11 century.

12 Thank you.

13 MR. ENGLISH: Your Honor, I move admission of
14 Exhibit 24 and make the witness available for cross-
15 examination.

16 JUDGE HUNT: Any objections to 24 being part of
17 the record?

18 No objections. Exhibit 24 will be admitted into
19 evidence.

20 (The document referred to,
21 previously identified as
22 Exhibit No. 24, was received
23 in evidence.)

24 JUDGE HUNT: Any questions? Yes, Mr. Yale?

25 //

1 CROSS-EXAMINATION

2 BY MR. YALE:

3 Q Mr. Tinklepaugh, are you aware of the fact that
4 you give this idea that everybody seems to agree that there
5 needs to be an adjustment to a Grade A price? I think you
6 made that statement.

7 A That's what I've heard so far, yes.

8 Q All right. Well, I want you to know the
9 proponents of Proposal No. 1 do not agree with that.

10 A Okay.

11 Q All right. I don't want anybody to get this sense
12 that there's a consensus here. There's none.

13 A All right.

14 Q Now, you indicate in there to go to a historic
15 price, and your counsel has submitted for official notice
16 this Federal Register announcement when the Department went
17 to CME minus nine cents. Do you remember that?

18 A Yes.

19 Q All right. If you read in the first paragraph,
20 one of the early paragraphs, it indicates under Supplemental
21 Information, and it identifies all these Federal Orders. It
22 says, "Currently, the CME Grade A butter price series is
23 used to establish values," right, so there was rule making
24 hearings that established that the CME Grade A butter price
25 was used for butterfat under those old orders. Is that

1 correct?

2 A Yes.

3 Q All right. But we now have the final rule that
4 was adopted January 1 of this year or effective January 1,
5 right?

6 A Yes.

7 Q Okay. Where in the final rule that we're now
8 operating under do we use a Grade A price for the pricing of
9 butterfat?

10 A I'm not aware of any.

11 Q So the point is that the Federal Order has caught
12 up to the modern situation where there is no more Grade A
13 butter, so they're going to use Grade AA butter, right?

14 A Well, I think it was just a technical oversight on
15 the Department's part.

16 Q How much Grade A butter do you sell?

17 A I don't sell any.

18 Q How much Grade A butter do you think is sold?

19 A Probably very little.

20 MR. YALE: I have no other questions.

21 JUDGE HUNT: Mr. Christ?

22 MR. CHRIST: Thank you, Your Honor. Paul Christ
23 from Land O'Lakes.

24 BY MR. CHRIST:

25 Q Mr. Tinklepaugh, you argued in your statement that

1 these increases in butterfat costs under the reformed
2 Federal Orders are likely to elevate Class I prices. Can
3 you explain how that happens?

4 A Well, since the Class I prices are based off of
5 either the Class III, the higher of the Class III or the
6 Class IV, to the extent that those prices are increased
7 Class I prices would also increase.

8 Q Is there an impact from the higher butterfat costs
9 as well on Class I prices?

10 A Yes.

11 Q Could you explain how that works?

12 A Well, we're going to have a technical witness
13 later --

14 Q Okay. We'll wait for the technical witness then.

15 A -- to get into a little more detail. Yes.

16 Q Okay. I'll raise those questions with him.

17 Another point. You stated that milk production is
18 up 5.1 percent during the --

19 A Or her.

20 Q Or her. Okay. Up 5.1 percent in the first
21 quarter of 2000.

22 A Right.

23 Q Are you aware that we had an extra day in that
24 first quarter relative to the year before?

25 A Leap year?

1 Q Yes.

2 A Yes.

3 Q Would you agree that if we adjusted for that extra
4 day, the increase is closer to 3.9 percent?

5 A Yes.

6 MR. CHRIST: Thank you.

7 JUDGE HUNT: Mr. Beshore?

8 BY MR. BESHORE:

9 Q Bill, you cited the 70 cent Class II differential
10 as a reason for not changing the price of Class IV butterfat
11 without also lowering the value in Class II. Are you
12 familiar with the final decision where the 70 cent
13 differential was established, Class II over Class IV?

14 A Not the details of it. I'm aware that that was a
15 differential that was established, but I can't tell you how
16 it was constructed.

17 Q The decision says a 70 cent differential between
18 Class IV and Class II skim milk prices is an estimate of the
19 cost of drying condensed milk and rewetting the solids to be
20 used in Class II products. Are you aware of that?

21 A I'm going to have to defer on that, Marvin, to our
22 technical expert. Yes.

23 Q Well, let me ask this. If in fact that's a
24 correct part of the decision and the differential was based
25 on the skim, a difference between drying and rewetting skim

1 milk solids as opposed to any conversion of butterfat, your
2 changing the butterfat price in Class IV has no impact
3 whatsoever on that skim milk differential, does it?

4 A Well, yes, I think it will.

5 Q How does it affect the skim milk price?

6 A Well, I'm going to defer to our technical
7 expert --

8 Q And that is?

9 A -- to go through the mechanics of it.

10 Q Who is your technical person?

11 A He or she will be appearing later in the hearing.

12 MR. BESHORE: Okay. That's all. Thank you.

13 JUDGE HUNT: Anyone else?

14 All right. Thank you very much, Mr. Tinklepaugh.

15 (Witness excused.)

16 JUDGE HUNT: Mr. English, did you have your third
17 witness now or later?

18 MR. ENGLISH: No, Your Honor. I think in fairness
19 to all other participants, these are the two who had to be
20 on today.

21 JUDGE HUNT: Okay.

22 MR. ENGLISH: My third witness needs to be out by
23 noon on Friday, but that's fine.

24 JUDGE HUNT: I'm sure they appreciate that.

25 Mr. Olson I think is the next in order.

1 Whereupon,

2 KENNETH OLSON

3 having been duly sworn, was called as a witness
4 and was examined and testified as follows:

5 JUDGE HUNT: Would you state and spell your name,
6 please, and organization?

7 THE WITNESS: My name is Kenneth Olson. That's
8 K-E-N-N-E-T-H, O-L-S-O-N. I'm a dairy specialist for the
9 American Farm Bureau Federation. These comments are
10 presented on behalf of AFBF and the many dairy producers who
11 are members of our organization.

12 DIRECT EXAMINATION

13 THE WITNESS: Included in our 4.9 million members
14 are the majority of the nation's dairy farmers. AFBF does
15 not handle or process any milk, so we reflect the interest
16 of those who produce milk and also those who purchase dairy
17 products.

18 Our proposal to USDA was identified in the notice
19 of public hearings as Proposal No. 16. It was indicated in
20 the notice Southeast Dairy Farmers submitted a similar
21 proposal. These comments are relative to the AFBF proposal,
22 but likely also pertain to the Southeast proposal relative
23 to the reasons for modifying the make allowance for cheese.

24 In our proposal, we noted that it dealt with
25 components of the formula used to determine the protein

1 price for the Class III mover rather than the formula
2 itself, so we believe that the basic model is appropriate.

3 We've recently become aware of the work that Dr.
4 David Barbano from Cornell University relative to the data
5 that impacts several of the underlying assumptions in the
6 USDA formula. This information has been presented at these
7 hearings. We do not have any new data to offer that would
8 provide additional insight on the issues, but we believe
9 that the data and the concepts included in Dr. Barbano's
10 testimony merit additional evaluation by the Department.

11 The current data he presents relative to the
12 percent of true protein that is casein, the level of fat
13 recovery in cheese and the fat to protein ratio in milk is
14 compelling. We encourage USDA to give serious consideration
15 to the points he raises and their impact on producer prices.
16 Still, our basic concern lies with the values that are used
17 in determination of the protein price paid by USDA. The
18 proposed modification will impact Class III price and also
19 Class I price and Class III skim price as used in
20 determining the mover for Class I.

21 AFBF proposed revising the make allowance and the
22 formula used to determine the protein price from cheese
23 that's included in the final rule. We suggested that the
24 make allowance of 17.02 cents per pound be changed to the
25 cost of production as determined in the Rural Business

1 Cooperative Service, RBCS, survey. We further suggest that
2 if the survey did not include adequate California
3 information that it be weighted with the cost determined in
4 the audited survey conducted by the California Department of
5 Food and Agriculture, CDFA.

6 We also ask that provisions be included for an
7 annual review of the cost of producing cheese with an
8 adjustment being made in the make allowance if this was
9 determined appropriate on the basis of new information. In
10 addition, we request the Department monitor the impact of
11 the forward pricing pilot program on NASS cheese survey
12 prices that are used in the formula.

13 In the explanation of the make allowance that was
14 included in the final rule, the USDA stated that if make
15 allowances are established at too low a level, manufacturers
16 will fail to invest in plants and equipment, and reduced
17 production capacity will result. If make allowances are
18 established at too high a level, there will be unwarranted
19 incentive to increase capacity above the needs of the
20 industry leading to over capacity and resulting in loss to
21 manufacturers.

22 Recent data indicates that the average cost of
23 manufacturing cheddar cheese is substantially less than the
24 make allowance used in the current price mover. This
25 justifies a modification to the formula so that it will

1 better reflect current market conditions. The most recent
2 RBCS survey found the simple average cost for producing
3 cheddar cheese to be 12.422 cents per pound in the 12 plants
4 supplying data for their survey. When this is weighted to
5 the amount of cheese produced in the survey plants, the
6 average cost was 12.92 cents per pound.

7 We note that this cost is significantly below the
8 make allowance used in the final rule. We do not believe
9 that the purpose of the make allowance is to lock in a
10 profit for plants, but rather to reflect the typical cost
11 associated with converting milk to cheese. The actual cost
12 that was found in California was also less than the value of
13 the final rule. The weighted average cost of production was
14 15.9 cents per pound. Including their average return on
15 investment of 1.03 cents brings their average cost up to
16 16.93 cents per pound.

17 Based on the USDA NASS Dairy Products 1999 summary
18 released in April, 2000, California produced 14 percent of
19 the cheddar cheese in the U.S. in 1989 and 15.2 percent of
20 the total in 1999. Based on production trends, it's
21 reasonable to expect the proportionate total they produce
22 will continue to increase in coming years.

23 It must also be noted that the NASS cheese survey
24 prices used in the formula do include cheese from all
25 regions of the country. We were unable to ascertain what

1 portion of the cheese in the survey comes from California,
2 as Arizona, Idaho, Nevada, Oregon, Utah and Washington sales
3 are combined with California in the calculation of the west
4 average price.

5 Cheese is marketed nationally, so the make
6 allowance used to determine national prices must reflect to
7 the greatest extent possible the national cost of
8 manufacturing cheese. In our proposal, we suggested
9 including data from the CDFA survey if the RBCS survey did
10 not adequately reflect California production.

11 It's our understanding that no California data was
12 made available for inclusion in the RBCS survey. Therefore,
13 provision should be made to consider California production
14 costs in make allowance. This is particularly true since
15 over half of the cheese sales included in the NASS survey
16 that is the basic input used in determining Class III mover
17 come from the west. It's reasonable to expect that a
18 significant portion of this cheese is produced in
19 California, so it is appropriate to reflect the cost of
20 manufacturing this product in the formula as well.

21 While certainly not a precise estimate of the
22 weighted average cost of manufacturing based in total cheese
23 production, in the RBCS survey and the CDFA survey appears
24 to provide a reasonable estimate of the cost to include in
25 the formula. I believe this is also consistent with the

1 current system.

2 We also recognize that the plants that remain
3 viable for the long run need to recover return on their
4 investment. We would propose using the estimate of the
5 current return on investment from the CDFA survey for this
6 purpose since the RBCS survey did not provide a similar
7 estimate.

8 The current make allowance includes .0015 cents
9 for marketing. We question the need for including this
10 since producers are already paying 15 cents per
11 hundredweight for marketing and promotion through the check
12 off program. In addition, the NASS survey is based on
13 wholesale prices that should entail minimum marketing costs.

14 Over 70 percent of the cheddar cheese is marketed
15 in a manner that the data is not included in the survey.
16 There would appear to be ample opportunities for processors
17 to recover marketing costs from this product, as well as
18 other Class III product, rather than taking it from the
19 producer price.

20 Based on these considerations, we would propose
21 that the manufacturing allowance be reduced from 17.02 cents
22 per pound to 15.21 cents per pound. I have included an
23 appendix that goes through the calculation of this based on
24 the weights, the cost and weights included in the RBCS and
25 the CDFA survey.

1 Based on the demonstrated changes in the cost of
2 manufacturing cheddar cheese between the data used in the
3 final rule and that currently available, we again suggest
4 including provisions for an annual review of these costs
5 with administrative authority for incorporation of needed
6 changes in the formula. By doing this, the formula could be
7 adjusted to reflect current conditions without the need for
8 expending the time and resources required to make such
9 changes through a formal rule making process. If problems
10 arise, a formal rule making process would continue to
11 provide a vehicle to address them.

12 We continue to support the use of the NASS survey
13 prices in the calculation of the Class III and IV price
14 movers. At the present time, they provide the broadest
15 sampling of competitively determined product prices at the
16 national level. However, we would ask the Department to
17 continue to review these prices in light of the pilot
18 forward contracting provisions that have been published and
19 which will soon be implemented.

20 We recognize that estimates of monthly cheese
21 production and monthly sales volume reported in the NASS
22 price survey are not directly comparable. However, they
23 should show the trends that are occurring. In 1999, sales
24 reported to NASS were 26.6 percent of the reported
25 production of cheddar cheese.

1 We're concerned that the use of forward contracts
2 might significantly reduce the volume of product available
3 for price discovery. It may also have ramifications
4 relative to the quality and thus the price of the product
5 included in these surveys.

6 If the cash market reflected in these prices were
7 to become a market of last resort, it would have a negative
8 impact on producer income. For this reason, we ask the
9 Department to monitor the data included in the NASS survey
10 following implementation of the pilot program to assure that
11 it continues to provide an accurate reflection of market
12 value of dairy products.

13 We appreciate the opportunity to provide this
14 input and strongly encourage the Department to reduce the
15 make allowance used in the calculation of the Class III
16 price mover. We also encourage reevaluation of the
17 underlying assumptions of the pricing formula relative to
18 the percent casein and true protein, the fat recovery in
19 cheese and the fat to protein ratio in milk based on current
20 data and processing technology.

21 We also encourage an annual review of the make
22 allowance and monitoring of NASS survey prices to assure
23 their continued validity relative to market conditions. We
24 are confident that this will provide a better indication of
25 market conditions to all parties and will improve producer

1 income.

2 I'd be happy to take any questions.

3 JUDGE HUNT: Mr. Olson is open for any questions.

4 Mr. Rosenbaum?

5 CROSS-EXAMINATION

6 BY MR. ROSENBAUM:

7 Q Mr. Olson, did you play any role in the conduct of
8 the Rural Business Cooperative Service survey?

9 A No, I did not.

10 Q Okay. Any of your members come to you for advice
11 as to how to fill it out or what information to provide?

12 A We only represent producers. We do not do any
13 processors.

14 Q If I said processors, I mis-spoke.

15 A No.

16 Q I meant to say producers. Do any of your members
17 rely upon the American Farm Bureau Federation for filling
18 out those forms or advice on how to fill out those forms?

19 A Again, we don't do any processing of milk. We
20 only represent milk producers. Milk producers do not fill
21 out those forms. That goes to processors.

22 Q Okay. I stand corrected. I was thinking in terms
23 of the producers who through their cooperatives own
24 processing plants. That's not a function your organization
25 plays, I take it?

1 A That's correct.

2 Q Okay. Now, you understand that under the current
3 product pricing formula you take the price that is gained in
4 the marketplace for the finished product, say cheese, you
5 subtract the make allowance, and what's left over is the
6 minimum price. Do you understand that to be the basic
7 mechanism?

8 A Yes.

9 Q Or to turn it around just slightly the way we
10 learned to do in third or fourth grade, if you take the
11 price of the cheese and you subtract the price you're now
12 required by law to pay the farmers, what's left over is the
13 make allowance, correct?

14 A Yes. Yes, basically that would be it.

15 Q Okay. So that the only thing that a processor has
16 to run his operations is whatever is in the make allowance,
17 correct?

18 A For that portion of the Class III product that's
19 included in the determination, which is a relatively small
20 portion. There's much more production that's not included
21 in that.

22 Q Well, it's based on cheddar cheese, right?

23 A Yes. The NASS survey that's used includes I
24 believe 26.6 percent of the cheddar cheese production in the
25 country, which --

1 Q Well, that's what is used to determine what they
2 think the price is, right?

3 A Right.

4 Q Do you have some reason to think that the price of
5 cheddar cheese that's not in the survey is different than
6 the price of the cheddar cheese that's in the survey?

7 A I would think that it would be because it's
8 handled differently.

9 Q Do you mean if it's aged or something else that
10 causes it not to meet those criteria?

11 A For that, and I have no way of knowing what the
12 price is for other cheese that sold.

13 Q Well, I'm just talking about cheddar. For cheddar
14 cheese that meets the NASS criteria, you don't have any
15 reason to think that the cheese that meets that criteria
16 that gets reported in the survey is different than the
17 cheese that meets that criteria that's not in the survey, do
18 you?

19 A There are several things that determine that. I
20 believe if it's sold in advance on a forward contract it's
21 not included. I would anticipate that those prices would be
22 somewhat different than what the NASS survey price is. I
23 have no indication of what that is, but I anticipate that
24 it's different.

25 Q All right. There may be some cheese that meets

1 the NASS reporting requirements but doesn't get reported,
2 correct? It's a voluntary system. That's all I'm saying.

3 A There may be, and I have no indication what the
4 price is on that.

5 Q Okay. All right. Now, in any event, let's focus
6 on cheddar cheese that meets the criteria for reporting
7 under NASS, and that price determines how much gets paid
8 over to the farmer, and at least as to that, at least we'll
9 agree as to that cheese the make allowance is all that's
10 left to run the operation, correct?

11 A Yes, for that cheese.

12 Q All right. Well, focus on that. You're in
13 agreement as to that cheese if there's not enough money in
14 the make allowance to cover all the costs of production
15 associated with making that cheese then the processor is
16 operating at a loss?

17 A On that particular portion of production.

18 Q Okay. And you would agree with me that that
19 processor incurs some cost of procurement for that milk?
20 Field men, for example.

21 A In most cases they probably have some costs.

22 Q Okay. Administrative overhead of the processing
23 plant?

24 A Obviously there's some. There are some costs
25 associated in operating a plant.

1 Q You know, for example, that the Rural Business
2 Cooperative survey excludes the cost of the plant manager
3 from their calculation?

4 A I know that they exclude the cost of some
5 administration.

6 Q Okay. All right. But that's a cost presumably
7 that's part of making cheese. You would agree?

8 A Yes. It's a cost to a company.

9 Q Okay. You mentioned that producers have a check
10 off program to help promote the sale of dairy products,
11 correct?

12 A Correct.

13 Q I assume those are directed toward consumers like
14 individuals?

15 A The promotion is broad based. It covers
16 everything from the retail food industry that's buying bulk
17 products through exports.

18 Q But you would assume, wouldn't you, that the
19 average processing plant itself incurs some marketing costs
20 for its cheese? Bulk cheese.

21 A I have no indication of what they would. I guess
22 for the bulk cheese I would think it would be relatively
23 small. The amount is relatively small in there.

24 Q Right. But you assume it exists, right?

25 A There may be some. I guess my anticipation and

1 our producers' anticipation is that they are paying to help
2 move product already and feel it's probably appropriate for
3 the plants to also assist in moving product.

4 Q Oh, we think we should. The question is whether
5 you're going to establish a make allowance that makes that
6 impossible because you're not putting it in our make
7 allowance, and we've already established if it's not in our
8 make allowance we don't have it.

9 A For the bulk product where there are minimal
10 costs, I guess the anticipation is that there are other
11 opportunities for recovering cost as well.

12 Q Well, but I thought we just established that all
13 we have left over in the make allowance is the difference
14 between what we can get for our cheese and what we have to
15 pay for the milk. That's it. I mean, that's just how the
16 formula works, isn't it?

17 A If your costs are exactly or if your selling price
18 is exactly the same as what the NASS survey price is.

19 Q Some people are going to be below that, and
20 they'll be under even more pressure, right?

21 A And some will be above it and making additional
22 profit.

23 Q And we're using a weighted average to address both
24 those people, right?

25 A So we're -- yes. Producers feel that they're

1 double paying for marketing by including that. They feel
2 they're already contributing to the marketing of product.

3 Q By the way, I think there's a typo in your
4 statement. The current make allowance for marketing is not
5 .0015 cents. It's .0015 dollars, right?

6 A Yes.

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

8 JUDGE HUNT: Anyone else have questions of Mr.
9 Olson?

10 Thank you very much, Mr. Olson, for coming.

11 THE WITNESS: Thank you.

12 (Witness excused.)

13 JUDGE HUNT: Mr. Schanback?

14 MR. YALE: I thought we were ready for Mr. --

15 JUDGE HUNT: He indicated to me he was going to be
16 leaving early. We'll take you after. I guess he's not
17 here, though.

18 Okay, Mr. Yale.

19 MR. YALE: Thank you.

20 JUDGE HUNT: Mr. Schanback? Okay. Hold on. You
21 indicated you were leaving today, and I wanted to get you
22 in.

23 //

24 //

25 //

1 Whereupon,

2 MARTIN SCHANBACK

3 having been duly sworn, was called as a witness
4 and was examined and testified as follows:

5 JUDGE HUNT: Would you state and spell your name
6 for the record, please, and who you represent?

7 THE WITNESS: My name is Martin Schanback,
8 S-C-H-A-N-B-A-C-K. I'm here as a principal stockholder in a
9 private company, Friendship Dairies. We market primarily in
10 the New York City market and along the corridor from
11 northern New York to and through and including Florida.

12 DIRECT EXAMINATION

13 THE WITNESS: We buy a significant amount of our
14 milk from independent producers, and we augment that supply
15 with an equally significant amount of milk purchased from
16 cooperative organizations in New York state. We formerly
17 marketed -- participated in the market under the old Order
18 II and are now a pool plant in the Northeast Order.

19 My statement covers both the impressions of myself
20 personally through over 40 years in the dairy business, as
21 well as the input that I have been able to receive from
22 advisors and consultants, and my opinions based on their
23 input have been modified by my own knowledge of the industry
24 and in various functions in the industry and in various
25 functions in the industry. I have a small and short

1 prepared statement which I'd like to read into the record.

2 Reducing the make allowance on a product whose
3 main input cost is tightly tied to the selling price of the
4 finished product risks reducing or eliminating the seemingly
5 ugly word profits. It also subjects the pricing mechanism
6 to manipulation by any person who stands to gain from such
7 manipulation.

8 If profits are eliminated, so will be proprietary
9 handlers, and if profits are reduced so are some proprietary
10 handlers. This would be a major factor toward completing
11 the 30 year drive to totally cooperatize the industry,
12 thereby reducing the ability of the producers to freely
13 choose where to market their milk and to maximize the
14 profits therefrom.

15 I've heard testimony advocating the establishment
16 of a make allowance using all different factors and
17 multiples, possibly leading to errors on the too high side
18 or the too low side. I suggest that there is no true
19 correct figure that fits all, and despite many attempts to
20 find one there has never been the ability to do so, and
21 there never will be.

22 The procedure in use today is no less or more
23 correct than any of the proposed new methods. The big
24 difference is that by trying to tie the knot too tightly you
25 are assuring the demise of the proprietary operator who must

1 pay producers the minimum prescribed price.

2 Are you of the opinion that the cooperatives can
3 do a better job of processing milk into end product and
4 passing the consumers' dollars back to the farmers? If not,
5 we're on the wrong track. Many natural economic forces tend
6 to balance a truly free market. If those forces are
7 eliminated or even if they are reduced, so are the abilities
8 of the market to stabilize itself.

9 One example of these forces are if a proprietary
10 handler seizes profit increase beyond his expected return.
11 That handler is very likely to attempt to maximize his
12 return by expanding his operation. He will need more milk,
13 and unless the market has more milk available than it can
14 process, he will likely have to pay or increase premiums
15 paid to farmers. All involved have benefitted -- the
16 handler, the producer and even the consumer -- as more
17 product will lead to more and better supplies and choices
18 for the consumer to fill his needs.

19 If the proponents of capturing every squeak have
20 their way, the ability to pay and receive premiums is
21 eliminated. The incentive to develop new products is
22 destroyed, and the industry consisting of both the handler
23 and the producer is hogtied and well on the way to
24 self-destruction.

25 Assuming for the moment that the make allowance is

1 too high, why is it too high? Isn't it in part because a
2 handler has invested and innovated, has increased yields,
3 developed and invested in new equipment, double O vats and
4 whey curd separators to capture the last quarter ounce of
5 product, invested huge sums in whey dryers and developed a
6 market for dried whey, developed high yield starters and
7 fast curing processes to reduce the cost of inventory, et
8 cetera, et cetera.

9 Take away incentive, and you take away the reasons
10 for one to innovate and, for that matter, even reasons to
11 continue to exist in business.

12 I thank you.

13 JUDGE HUNT: Any questions of Mr. Schanback? Mr.
14 Christ?

15 CROSS-EXAMINATION

16 BY MR. CHRIST:

17 Q Mr. Schanback, I'm Paul Christ from Land O'Lakes.
18 Could you describe your business, Friendship Dairies,
19 please?

20 A Yes. We're in a prime business of a Class II
21 producer of soft products and cultured products in fluid
22 form.

23 Q Okay. Do you have more than 500 employees?

24 A We do not.

25 Q Okay. And would you characterize yourself as a

1 small business in that respect?

2 A Absolutely.

3 Q Okay. But your primary business is Class II, not
4 Class I?

5 A That is correct.

6 Q Do you engage in Class I sales?

7 A We have a small amount of Class I sales.

8 Q Does this operation produce surplus cream from
9 your Class I sales?

10 A No.

11 Q You do not --

12 A I'm sorry. Let me correct that. The answer
13 technically is yes.

14 Q Okay. And then that surplus cream is absorbed
15 within your own operation?

16 A That is correct.

17 Q And you don't sell it to butter manufacturers or
18 other --

19 A No. We sell very little or no cream to outside
20 operators.

21 MR. CHRIST: Okay. That takes care of it. Thank
22 you.

23 JUDGE HUNT: Any other questions of Mr. Schanback?
24 Mr. Berde?

25 MR. BERDE: Just a short question.

1 BY MR. BERDE:

2 Q I take it then that the question of what level the
3 make allowance should be that's at issue in this proceeding
4 does not really affect your operation. Is that correct?

5 A It does not affect my operation directly.
6 However, to the extent that the proponents of changing the
7 Class IV base price directly reflects on the Class II base
8 price, it does affect it from that viewpoint.

9 Q And that's the only concern that you have with the
10 proposals that are being considered at this hearing?

11 A Absolutely not. I have major problems with the
12 thought that in restricting the ability of independent
13 operators to operate in a profitable way within the order
14 structure will reduce the number of those operators, and I
15 might well be one of those who will get reduced.

16 Q But that's a general philosophical comment on the
17 entire concept of regulation of your industry, isn't it? I
18 mean, it has nothing to do --

19 A No.

20 Q -- specifically with the impact of the make
21 allowance issues or proposals on your direct operations as a
22 Class II handler.

23 A No. That's no so at all. I am much concerned
24 with the loss of flexibility that proposals of the very type
25 you are considering today have in the past and seem to be

1 headed in the future, what restrictions that will put on the
2 ability of the independent proprietary operations remaining
3 in business.

4 If you restrict the flexibility, we cannot be
5 competitive with the cooperative organizations who are also
6 in similar or the same business that we are.

7 MR. BERDE: Thank you.

8 JUDGE HUNT: Mr. Vetne?

9 BY MR. VETNE:

10 Q Mr. Schanback, I'm John Vetne. I represent Kraft
11 at this proceeding.

12 I'm concerned about the products that you make
13 that you've identified, leaving the impression that that's
14 all you do. You also have a line of Class III cheese that
15 you market. Is that correct?

16 A That is correct.

17 Q And this is a farmer cheese that has a bit less
18 fat in it than cheddar cheese. Is that correct?

19 A That is also correct.

20 Q And on occasion you also make both of the Class IV
21 products, butter and powder?

22 A We operate a self-contained, fully balanced
23 manufacturing operation. We do make Class IV product. We
24 make Class III product. We make Class II product and Class
25 I.

1 Q Okay. And the Class III product that you make, by
2 the way, the cheese line, that is a product that is marketed
3 along the east coast down to Florida?

4 A That is correct.

5 MR. VETNE: Thanks.

6 JUDGE HUNT: Anyone else?

7 Thank you very much, Mr. Schanback.

8 THE WITNESS: Thanks for the opportunity.

9 (Witness excused.)

10 JUDGE HUNT: If Mr. Yale will bear with us, we'll
11 have a short break. You can set up. We'll get to you right
12 away.

13 MR. YALE: It's my mistake for not being ready
14 Monday.

15 (Whereupon, a short recess was taken.)

16 JUDGE HUNT: Back on the record.

17 Whereupon,

18 GEOFFREY T. VANDEN HEUVEL

19 having been duly sworn, was called as a witness
20 and was examined and testified as follows:

21 JUDGE HUNT: Would you state and spell your name,
22 please?

23 MS. REED: Your Honor?

24 JUDGE HUNT: Yes.

25 MS. REED: If I may quickly? My name is Kristine

1 Reed, and I'm here on behalf of the proponents to Proposal
2 No. 1. As a preliminary matter before Mr. VandenHeuvel
3 testifies, we have a couple of exhibits that I'd like to
4 have marked.

5 JUDGE HUNT: Do you want to distribute those?

6 MS. REED: They're available in the back of the
7 room.

8 JUDGE HUNT: Okay. All right.

9 MS. REED: Okay. The first one is titled Tables
10 and Figures in Support of --

11 JUDGE HUNT: These are proposed exhibits?

12 MS. REED: Correct.

13 JUDGE HUNT: All right.

14 MS. REED: This is in a booklet form. People that
15 picked up the testimony in the back of the room, this is
16 actually the back half of Mr. VandenHeuvel's testimony, so
17 it's incorporated in that book.

18 The second exhibit that we have --

19 JUDGE HUNT: Let's go through them in sequence,
20 and I'll assign numbers to them.

21 MS. REED: Okay.

22 JUDGE HUNT: So the first one, that would be
23 proposed Exhibit 25. What's the identification for that?

24 MS. REED: Tables and Figures --

25 JUDGE HUNT: Tables and Figures --

1 MS. REED: -- in Support of Testimony of Geoffrey
2 VandenHeuvel.

3 JUDGE HUNT: Okay. All right. That's 25.
4 (The document referred to was
5 marked for identification as
6 Exhibit No. 25.)

7 MS. REED: Okay.

8 JUDGE HUNT: All right.

9 MS. REED: And the second one was a separate
10 document at the back of the room, and that one is the
11 Addendum to Tables and Reports in Support of the Testimony
12 of Geoffrey VandenHeuvel.

13 JUDGE HUNT: All right. That will be assigned
14 Exhibit No. 26.

15 (The document referred to was
16 marked for identification as
17 Exhibit No. 26.)

18 MS. REED: That's it. Thank you.

19 THE WITNESS: Your Honor, do you want me to state
20 my name and spell it for the record?

21 JUDGE HUNT: Oh, yes. I'm sorry. Please. Yes.

22 THE WITNESS: My name is Geoffrey VandenHeuvel.
23 The first name is spelled G-E-O-F-F-R-E-Y. The last name is
24 spelled V-A-N-D-E-N, capital H-E-U-V-E-L.

25 JUDGE HUNT: All right. Mr. Yale?

1 DIRECT EXAMINATION

2 BY MR. YALE:

3 Q Mr. VandenHeuvel, what is your primary vocation at
4 this time?

5 A I'm a dairy farmer.

6 Q And where is your dairy farm located?

7 A Chino, California, which is in southern
8 California, near Los Angeles.

9 Q And how long have you been a dairy farmer?

10 A Over 20 years.

11 Q Do you have any other responsibilities other than
12 operating -- well, let's take this. In the dairy industry,
13 other than operating the dairy farm have you performed any
14 other functions in the dairy industry?

15 A I have. Currently I am a consultant to Milk
16 Producers Council, which is a dairy producer trade
17 association, and I do state milk pricing issues for them, as
18 well as other environmental and water issues.

19 Q And how long have you been doing that?

20 A Probably directly four to five years.

21 Q Okay. Indirectly, how long have you been doing
22 that?

23 A I've been involved in dairy pricing issues
24 primarily in the State of California as far back as 1983.

25 Q All right. When you say dealing with dairy

1 pricing issues in California, could you explain and lay out
2 in the record what type of proceedings those would be and
3 how you would be involved?

4 A California has its own state Milk Pricing Order,
5 and it makes changes in that state Order through a hearing
6 process, an administrative hearing process, and I've
7 participated in those hearings.

8 Q In what capacity, I mean in terms of function,
9 have you participated in those hearings?

10 A I've been a witness. I've been a lead petitioner.
11 I've been involved in a variety of capacities.

12 Q And how many times have you testified at these
13 hearings?

14 A I don't have a count, but California holds
15 hearings quite often, and I don't miss many.

16 Q Could it be several dozen over the years?

17 A I couldn't say for sure, but it's quite a few.

18 Q Now, in California do they have end product
19 pricing?

20 A They do.

21 Q And have you been involved with the end product
22 pricing, the development of that through the hearing process
23 in California?

24 A Yes, I have.

25 Q Explain in the record and to those here present

1 the degree to which you've been involved in that.

2 A Actually, when I began to become involved in dairy
3 pricing issues, California had their class -- they had a
4 Class IV-A and a IV-B, IV-A covering milk used for butter
5 and powder, IV-B covering milk used for cheese, but they
6 were identical prices, and it was primarily a butter/powder
7 formula as far as the make allowances and yields and so on
8 were concerned.

9 I was involved then in 1989 they broke the IV-A
10 and IV-B apart and established a cheese formula for IV-B. I
11 was part of that hearing that developed that and subsequent
12 updates to those as time has passed where those various
13 formulas have been modified, make allowances have been
14 adjusted. I've been involved in all of that, all the
15 mechanics of that.

16 Q All right. When is the most recent time that you
17 participated in such a rule making proceeding?

18 A In California?

19 Q Yes.

20 A There was a hearing just recently on Class I that
21 I was involved in.

22 Q What about Class IV-A and IV-B?

23 A The last time to my recollection those were
24 extensively evaluated was in the fall of 1997.

25 Q And what was your role in those hearings?

1 A I was one of the lead petitioners in that hearing.

2 Q And when you say lead petitioner, what did that
3 involve?

4 A The hearing was called in response to a petition
5 that I submitted on behalf of Milk Producers Council.
6 Subsequent to my submitting of that petition on behalf of
7 Milk Producers Council, others did join and come up with
8 other proposals, but as such the Department identified me as
9 a lead petitioner, and in California, unlike the federal
10 proceedings I'm becoming aware of, there's a time allocated
11 to a lead petitioner, so I received an hour to make my
12 presentation.

13 Q Is that a recommendation that you have today?

14 Besides your participation as a consultant and in
15 the CDFA proceedings, what other areas have you been
16 involved in with end product pricing on a professional
17 basis?

18 A I managed a co-op, a marketing co-op, in the early
19 1990s where we sold to a small cheese plant, and we did
20 negotiate with that cheese plant a protein premium program.

21 Prior to that I had shipped my own milk to another
22 cheese plant which had a protein pricing program, and so as
23 protein became an issue that affected me directly
24 financially. I had an interest in learning all that I could
25 about the effects of that, of milk and protein on cheese

1 yield, and those became relevant issues to me.

2 Q During the development of -- you're aware of the
3 Fair Act of 1996? Is that right?

4 A Yes.

5 Q Okay. During the development, during the rule
6 making proceeding step, did you have any participation in
7 that on a consulting basis or reviewing the information that
8 was out?

9 A In the development of the congressional --

10 q No. I'm talking about during the development of
11 proposals and discussion of proposals.

12 A Yes. In my responsibilities to Milk Producers
13 Council and then to the extent that Milk Producers Council
14 was a participant with other dairy producer trade
15 associations as part of the Western States Dairy Producer
16 Trade Association, I had the responsibility of analyzing
17 those proposals, their impacts on various prices for the
18 members of that organization for the board of directors so
19 that we could take appropriate positions and so forth.

20 Q Very well. Who are you here to testify on behalf
21 of?

22 A Testimony is given on behalf of Select Milk
23 Producers, a New Mexico marketing cooperative in Artesia,
24 New Mexico, with producers in New Mexico and Texas; Elite
25 Milk Producers, a Texas milk marketing cooperative in

1 Dublin, Texas; and Continental Dairy Products, Inc., in
2 Ohio, a milk marketing cooperative of producers in Ohio,
3 Michigan and Indiana.

4 I'm also testifying on behalf of Western States
5 Dairy Producers Trade Association, and that includes dairy
6 producers in New Mexico; Texas Association of Dairymen; Milk
7 Producers Council in California; the California Dairy
8 Campaign; Western United Dairymen California; Idaho
9 Dairymen's Association; and Utah Dairymen's Association.

10 Q Would you please explain what Western States Dairy
11 Producers Trade Association is?

12 A Yes. It's an organization that's made up of --
13 its membership is those various dairy producer trade
14 associations.

15 Q And what is its primary goal or purpose?

16 A Well, the real purpose that prompted bringing all
17 those various groups together was the realization that what
18 was happening with reform of Federal Orders was going to
19 impact us and that we needed to work with other producers in
20 the west to make sure that our concerns were heard and that
21 we could work together to accomplish our goals.

22 Q Okay. Approximately how much milk is represented,
23 do you recall, by those producer groups?

24 A I don't directly recall, but it's a pretty
25 significant sum of milk.

1 Q What Federal Orders are these producers
2 participating in?

3 A I believe all of them except for the Northeast.

4 Q You said the Northeast, right?

5 A Correct.

6 Q Okay. So ten of the 11 Federal Orders have
7 producers who are pooled and participating in those Orders
8 that are represented by either one of these co-ops or one of
9 these producer trade groups? Is that correct?

10 A That is my understanding.

11 Q Very well. You have some testimony here on behalf
12 of Proposals 1 and others that are other being presented by
13 these trade groups and these cooperatives?

14 A That is correct.

15 Q Very well. If you want to go ahead and proceed
16 with that?

17 A Okay. I'm going to try to get through this as
18 quickly as possible, the written testimony.

19 How we will approach rule making. Setting the
20 proper minimum prices for Class III and Class IV is
21 essential. As the first hearing formulating end product
22 pricing, it is also important to establish a framework and
23 methodology that will insure predictability and stability
24 not only in the pricing, but in the rule making process
25 itself.

1 The prices coming from this record must be based
2 upon sound economics, solid product formulas and valid
3 assumptions. Properly done, we will discover the price
4 rather than bureaucratically setting the price. In that
5 regard, our proposal is at first a comprehensive proposal
6 that adopts the manufacturing pricing formulas in the final
7 rule and then adjusts them to conform to recognized industry
8 standards and conventions. This should be the framework
9 upon which the proposals in this hearing are evaluated and
10 upon which the rule is chosen.

11 Secondly and equally important, our proposal
12 identifies the values these formulas will use to compute
13 monthly prices. The values will either be constant based
14 upon solid assumptions of industry practice or reasonable
15 methodologies to obtain the numbers each month for the
16 formula.

17 Finally, by approaching the choice of formula
18 correctly and assigning the appropriate numbers, the result
19 will result in the value of milk used for manufacturing. In
20 short, this framework must tell us what the price is rather
21 than decide what price producers should receive and contrive
22 formulas and numbers to approximate this preconceived price.

23 After all is said and done, there is still a
24 marketplace for dairy. Any pricing regulation of this sort
25 will impact this market, and by trying to figure out what

1 the market tells us about the value of milk as we propose
2 such should have a minimal impact on the day to day market
3 functions.

4 On the other hand, imposing price levels in spite
5 of actual data will seriously distort the market. What we
6 are trying to do, the role of establishing minimum Class III
7 and IV prices, is to discover the price and insure that all
8 producers receive the minimum price the market should be
9 paying. We are trying to replicate what happens in the
10 marketplace between a willing buyer and seller of milk.

11 Unfortunately, there is no free market sales of
12 Grade A milk to provide that amount. The BFP futures on the
13 CME and CSCCCE are not mature enough to provide this
14 service. There is, however, a free market in the sale of
15 end products, such as butter, cheese and nonfat dry milk.
16 By applying in reverse a conversion factor and rate, we can
17 determine what the value of raw milk should be based upon
18 the commodity values.

19 In short, we can approximate what the market would
20 pay for raw Grade A milk based upon the prices of butter,
21 cheese and nonfat dry milk. End product pricing simply
22 reverses the flow of goods and money. It starts with the
23 finished product and works back to the raw product.

24 The reason that this can work when designed
25 properly is that a manufacturing plant on a long-term basis

1 will pay in a competitive market the difference between what
2 it generates in sales, a function of its sales of product
3 and yield, less its cost to convert raw milk to finished
4 product.

5 We prefer the term conversion margin over make
6 allowance because what needs to be considered is the cost to
7 take raw milk from the receiving dock, make a salable
8 product, sell it and collect the money. The conversion
9 margin looks primarily at gross dollars implicitly
10 incorporating the other essential factors such as product
11 prices, product yields and other factors that contribute in
12 converting raw milk to a finished product.

13 There is in reality more than just make involved.
14 The final rule's use of end product pricing is based upon
15 the sound assumption that a plant in competition with other
16 plants for the milk supply will pay its producers all it can
17 afford after taking into account what it sold the product
18 for and its conversion margin. This is not the payment of
19 premiums because this amount actually represents the true
20 value of milk as determined by the marketplace.

21 This is not the only side of the equation. It
22 also costs money to produce milk. Like the processing
23 plant, over the long term a person cannot continue to
24 produce milk while selling it at a loss. For a lot of
25 reasons -- economic, economies of sale, cultural and legal

1 -- dairy producers cannot recover from the plants increases
2 in producer costs as easily as the plant can recover
3 additional costs through high costs, changes in product mix,
4 changes in scale and other market and manufacturing
5 conditions.

6 During the rule making phase under the Fair Act,
7 we proposed a market driven competitive pricing program. We
8 are not going to revisit that issue at this time. The
9 Secretary has made the decision to use end product pricing
10 with an elegant system that converts the four most common
11 dairy commodities sold, butter, cheese, nonfat dry milk and
12 dry whey, into four components, butterfat, protein, other
13 solids and solids nonfat, which are the elements of four
14 class prices. Because so much good work has been used in
15 building this system, our proposal will suggest only a few,
16 but critical, modifications of what the Secretary has
17 already promulgated.

18 In summary, we believe that end product pricing is
19 acceptable so long as it truly reflects free market
20 commodity prices, honestly approximates the full use of the
21 milk in the processing of milk into products and provides a
22 legitimate conversion cost of average plants. Failing to
23 use a free market price or improperly by mistake or design
24 to approximately reflect the conversion costs will render
25 end product pricing a scheme that ceases to be a tool to

1 assist the dairy industry, but instead is a weapon against
2 it. Determining which it will be is the real challenge in
3 this hearing.

4 How we will evaluate the proposals. The Secretary
5 has identified the measurements. In the development process
6 of the reforms under the Fair Act, the BFP committee
7 identified in a preliminary report on the alternatives to
8 the basic formula price, April, 1997, the following criteria
9 for replacement of the BFP. Stability and predictability,
10 simplicity, uniformity and transparency, sound economics,
11 reduced regulation.

12 The Secretary accepted these criteria as a means
13 to meet his three goals of the BFP replacement. Those three
14 goals are A, the replacement must meet the supply and demand
15 criteria set forth in the Agriculture Marketing Agreement
16 Act of 1937. B, the replacement should not deviate greatly
17 from the general level of the current BFP. C, the
18 replacement should demonstrate the ability to change and
19 reaction to changes in supply and demand.

20 There are some Federal Order citations there.
21 Though the final rule has been implemented, we are in the
22 final phase of this reform, and these standards should
23 continue to guide us. Our standards.

24 In addition to these, we believe it prudent to
25 evaluate any revision to the final rule with this

1 requirement. The revision must do only the minimal amount
2 of change to the structure of the final rule's pricing
3 program necessary to correct the few errors. The numbers
4 may need significant revision, but the overall structure is
5 well designed and deserving of continued use.

6 Finally, implicit in all of these is the principle
7 that in using end product pricing, all of the marketable
8 product the plant receives will be reflected in the pricing
9 formulas.

10 How we will judge compliance with these goals and
11 criteria. Any revision to the final rule must satisfy all
12 of these criteria. Our proposal certainly does. Rather
13 than detail each of them now, we want to address in more
14 detail just two. These two are the ones which the final
15 rule missed, the goal that the replacement should not
16 deviate greatly from the general level of the current BFP
17 and the criteria that any BFP replacement should reduce
18 regulation. We address those primarily.

19 Number one. The final rule does result in prices
20 that deviate greatly from the general level of the previous
21 M-W and BFP. Over the years, USDA and others have compiled
22 a number of competitive price series, producer pay price
23 series, as well as various product price series. Though
24 these are historic and thus cannot tell us the value of milk
25 today, we can learn from the relationship between a product

1 series and a contemporary producer pay price series what the
2 market has either dictated or tolerated in terms of
3 conversion margins for milk made into cheese.

4 This goal of no grade deviation in pricing means
5 that we must compare the final rule's results with historic
6 relationships between listed cheese prices and producer pay
7 prices. From the outset, it is necessary to define greatly.
8 For dairy producers, a loss of one dime a hundredweight on
9 all milk for the year is a great deviation.

10 One dime in the FMMO system for the year
11 represents a change of \$100 million to producers. In rural
12 America, that multiplies three to seven times in the economy
13 and represents as much as one-half to two-thirds of a
14 billion dollars to the rural economies in the FMMO system.

15 These losses are off the top. That is, if
16 everything else is in order, these losses mean that
17 producers do not have money to live their lives like others.
18 There's less money for cars, appliances and clothes.
19 Luxuries such as a meal at a restaurant or a tip are
20 reduced. College education is curtailed. When encountered
21 at the producer level, these are real losses that have real
22 effects and deserve real concern.

23 In all of the discussion about pricing in the Fair
24 Act, reform process and the proposals submitted in this rule
25 making proceeding, no one has argued that current market

1 conditions demand that the Secretary take an active role in
2 reducing producer prices. There is no evidence that
3 producers should receive a smaller share of the dairy dollar
4 than they have in the past. It is incumbent that any
5 revision insure that these reductions do not occur.

6 One historical relationship is the difference
7 between the market prices as stated on the NCE and the CME
8 as compared to the M-W or BFP prices for that month. Using
9 the NCE or National Cheese Exchange, CME, Chicago Mercantile
10 Exchange, price series for 40 pound blocks, we subtracted
11 the BFP for the month to derive an approximate conversion
12 cost as shown in Table 1, Implied Conversion Margin, NCE to
13 BFP, 1991 to 1999.

14 The 1991 to 1999 shows the maximum, minimum and
15 mean conversion margins for 1991 through 1999. Prior to
16 1999, the average implied conversion margin was about \$1.20.
17 For the period July, 1998, through 1999, it was \$2.04.
18 Figure 1 shows graphically the wide swings in conversion
19 margins in late 1998-1999.

20 Figure 2 plots the implied conversion margins from
21 1991 to 1999. You can see those in the exhibits in the
22 back. Do we have that one, Kristine?

23 Q Mr. VandenHeuvel, that appears as Figure 1 in one
24 of the exhibits on the table.

25 A Okay. On the table in the back, you can see the

1 implied conversion margins, and the mean is the red line.
2 That's what we're referring to. The data for that to back
3 that up is right before it with Table 2 being the summary of
4 that data.

5 Thus, to suggest that the period of 1999
6 represents the right relationship of pricing is to say that
7 an implied conversion margin of over \$2 is appropriate. It
8 is not. During a time when manufacturing costs are
9 shrinking as reported by both the RBCS studies and the
10 recent CDFA manufacturing cost study, there is no
11 justification for increasing conversion margins by as much
12 as 60 percent.

13 The final rule significantly and radically
14 increases regulation. The final rule does something never
15 done before. It sets the minimum prices that producers will
16 receive rather than discovers them, as in the past. The use
17 of the NASS survey, one designed and collected and reported
18 by USDA as the price series, coupled with a fixed, simple
19 arithmetic conversion margin, tells what plants will pay for
20 Class III and Class IV milk in most of the country. Instead
21 of two numbers, BFP and III-A, announced once a month, we
22 now receive 15 numbers weekly, and they are subject to
23 revision for several weeks. In total, we receive over 60
24 numbers per month to compute a price.

25 The NASS survey prices are not without challenge.

1 Virtually every proposal sent to AMS dairy programs
2 regarding the NASS survey either requested it be replaced or
3 that there be mandatory reporting and audits. In other
4 words, more regulation is necessary to support the
5 additional regulation.

6 The introduction of make allowances is new. As
7 California has shown, the cost of converting end product
8 prices to raw milk prices is an ongoing and tedious exercise
9 in adjustments after adjustments; more regulations still.
10 Our proposal cannot end this because some regulation comes
11 with end product pricing, but we should strive to keep it to
12 a minimum until a market replacement is found.

13 Looking at the implications to dairymen, another
14 important tool is to look at price levels in terms of the
15 long-term economic viability of producers. It is
16 fundamentally wrong to say that the dairy policy is right so
17 long as there is enough milk. Instead, dairy policy must be
18 established to insure that the supply side of milk is
19 supplying enough milk to a level that is reasonably
20 profitable to a large enough base of producers to insure
21 continued supply of milk. Not only is this fair in light of
22 considerations of plant viability, but the AMAA requires
23 such consideration.

24 Q Mr. VandenHeuvel, you indicated there at the top
25 of page 8 that there was a great deal of regulation and rule

1 making with California. Do you not have as Table 4 as one
2 of the exhibits, and it's not cited in there, the list of
3 the California hearings?

4 A Yes. Just as an example, we've included a list.
5 These are the just hearings going back to 1978, and it's
6 basically there just to demonstrate the amount of hearings
7 that California held between 1978 and 1995.

8 I can assure you that the pace of hearings has not
9 slowed. They are still continuing to need lots and lots of
10 hearings, which is the nature of doing this type of
11 regulation.

12 Q Thank you. Go on.

13 A What we will not be doing. Relying upon
14 competitive premiums to make up the difference between the
15 value of milk and the minimum price. Repeatedly we hear
16 comments that these are minimum prices and that the market
17 will make up the difference. This is both an advocacy of
18 the statutory mandate to do what the market will not do,
19 give producers a fair price, and wishful thinking that what
20 has not happened in much of the country will suddenly
21 appear.

22 Primarily in the west there exists an
23 institutional prohibition to premiums for milk used in
24 manufacturing. Due to long-term contracts at class prices
25 and other factors, the minimum price for manufacturing will

1 be the price for producers. Economic theory is thwarted by
2 marketplace reality. In the west, there will not be
3 premiums to make up for incorrect formulas caused by these
4 formulas that are in the current final rule.

5 Finally, to those who argue that the market will
6 make up the difference, they fail to answer the questions of
7 when and how. That is, there will be the creation of a
8 market equilibrium in time. That does not mean that prices
9 to producers will go up. It could mean that producers will
10 go out of business and/or reduce costs to sell milk even
11 cheaper. If the correction will eventually mean more money
12 to producers, that statement does not answer the question of
13 when.

14 The AMAA was formulated in response to the failure
15 of competition to provide adequate prices for milk to
16 producers. That need still exists. Producers will compete
17 for sales by pricing their product lower and lower until
18 neither they nor their competitors can survive. That is as
19 true today as it was 60 years ago.

20 The market that is supposed to fill in the
21 shortfall is the same market that has repeatedly failed
22 dairy producers. It is the same market whose failure
23 brought Congress into the issue and directed that the
24 Secretary use his power to withstand these market forces on
25 behalf of producers.

1 Experience in marketing milk tells us that due to
2 seasonable production and counter seasonal demand, the long
3 supply months are longer than the short supply months.
4 There is simply not enough time for producers to bargain
5 during the short months so as to capture the losses earlier
6 in the months of long supply. Even the upcoming long months
7 reduce the ability to capture the price during short times
8 because preservation of market is as important as momentary
9 opportunity.

10 The reform should not unfairly induce higher than
11 market prices to producers. We do not view this program and
12 the prices we propose as being used to supply income to
13 producers in excess of what the market will and can bear.
14 Further, this is not a replacement to the dairy price
15 support program.

16 The reform should not create an incentive to build
17 more plants than the market demands. There is no shortage
18 of plants. It is not the policy under the AMAA to develop
19 manufacturing plant capacity in the nation. As a result of
20 regulatory pricing programs, generous conversion margins
21 that will encourage undue expansion of processing should be
22 avoided.

23 The reform should not model California. The
24 California system represents the ultimate in regulatory
25 pricing, as opposed to free markets. It establishes the

1 highest degree of government interference in agricultural
2 markets by setting the prices that all plants must pay to
3 producers. These prices are the result of a policy driven
4 by a mercantilist state policy on dairy and supported by
5 policies in direct contradiction to the AMAA.

6 By mercantilist, we mean that the state uses its
7 powers to provide its merchants a significant competitive
8 advantage in the marketplace, both domestic and foreign.
9 The California system is an all play/all pay program. That
10 contrasts with the Federal Milk Order program, which is
11 voluntary for producers, and only Class I processors with
12 distribution in regulated areas are subject to regulation.
13 All others can or cannot participate as they wish.

14 The California pricing system is a direct result
15 of the all play/all pay system. In order that processors
16 are not burdened with so high a cost for product that they
17 must refuse to take milk, regulatory prices are very low and
18 are designed to give plants a cushion in the manufacture of
19 milk products to avoid that result.

20 California has shown the ability and willingness
21 to quickly modify its programs to meet its own policy goals.
22 Attached is Table 4, which we referred to earlier. It lists
23 a series of hearings held by California resulting in a
24 modification of pricing formula or prices paid to producers.
25 The FMMO cannot respond so quickly and so often, nor should

1 it.

2 Keeping California's processing plants competitive
3 is a very high priority of the California program. The
4 California program has its roots in different legislation
5 with a different policy goal than that of the AMAA. Giving
6 processing plants a competitive advantage is not a high
7 priority under the AMAA. It would be inappropriate, if not
8 futile, for the Secretary to embark upon a course of pricing
9 that sought to match California or respond directly to its
10 pricing.

11 Our proposal. The Secretary has determined that
12 end product pricing is the means to discover prices paid to
13 producers. In the current regulations, the formulas are as
14 follows, and you can read them there. Each of these four
15 formulas are comprised of assumptions, variables, constants
16 and policy decisions. Which is which is not easily
17 identified by looking at these formulas.

18 As a first step to analyzing these formulas, we
19 need to identify each of their respective elements. Each of
20 these are elements of the basic formula. One pound of
21 component dollars, the value of one pound of the component,
22 equals one pound of commodity price less a conversion margin
23 divided by the pounds of components in one pound of the
24 commodity.

25 Because protein is derived from cheese and it

1 contains three components, including protein, its formula is
2 a bit more complicated, but that is explained in more detail
3 later. Nonetheless, it is a function of the same formula.

4 This basic formula has three elements, commodity
5 product price, the make allowance and the yield. This can
6 easily be remembered as PAY for product, allowance and
7 yield. The PAY is found as follows in the formulas.
8 Protein. You have the cheese price minus a make allowance
9 times the yield plus cheese price minus a make allowance
10 times a yield less the butterfat price times 1.28. We go
11 through that.

12 The make allowances you can see as the 17.02 cents
13 we've been talking about today and this week is the make
14 allowance. The yield. You can see the numbers, the 1.405
15 in the protein part of the cheese price pattern on the
16 VanSlyke and then the 1.582, and the 1.2 is also somewhat of
17 a yield conversion factor.

18 On the solids nonfat you have a powder price
19 divided by 1.02, the butter price less the make allowance
20 divided by .82, and the other solids being a dry whey price
21 and then the yield being divide by .968. All three of these
22 factors must be viewed in conjunction with each other. Each
23 is interdependent upon the other. Any change in one
24 variable necessarily results in changes in the other two
25 variables.

1 Product price series is the reported price for the
2 commodity to be used to compute the value of the various
3 components. The product price series is more than a
4 decision of where the number comes from, such as whether it
5 is a NASS or a CME cash settlement price, but what commodity
6 is to be included, what are the standards of the product and
7 at what market will the price be set.

8 We choose the CME over NASS for several reasons.
9 For all but dry whey, we propose the use of the cash
10 settlement price on the CME. Dry whey is not recommended
11 because there is no trading of dry whey on the Chicago
12 Mercantile Exchange at this time. This is the first time
13 the USDA will set prices for a commodity. Using the NASS
14 survey in the current context is more than price reporting.

15 On dairy, the reporting in the NASS survey is the
16 first step in an automatic process to setting producer
17 prices. That is what is happening in livestock and other
18 commodities. In dairy, the USDA proposes to set prices.
19 The difference between what producers will be paid and the
20 USDA reported NASS price is simply an arithmetic function of
21 conversion values through yield and make allowance. We do
22 not oppose collecting and reporting NASS data. It is very
23 important as information. It simply should not dictate
24 prices.

25 B, the CME immediately reflects supply and demand.

1 CME reflects daily supply and demand. Plants can and will
2 respond to those daily price changes. Waiting up to 11 days
3 to find out what is happening in the NASS creates delay in
4 the system.

5 I'm going to skip the next paragraph and sentence.
6 We'll get to that issue later.

7 CME is much simpler. Many of the issues
8 accompanying the use of the NASS are avoided. There's no
9 need to decide whether to use barrels as well, moisture
10 levels and production amounts. When entering weekly data to
11 compute the various class prices, there would only be four
12 entries with our proposal, CME cheese 40 pound blocks, CME
13 nonfat dry milk, CME AA butter and NASS dry whey price.

14 Entry of data for the NASS price series as
15 currently used requires ten entries alone for cheese,
16 assuming the remaining can be computed, and two each for the
17 remaining three commodities. The use of the CME is
18 consistent with the criteria of simplicity, uniformity and
19 transparent.

20 D, CME is open and honest. To be sure, the price
21 in the CME is manipulated. It is manipulated by buyers,
22 sellers and speculators each trying to manipulate in their
23 favor the price, but supply and demand forces cause the
24 setting of the real price. The rules are fair, and the
25 results are transparent. There are many players on all

1 sides of the transaction, and any one of them can play.

2 In contrast, the NASS can only be manipulated by
3 sellers of cheese. They are not disinterested parties.
4 There are no rules insuring fairness among the few players.
5 Even the reporting of NASS as compared to the CME shows the
6 ability to manipulate. Each Friday, NASS publishes the NASS
7 prices. Plants can modify their numbers or report for the
8 first time after easily calculating what impact the new
9 reporting will have on the price. If they wish, they can
10 withhold the information if it increases the price and
11 report it if it lowers the price.

12 A comparison of the first 17 NASS weekly reports
13 in 2000 shows that in subsequent weeks there were 11 changes
14 to cheese prices, and eight were decreases. With the CME,
15 the decision is instant, and the results cannot be altered.

16 E, the NASS needs to be fixed before it can be
17 used and trusted. In virtually every request to the
18 Secretary for proposals in this hearing that involve the
19 price series, those that did not request a series other than
20 NASS requested that it be audited and made mandatory. These
21 demands illustrate the general consensus that the NASS as it
22 stands now is inherently incorrect. There is no assurance
23 that all the right numbers have been given. The selected
24 use of this information can and will be a tool to manipulate
25 pricing.

1 The mandatory requirement is not improper.
2 There's nothing to prevent manufacturing plants from
3 selectively reporting sales prices. Further, discounts,
4 delays in payment, special packaging and other
5 considerations in the real marketplace are not factored into
6 this price.

7 Mandatory is not the issue. We are trying to
8 force the entire market price through a single number. We
9 will choke on that. There is nothing to prevent plants from
10 indexing their sales on the NASS price, mandatory or
11 voluntary, so long as it sets prices paid to producers.

12 Another issue of mandatory pricing needs to be
13 considered, and that is the law of unintended results. One
14 can disqualify a plant from reporting by simply changing the
15 product mix or the way a product is sold. As shown in the
16 NASS survey reports, only natural, unaged cheddar cheese in
17 40 pound blocks and 500 pound barrels are considered.
18 Audits are not the answer. They are the beginning of
19 questions. What about discounts, delayed payment terms,
20 discounts on other products? The list is endless.

21 F, NASS feeds on itself and will result in price
22 setting, not price discovery. The use of the NASS survey
23 violates USDA's criteria that a BFP will not reflect
24 regulatory prices. This is the first time in which USDA is
25 setting prices, not discovering them. There is a history of

1 how such will happen.

2 California reports a weekly nonfat dry milk price.
3 In its announcement of that price, the California Department
4 of Food and Agriculture states, and I quote, "Prices for
5 both periods..." -- they usually report two weekly periods
6 -- "...were influenced by the effect of long-term contract
7 sales." See, for example, Dairy Market News, April 24-28,
8 2000.

9 This is not a question of accuracy. The use of
10 the plant survey price as opposed to a market exchange for
11 the price discovery system will have significant price
12 distortions and price levels. In the California state Milk
13 Order, the Class IV solids nonfat price is directly driven
14 by an audited survey of the price at which California powder
15 plants are selling their powder.

16 CDFA has found that over 95 percent of the product
17 volume in that price survey is sold on a long-term contract
18 basis for a price that is directly indexed to the very same
19 plant survey price that sets the milk price. The result is
20 a circular pricing system that is mathematically incapable
21 of fully reflecting the top of the market price for powder
22 because so little of the survey volume is priced off of the
23 spot market. This system has deprived California producers
24 of the full benefit of rising powder markets.

25 When spot prices are lower than the survey price,

1 the survey price falls rapidly. The result is that
2 producers are deprived of the highs, but absorb the effects
3 of the lows. I confirm this effect by asking a producer who
4 was an active participant in these sales.

5 Figure 4 is a graph that compares the California
6 nonfat dry milk prices to the top of the mostly range in the
7 central states nonfat dry milk report in the Dairy Market
8 News. The central states price most closely resembles a
9 spot market cash price. This graph demonstrates that when
10 the spot price moves up, California prices are very slow to
11 respond, and when they do they do not reach the top of the
12 market. However, when spot prices fall, California prices
13 fall almost immediately, thereby depriving California
14 producers, whose milk is priced off of the California price
15 survey, from the benefits of the rising market.

16 What you have in front of you, and you have a copy
17 in the attachments, is the last time that over that period
18 of time that stretches, and it's hard for me to see, but
19 several years ago when powder actually took market
20 movements. We took the central states nonfat dry milk price
21 and plotted those market movements in the central states
22 price and plotted what happened to the California plant
23 survey price. You can see that the central states price
24 moved up significantly.

25 There was a period of time lag before the

1 California prices began to move up. They never reached the
2 top, and as soon as the central states prices fell,
3 reflecting that shortage of powder was over and the market
4 was coming down, the California prices fell right away, so
5 the argument that well, you'll be slow to go up, but you'll
6 be slow to come down, in both of these examples, both of
7 these time frames, we had over this time frame two periods
8 of time where we had market prices, market powder prices,
9 moving up and so we got over support.

10 Right now you can't tell because all the powder
11 prices are at support and have been at support for a long
12 period of time, but you can see in both cases the California
13 powder price was slow to move up. It never reached the
14 peak, but as soon as the spot price fell, the California
15 prices fell right with it. That's the fatal flaw of NASS as
16 we see it is that if what's happening in powder in
17 California becomes what happens in butter and cheese in the
18 rest of the nation.

19 One of the arguments for NASS reporting weekly was
20 so that the industry has timely information. The role of
21 timely information is to make timely decisions such as the
22 price at which to sell cheese, butter or other commodity.
23 It can only be expected that this transparency of
24 information will mean that plants and their buyers will
25 obtain the information this week and next week sell the

1 commodity at a price as derived in large part from the price
2 announced this week. The plant will report next week that
3 it sold a commodity and at what price, the price that NASS
4 had reported the week earlier.

5 This is the big problem with the NASS survey, and
6 in the questioning of Dr. Ling we discovered that there's
7 nothing in -- not Dr. Ling, but the person from NASS. It
8 was reported there's nothing in the NASS rules to prevent
9 prices from being reported that are directly indexed to
10 those very same NASS prices.

11 CME is a generally accepted index in the market.
12 The following table shows a comparison of reported prices
13 for non-cheddar cheeses. The correlation to the 40 pound
14 block price is very close. Table 5 in the back, Select
15 Cheese Prices, 1995 to 1999, consists of five tables showing
16 the average monthly prices for a wide variety of cheese in
17 each of the years 1995 to 1999. These come from the weekly
18 reports of Dairy Market News. These simple average prices
19 are compared to the average CME price for the year, as well
20 as simple average of all of the prices. All of these prices
21 are compared to the CME.

22 The following figure graphically shows what the
23 differences between the simple average of these prices and
24 the CME has been for five years. To develop the table we
25 took all of the announced prices in the Dairy Market News

1 for each month and averaged them by a simple average. We
2 were looking for a relationship between pricing, not value,
3 so a simple average is appropriate. The CME 40 pound block
4 for the same month was subtracted from that number. The
5 table shows these differences.

6 In Table 6, Summary of Selected Cheese Prices, we
7 took the arithmetic mean for each year and also determined
8 the standard deviation. As the table shows, the averages
9 are from 40 to 49 cents per pound, and the standard
10 deviation is three to eight cents, indicating a very stable
11 correlation. It is worth noting that the correlation got a
12 little less stable in 1999, but maintained a good
13 relationship even when the BFP and the CME correlation
14 deteriorated significantly.

15 The CME prices all cheddar. The NASS cheddar
16 reflects only ten percent of all cheese sold in the market
17 and only about a third of the cheddar. The cheddar
18 considered in the NASS survey only includes industrial,
19 i.e., barrels, and cheese which is immediately placed on the
20 consumer market. It does not consider aged cheddar. Thus,
21 it reflects the lowest ten percent of cheese sold in the
22 nation. It does not consider mozzarella or the other
23 Italian cheese, which represent about 40 percent of the
24 market. These are priced significantly higher or different
25 than cheddar.

1 Table 7. Table 7 is a summary of cheese
2 production from the annual summary of the Dairy Market News
3 for 1999. It shows that total cheese produced in the United
4 States was 7,941,316,000 pounds. The amount of cheddar was
5 2,835,897 or about 35 percent of the total cheese produced
6 in the nation. At the same time, the NASS reported only
7 752,731,419 pounds of cheddar cheese or less than ten
8 percent of all the cheese marketed in the United States.

9 CME solves the data collection problems of what
10 plants, audits, et cetera. By using the CME, all of the
11 cries for mandatory reporting and auditing, the need for
12 more regulation, more bureaucracy, all disappear. Since it
13 is transparent, there is no need to require mandatory
14 pricing. The rules of the CME take away the need for
15 audits.

16 I, With the BFP, the NASS only was used to
17 establish movement and change, not set the price. Some may
18 argue that we have used NASS already. That is not true.
19 The role of the NASS in the BFP was to reflect changes in
20 commodity price levels from one month to another. The base
21 that this change adjusted was set by the market each month.
22 Now the NASS is used to be the base, and there is no free
23 market factor to change it. Each month, the old way got a
24 fresh start.

25 If the NASS is used, it must do several things.

1 The Secretary may still decide to use the NASS survey for
2 finding the commodity prices. Though all of its problems
3 cannot be cured, there are changes that should be made to
4 make it more usable in this pricing scheme.

5 A, Standardize the barrel cheese to 38 percent.
6 We need to recognize that the various yield formula are
7 based upon the amount of dry matter in cheese. The barrels
8 are now reported and adjusted to 39 percent moisture. The
9 yield formula for butterfat recovery assumes 38 percent
10 moisture. There is no reason to adjust the price of cheese
11 to 39 percent and compute its protein value equivalent
12 assuming 38 percent. Increasing the moisture also increases
13 the make allowance.

14 It is inappropriate to discount the barrel cheese
15 by adjusting to 39 percent, a level barrel cheese has never
16 sold at, while computing the yield at 38 percent. At the
17 same time, the kind of blocks being sold and reported to
18 NASS are those in which the processors will try to put as
19 much moisture as possible without providing any blocks in
20 excess of 39 percent. Thus, the Secretary's decision to use
21 38 percent in the yield formula was correct and needs to be
22 extended to the adjustment of the barrel prices.

23 Maintain the barrel make allowance adjustment.
24 The Secretary determined that there was about a three cent
25 per pound difference between the make cost for blocks and

1 barrels with the latter being lower. As a result, he
2 determined that once the barrel prices were adjusted to a
3 standard moisture, they should receive an increase in price
4 of three cents. That adjustment should remain.

5 Conclusion on the price series. In summary, the
6 use of NASS as the product series cannot be sustained. It
7 is necessary to use free market prices for the end product
8 pricing formulas.

9 I'm moving on to cheese yield or to yield. The
10 most significant factor in creating a proper end product
11 pricing is to getting the yield right. An improper product
12 yield is the one area that can result in significant value
13 reduction. If the yield of the product is set too low, an
14 unnecessary windfall goes to the manufacturers. In today's
15 market, it is appropriate to anticipate that modern plants
16 are seeking to recover every marketable product out of the
17 raw milk they purchase.

18 For government policy, it is equally inappropriate
19 to indirectly subsidize or support plants that are
20 inefficient or wasteful. Forcing additional risk of
21 inefficiency on the part of producers in order to cover and
22 protect the inefficiency of plants is improper policy and
23 probably violates the statute.

24 One, chief yield. Under the current regulations,
25 the formula for protein is protein equals cheese price minus

1 .1702 times 1.405 plus cheese price minus .1702 times 1.58
2 minus the Class IV butterfat price times 1.28. This is a
3 simplification and reduction of the VanSlyke formula where
4 the VanSlyke formula determined the number of pounds of
5 cheese from 100 pounds of milk with certain component
6 characteristics. It can be easily adjusted to determine the
7 value of one pound of protein based upon the same input plus
8 the value of other commodities.

9 The VanSlyke formula abbreviated is percent
10 butterfat times butterfat recovery plus percent protein
11 times casein recovery minus .1 times 1.09 divided by one
12 minus the moisture, where BF is butterfat, and you can read
13 that, those abbreviations.

14 In 100 pounds of milk at standard test, there
15 would be 3.5 pounds of fat and 2.9915 pounds of true protein
16 in the milk. Thus, the formula would look like this. You
17 have 3.5 times butter recovery plus 2.99 times casein
18 recovery minus .1, all times 1.09 divided by one minus the
19 moisture.

20 Each of the components, butterfat and protein, can
21 be solved for individually since the yield of butterfat
22 equals the cheese yield less the protein yield and the
23 protein yield equals the cheese yield less the butterfat
24 yield. By reducing the formula, individual components can
25 be solved as follows. You subtract out the protein pounds.

1 You've got the cheese yield minus the protein pounds times
2 the casein percentage minus .1 times 1.09 divided by one
3 minus the moisture equals the butterfat times butterfat
4 recovery times 1.09 divided by one minus the moisture.

5 Since the cheese yield less the protein yield is
6 by definition the butterfat yield, the formula is now
7 butterfat yield equals butterfat times butterfat recovery
8 times 1.09 divided by one minus moisture. Assuming 3.5
9 pounds of butterfat in 100 pounds of milk and a butterfat
10 recovery of 90 percent in the vat and applying these numbers
11 to this formula, we get the following result. Butterfat
12 yield equals 3.5 times 90 percent, .90, times 1.09 divided
13 by one minus .38. That equals 5.5379.

14 The single pound of butterfat can then be
15 determined by dividing 5.5379 by the number of butterfat
16 pounds in the 100 pounds of milk, which is 3.5, so the
17 butterfat yield then is 5.5379 divided by 3.5 or 1.582.
18 Thus, the factor of 1.582 found in the final rule is the
19 result of applying VanSlyke's formula and is dependent upon
20 the values provided. In the case of the final rule, the
21 butterfat yield factor assumes 3.5 pounds of butterfat in
22 100 pounds of milk, a fat recovery rate of 90 percent and
23 moisture of 35 percent.

24 MR. MCCLUSKEY: Thirty-eight. You said 35.

25 THE WITNESS: I'm sorry. Thirty-eight percent.

1 Thirty-eight percent moisture. You guys might luck out. My
2 voice may give out.

3 The 3.5 percent butterfat is appropriate as it is
4 used consistently throughout all the formulas for class
5 prices. The remaining two, fat recovery and moisture, must
6 be determined. Since there is no practical way nor need to
7 compute actual recoveries each month and moisture can and
8 should be standardized, it is necessary to determine what
9 those two values will be in terms of a constant in the
10 pricing formula.

11 A, Determining the butterfat recovery. A
12 cheddaring process produces cheddar cheese, as well as
13 sellable or useable cream in the form of whey cream that can
14 either be reused in the vats or sold as cream on the market.
15 The butterfat recovery in the process is between 91 and 93
16 percent, which leaves seven to nine percent of the butterfat
17 left over.

18 Two percent of the butterfat received from
19 producers is lost either by sticking to the vat or other
20 vessels, dripping onto the floor or otherwise irretrievably
21 lost. That means that fully 98 percent of the butterfat
22 that is delivered to the cheese plant in raw milk is
23 recovered by the plant in marketable form either as whey
24 cream reintroduced into the vat or as whey cream converted
25 to whey butter.

1 I think Dr. Barbano walked us through that this
2 morning and talked about the losses as between 1.5 and 2.5
3 percent of the fat that comes into the cheese plant, leaving
4 somewhere between 97.5 and 98.5 percent of the butterfat
5 recovered in some form.

6 The final rule not only understates the butterfat
7 recovery by one to three points because it uses 90 percent;
8 it totally ignores the value of whey cream. This answers
9 the question raised by a 90 percent butterfat recovery. If
10 100 pounds of butterfat go into the vat and only 90 percent
11 is recovered in the process, then what happens to the
12 remaining ten percent?

13 There is evidence that the entire 98 percent of
14 the butterfat ends up in the cheese. The difference between
15 the 98 percent that is in the cheese and the 90 percent in
16 the current regulations is eight percent. Eight percent of
17 3.5 pounds of butterfat is .28 pounds.

18 If we look at Table 8, California Milk Production
19 by County for 1997, that table gives a total composite
20 average butterfat test for the entire milk supply in
21 California. It shows that the average butterfat test of
22 milk marketed by producers was 3.64 percent. That's the
23 composite average butterfat test.

24 That's interesting. I believe it's Table 14 in
25 the document that Mr. Christ was talking about this morning

1 has about that same figure for the national milk supply.
2 That's one of the reference documents. Three point six four
3 percent.

4 This percentage of butterfat in the California
5 milk supply is also supported by the California DHIA report
6 for 1999 that showed a composite 3.65 percent butterfat test
7 for the entire state. We've got that table in your handout
8 as well.

9 For the same period as the DHIA report, Table 10,
10 CDFA's cheddar cheese processing cost study showed that the
11 composite average vat butterfat in all of the plants in the
12 study was 3.92 percent. This study encompassed virtually
13 all the cheddar cheese produced in California. The
14 difference between the 3.92 percent in the cheese and the
15 3.64 or 3.65 percent in the raw milk supply is .27 to .28
16 pounds of butterfat recovered in the process and returned to
17 the vat for a true fat recovery of 98 percent.

18 The California pricing system explicitly
19 recognizes this value of whey cream in its IV-B formula.
20 CDFA adds to the IV-B price the amount equal to .27 pounds
21 of whey cream, and it uses the CME AA butter price less 19.7
22 cents, the sum of ten cents for product adjustment and the
23 9.7 cent butter make allowance, to establish a value for
24 this whey cream, whey fat, and it adds it to the IV-B price.

25 We do not propose the use of that formula, but we

1 bring this up to point out that CDFA in its end produce
2 pricing program for cheese does recognize a whey cream value
3 in the computation.

4 Now, there are four options to value this extra
5 butterfat. We could, one, ignore it, we could value it as
6 Grade B butter, we could adjust the make allowance for the
7 value, or we could include it in the yield.

8 The first option violates our principle to include
9 all the values received for all the products. The second
10 would require another price series for a commodity making
11 the formula more complex. Of the remaining two, both have
12 merit, but adjustment to the make allowance would still
13 require some value series to compute. The most common
14 approach by plants is to incorporate the whey butter into
15 the vat, and we have, therefore, chosen to include it in the
16 yield.

17 To correct the butterfat portion of the protein
18 formula, it is necessary then to raise the amount of
19 butterfat recovery in the formula to more accurately reflect
20 the industry practice. In the publication, Cheese and
21 Fermented Milk Foods, it states that recovery is 93 percent.
22 I think we heard from Dr. Barbano on this subject this
23 morning.

24 We propose using the midpoint, which is 92
25 percent. Thus, the protein formula so developed would be

1 butterfat yield is 3.5 times .92 times 1.09 divided by one
2 minus moisture. As for the moisture, the Secretary's choice
3 of 38 percent is correct and so that when you do the math
4 and divide by .062 you come up with 5.661. As we noted
5 above, to derive the factor for the use in the formula to
6 determine the value of protein, the butterfat yield factor
7 is 5.661 divided by 3.5. When you do that, you come up with
8 a new butterfat yield factor of 1.617.

9 This butterfat yield factor now accounts for 92
10 percent of the butterfat delivered to the plant. Two
11 percent is lost, leaving six percent that still needs to be
12 valued. Under the final rule, 100 percent of the Class IV
13 butterfat price per pound is deducted from the butterfat
14 side of the protein price calculation with the remaining
15 value allocated to the protein price.

16 What we are proposing is to keep the Class III
17 butterfat the same as the Class IV butterfat, but to deduct
18 only 94 percent of the Class IV butterfat price per pound
19 from the butterfat portion of the protein value to account
20 for the whey cream. We propose 94 percent of the Class IV
21 butterfat price to account for the .06 pounds of whey cream
22 recovered.

23 I think Dr. Barbano in his final example had taken
24 out 90 percent of the Class IV butterfat price. We're
25 proposing 94 percent, so this section of our protein formula

1 reads as follows. Cheese price minus make allowance times
2 1.617 minus Class IV butterfat price times .94 times 1.28.

3 Capture all the protein. In the same way we
4 determine the butterfat formula, we can also determine the
5 protein value where protein recovery is the pounds of true
6 protein, 2.9915, and casein is the casein portion of the
7 true protein, .8326. The minus one represents the loss of
8 one-tenth of a pound of casein. The 1.09 factor accounts
9 for the additional nonfat, non-casein milk solids and salt
10 that are retained in the cheese. The 83.26 percent casein
11 is the approximate mathematical equivalent for true protein
12 of 78 percent casein in crude protein.

13 The final rule protein yield factor, like the
14 butterfat yield factor, had its genesis in the VanSlyke
15 formula with the assumption that 78 percent of crude protein
16 is casein. We agree with the USDA's yield conversion of
17 1.405 for true protein.

18 By applying the VanSlyke formula and the numbers
19 adjusted for true protein, we have the following equation of
20 2.9915 times, and that should be .8326 minus .1 times 1.09
21 divided by one minus .38 equals 4.2030. Dividing 4.2030 by
22 the 2.9915, we determine how many pounds of cheese one gets
23 for each pound of protein. You do that math. You come up
24 with 1.405.

25 Another approach is to multiply the casein rate by

1 .96 rather than subtracting the .1. When you do that math,
2 you come up with the same number, 1.405. This number should
3 look familiar as it is the protein factor in the protein
4 formula used in the final rule, and we accept that.

5 Conclusion on cheese yield. Now that we
6 understand that the factors in the protein formula for
7 butterfat and protein are not arbitrary, but instead are the
8 results of standard computations of the VanSlyke cheddar
9 cheese formula, the butterfat yields and protein are the
10 result not of an approximate number, but derived by exact
11 computation using the appropriate assumptions.

12 These assumptions are as follows. Butterfat
13 recovery is .92 or 92 percent. Moisture is .38 or 38
14 percent. Casein as a percent of true protein is 83.26
15 percent, and whey cream is valued at .06 pounds of
16 butterfat. The formula before adjusting to the make
17 allowance now reads cheese price minus .1702 times 1.405
18 plus cheese price minus .1702 minus .94 times the Class IV
19 butterfat price times 1.28.

20 BY MR. YALE:

21 Q Mr. VandenHeuvel, if you'll let me just point that
22 out so that everybody understands that in that formula at
23 this point two changes have been made to the number as it is
24 in the final rule. Could you identify those, please?

25 A Yes. The two changes have been to change the

1 butterfat recovery from 90 to 92 percent.

2 Q And what does that change in the yield? The
3 number in the formula. How does that change that?

4 A Yes. It goes from 1.582 to 1.617.

5 Q All right. In the final rule there was an implied
6 multiplication by one times the butterfat, Class IV
7 butterfat price, right?

8 A Right. A full pound of Class IV butterfat price
9 value was taken out, and what we are proposing is to take
10 out 94 percent of one pound of Class IV butterfat to account
11 for the six-tenths of one -- six-hundredths of a pound of
12 butterfat that remained in the whey cream.

13 Q And those are the only two changes in that
14 butterfat recovery that you're proposing at this time?

15 A That is correct.

16 In summary, we have captured all of the butterfat
17 recovered in the cheddaring process and the whey cream and
18 added it to the protein value.

19 No need for a separate price for Class III
20 butterfat. By accounting for all of the butterfat that is
21 delivered to a cheese plant and adding the extra value to
22 the protein side of the equation, we have greatly reduced
23 the potential of a situation where high butterfat prices
24 combined with low cheese prices could result in a protein
25 price of zero. Thus, proposals to have a separate Class III

1 butterfat as invited by AMS in the notice of hearing are
2 made unnecessary by our correction.

3 We agree with the Secretary in the final rule when
4 he wrote regarding a separate butterfat price for Class III,
5 and we quote, "However, having multiple butterfat prices
6 would require full plant accountability of components in all
7 manufacturing plants. The resulting increased accounting,
8 reporting and administrative costs were determined not to be
9 warranted when viewed against the small gain from having an
10 additional butterfat price." That is still the case.

11 Q Mr. VandenHeuvel, based upon that statement that
12 you just made, then the proponents of Proposal 1, 10, 19 and
13 26, what is their position in terms of the proposals to
14 reduce the butterfat price in either the Class IV or Class
15 II, III and IV as various parties have suggested?

16 A We oppose reducing those butterfat prices.

17 Q Thank you.

18 A Other solids. Upon careful review, we find
19 nothing to change in the other solids computation in the
20 final rule. It is a necessary component of the cheese
21 formula. The use of dry whey as a commodity is correct.
22 There is no need of changes at this point. There are 96.8
23 pounds of other solids in 100 pounds of dry whey, and so we
24 are not proposing any changes.

25 We do have in our attachments testimony given by

1 Dr. Robert Cropp in the 1997 California hearing in which he
2 outlines the value of these other solids in the upper
3 midwest. It's very, very valuable information, and we
4 include it here.

5 MR. ROSENBAUM: Your Honor, this is Steve
6 Rosenbaum. I will insert an objection to the incorporation
7 by reference of testimony from another hearing.

8 These are not official government findings, which
9 is different, which is reflected in some of the other
10 documents that have been incorporated into the exhibits. To
11 simply have a witness provide testimony that somebody else
12 gave at another place and time is just wholly inappropriate.
13 I mean, that's the whole purpose of a hearing is to be able
14 to examine any person who's putting in substantive evidence.
15 You can't do that. I mean, I can't take the stand and say
16 here's some evidence that proves my point that someone else
17 testified to. That's not how hearings work.

18 MR. YALE: Your Honor, by a few questions of Mr.
19 VandenHeuvel I can establish the appropriateness of this
20 document.

21 BY MR. YALE:

22 Q Mr. VandenHeuvel, you have already testified that
23 you're an expert and have testified on behalf of proponents
24 on end product pricing before the California Department of
25 Food and Agriculture. Is that correct?

1 A Yes, I have.

2 Q And in doing that, do you review publications and
3 writings and information from other sources regarding yields
4 and product prices and the like?

5 A Yes, I do.

6 Q When you prepared your testimony today to indicate
7 what the proposal or the support for the other solids was
8 going to be, did you reply upon Dr. Cropp's testimony?

9 A I relied on his testimony to indicate to me that
10 the conclusion that we found that there are no need for
11 changes was very much supported by what I had read in the
12 opinion of those experts.

13 Q So you're not so much supporting and saying that
14 Dr. Cropp's testimony is adopted. You're supplying this as
15 information that you used to come to your own conclusion as
16 an expert?

17 A That's right.

18 MR. YALE: And that's the purpose that it's
19 supplied, Your Honor, and that's very appropriate even under
20 the Federal Rules of Evidence.

21 MR. ROSENBAUM: Your Honor, I don't know that
22 we're under the Federal Rules of Evidence. If we were,
23 though, that would be absolutely 100 percent untrue. You
24 cannot. Although you can rely upon materials from another
25 expert, you don't introduce them into evidence as an

1 exhibit. That is for sure.

2 If there is a piece he took out and used himself,
3 people do that in testimony, but people don't say here's a
4 copy of the transcript of someone else's testimony at a
5 different hearing. It's part of my exhibit offered into
6 evidence.

7 JUDGE HUNT: At this point you're just referring
8 to Mr. Cropp's testimony?

9 MR. YALE: That is the purpose, Your Honor.

10 JUDGE HUNT: And that's in this addendum, proposed
11 Exhibit 26?

12 MR. YALE: Yes.

13 JUDGE HUNT: You haven't offered that yet.

14 MR. YALE: Well, we've identified it. That's
15 correct.

16 JUDGE HUNT: You've identified it.

17 MR. YALE: That's right.

18 JUDGE HUNT: You're just referring to Cropp at the
19 moment?

20 MR. YALE: That's correct.

21 JUDGE HUNT: I'll allow him to refer to it, but
22 I'll take up your objection if they offer his testimony into
23 evidence.

24 All right. Proceed.

25 THE WITNESS: Thank you, Your Honor.

1 Next to nonfat dry milk. The nonfat dry milk
2 formula needs correction. In response to requests by some
3 parties, comments made in error were accepted by the
4 Secretary with the errors. The final rule formula assumes
5 that there are 102 pounds of nonfat milk solids in 100
6 pounds of nonfat dry milk. This cannot be.

7 It is irrational to assume that there are more
8 pounds of nonfat milk solids than there are pounds of nonfat
9 dry milk in a quantity of nonfat dry milk. Nonfat dry milk
10 is approximately 3.2 percent moisture. Thus, the final rule
11 represents a loss of 5.2 pounds of nonfat milk solids in
12 every 100 pounds of nonfat dry milk or a five percent loss.

13 The Secretary stated in the final rule the .96 in
14 the proposed rule was intended to represent the 96 pounds of
15 solids and 100 pounds of nonfat dry milk. Since buttermilk
16 powder is also a product of manufacturing butter and nonfat
17 dry milk, its value needs to be addressed. Failing to
18 account of the buttermilk powder resulted in overstating the
19 nonfat solids milk price since the pounds of nonfat solids
20 was understated. That's the end of the quote from the final
21 rule.

22 Both the Cornell study, Stephenson and Novacavick,
23 Determination of Butter Powder Plant Manufacturing Costs
24 Utilizing an Economic Engineering Approach, June, 1990, and
25 the Stephenson and Novacavick Manufacturing Costs in Ten

1 Butter Powder Processing Plants, September, 1989, and the
2 recent study by the California Department of Food and
3 Agriculture indicates that these solids are salvaged and
4 processed into butterfat powder.

5 All of these studies show a combined nonfat dry
6 milk and buttermilk powder yield in excess of 1.025 pounds
7 of product from each pound of solids nonfat or .975 pounds
8 of SNF in each pound of finished product. However,
9 buttermilk powder is slightly less valuable than nonfat dry
10 milk, and so we are proposing a yield of .98 pounds of SNF
11 in each pound of finished product. Thus, the formula for
12 nonfat dry milk before adjusting for the make allowance
13 should be $\text{SNF equals nonfat dry milk minus the make}$
14 $\text{allowance divided by .98}$.

15 Butter. After careful review, we find no need to
16 modify the yield formula for butter. Dividing by .82 is
17 acceptable. We also agree with the Secretary's decision to
18 use Grade AA butter in the final rule. In July, 1998, the
19 CME discontinued the reporting of Grades A and B butter due
20 to a lack of market. Butter is now virtually all Grade AA.
21 This is a higher grade due to the combined efforts and
22 better milk from producers. The Secretary's decision to
23 give producers the full value recognition for Grade II
24 butter is appropriate.

25 Allowances for manufacturing costs. In the final

1 rule, the Secretary arrived at make allowances by taking the
2 RBCS studies with the California studies and taking a
3 weighed average of the two. In combination with the NASS
4 survey of product prices, the end result of the pricing
5 formula for the FMMO was that a blended price of all the
6 product prices in the nation wherein California represents
7 approximately 13 to 14 percent, was reduced by a make
8 allowance wherein California plants represented 48 percent
9 of the weighted price in order to derive a price for
10 producers in which California purchased none of the milk.
11 Figure 5 shows this graphically.

12 Rather than go through the mechanization of taking
13 two different cost studies done by two different
14 organizations for different purposes with different
15 guidelines and mixing them, the federal government should
16 trust its own agency and rely on that data.

17 As shown elsewhere in this proposal, the number is
18 supported by empirical evidence of implied makes at least on
19 cheese. We, therefore, propose using the Rural Cooperative
20 Business Service's most recent survey on cost for the
21 manufacturing of cheese, butter and nonfat dry milk.
22 Because of extremely low data on dry whey, there is no
23 information that can be used to revise the conversion
24 allowance for dry whey, so we propose that it remain at .137
25 per pound of product.

1 The use of the RBCS is appropriate because it
2 represents what it costs to make these products in plants
3 that are located in markets that are subject to this pricing
4 program. Because California is not presently under the
5 FMMO, none of its plants will be subject to minimum prices
6 announced and its plants do not purchase milk in an area
7 subject to the regulations.

8 Our rejection of California is not because the
9 numbers are intrinsically wrong. Nor is our rejection based
10 upon the results of adding California to the mix, which will
11 result in higher numbers. Using the rationale of the
12 Secretary in the final rule and the recent studies of RBCS
13 and CDFA, the resulting prices would be higher than ours for
14 cheese, but lower for nonfat dry milk. It's simply wrong to
15 pick and choose numbers. Rather, the appropriate
16 methodology is to pick a survey that does the task and rely
17 upon it regardless of the results. We are sticking with the
18 RBCS.

19 The RBCS study was done on a voluntary basis.
20 Plants knew that the information would be used to consider
21 manufacturing costs. The plants are diverse in their
22 geography, their operations and their markets. We took the
23 most recent RBCS study and adjusted the numbers for the cost
24 of marketing and the return on investment. We have no
25 numbers that would conflict those. We also adjust the RBCS

1 butter prices to account for the packaging and printing of
2 butter that are not part of the pricing for bulk milk used
3 in the pricing formulas.

4 Proposed manufacturing allowances shows what these
5 numbers should be. We understand that National Milk
6 Producers Federation has taken the same RBCS study but
7 weighed it with the most recent California data on
8 manufacturing costs. The make allowance for cheese at
9 National Milk reached under that analysis is approximately
10 15.36 cents.

11 Some might argue, and with reason, that the
12 difference is small and why demand a lower price. The issue
13 is not the price because we are proposing a higher nonfat
14 dry milk make allowance than National Milk. The issue is
15 how we get there.

16 There is no right number. There is a right way to
17 get there. The make allowance, along with all these issues,
18 will result in a direct dollar impact on producers. Make
19 allowances are not without controversy, but they should be
20 and can be derived with a transparent, rational and
21 understandable method.

22 Giving California one weight in the pricing and
23 another weight in the make allowances and no weight in
24 prices paid to producers is neither of those. As a result,
25 we propose the following make allowance based upon average

1 plants. Cheese, .141; butter, .0952; nonfat dry milk, .145;
2 dry whey, .137.

3 There are other policy considerations such as the
4 concern about maintaining sufficient national manufacturing
5 plant capacity or regional considerations. It is in setting
6 the make allowance that these policy considerations can be
7 spelled out and applied.

8 Needed changes. Based upon the information
9 presented, the formulas for computing the component prices
10 should be as follows. These are our revised formulas. You
11 can see the current final rule prices. I'm sorry. The
12 current final rule formulas and then the revised formulas on
13 the right. I'm just going to read the revised formulas.

14 Cheese price minus .141, and this is for protein,
15 times 1.405 plus cheese price minus .141 times 1.617 minus
16 .94 times the Class IV butterfat price times 1.28. Solids
17 would be the powder price minus .146 divided by .98. For
18 butter, the butter price would be the butter price minus
19 .0952 divided by .82. Dry whey price for other solids would
20 be dry whey price minus .137 divided by .968.

21 The text of the proposed changes is on a table
22 showing the changes found at Tables 12 and 13 in the back.
23 Those are the proposed changes in the text of the final rule
24 that we would propose.

25 Conclusion. We have met all the criteria that

1 have been established for a BFP replacement. When we began,
2 we identified several goals and criteria by which to judge
3 our proposal. The BFP committee recommended the following.
4 Stability and predictability, simplicity, uniformity and
5 transparency, sound economics and reduced regulation. Our
6 proposal will promote stability and predictability because
7 it has based upon market prices of dairy commodities.

8 The fixed values for the conversion margins and
9 the formulas for product conversion are based upon sound
10 study and research. Changes in market conditions should not
11 undermine their fundamental value. Our proposal is simpler
12 than the final rule. Only four numbers are required each
13 week to input the values. There are no revisions of data
14 from week to week. With the CME, the pricing is transparent
15 and no longer subject to manipulation.

16 Our proposal is based upon sound economics. It
17 uses market prices as the starting point. Each and every
18 month the pricing starts all over again. There will be no
19 circularity of pricing to undermine the pricing system. The
20 formula are based upon industry standards and the current
21 state of technology. The conversion margins are not so high
22 to distort manufacturing nor so low as to put plants at
23 unnecessary risk. Our proposal will reduce regulation.
24 Most importantly, it will remove USDA from setting product
25 prices and allowing the marketplace to dictate value rather

1 than government announced surveys.

2 In order for the final rule to meet the supply and
3 demand criteria set forth in the Agriculture Marketing Act
4 of 1937, it must predicate its end pricing product formulas
5 on the theory that plants will convert all the producer milk
6 into marketable product, proper yields, at a reasonable cost
7 of conversion, reasonable make allowances and sell them at
8 the market price, the use of market prices. Failure to do
9 any of those results in a contrived price rather than a
10 market derived price.

11 Finally, and most importantly, our proposal as
12 compared to the final rule results in numbers that do not
13 deviate greatly from the general level of the BFP M-W prior
14 to 1999. There is no justification for reducing prices 80
15 cents to \$1.00.

16 That concludes my formal testimony.

17 BY MR. YALE:

18 Q Mr. VandenHeuvel, I want you to turn to Table 12.
19 This is the text of the proposed regulation. I think
20 there's an area we need to correct down under Subpart
21 (n)(3)(ii) where it said subtract 0.927. Do you see that?

22 A Yes.

23 Q And that should be --

24 A Yes.

25 Q -- .94?

1 A Yes. That's correct.

2 MALE VOICE: Repeat that, please.

3 MR. YALE: Okay. On Table 12, the first page
4 under (n)(3)(ii) where it says subtract 0.927, that should
5 be 0.94.

6 MALE VOICE: Do you mean (ii)?

7 MR. YALE: Yes, (ii).

8 MALE VOICE: 0.940?

9 MR. YALE: Yes, instead of the .927.

10 BY MR. YALE:

11 Q Then there's a table behind that that simplifies
12 the language for those who want to read it quickly, and that
13 same correction needs to be made there, isn't that correct,
14 on the last page? It's the last page in your book.

15 A Yes. Yes, that is correct. That would be in the
16 proposed there's a .927 that needs to be corrected to a .94
17 in the protein formula.

18 MALE VOICE: Tell us where that is.

19 MR. YALE: That's the last page in the bound
20 books.

21 THE WITNESS: Yes. The last page, Table 13, Table
22 of Revised Formulas.

23 BY MR. YALE:

24 Q .94 instead of the .927.

25 A That's correct.

1 Q .94. Also, if you would turn to page 13 of your
2 testimony? I want to draw your attention. I think there's
3 a not that needs to be added to a sentence.

4 A Okay.

5 Q And that appears at (1)(a) in the first paragraph.
6 It appears to be the third sentence. "That is not happening
7 in livestock and other commodities." Isn't that correct?
8 We're not setting prices. We're just reporting them in the
9 other --

10 A Yes. That is not what is happening.

11 Q Right. And then on page 26 I think we have
12 another typo where we say, "The formula before adjustment to
13 the make allowance now reads..."

14 It's correct on the screen, but it says protein.
15 Shouldn't there be a factor there after the cheese price
16 minus 17.02 before the minus 94?

17 A Yes.

18 Q Should that not be times 1. --

19 A Yes, that's right. Yes. Times 1.617.

20 MALE VOICE: Repeat that.

21 MALE VOICE: Where?

22 MR. YALE: Okay. Page 26. The formula says
23 protein equals (cheese price minus .1702) times 1.405 plus
24 (cheese price minus .1702), and there needs to be inserted
25 there times 1.617, and the rest of it is the same.

1 BY MR. YALE:

2 Q Is that correct, Mr. VandenHeuvel?

3 A Yes, that's correct.

4 MALE VOICE: Times what?

5 THE WITNESS: 1.617.

6 MR. YALE: And then, Your Honor, because of some
7 changes and there were some tables he did not read directly,
8 we would like to have identified as the next exhibit number
9 the copy of his testimony.

10 JUDGE HUNT: Let's see. Well, you had his
11 testimony as Exhibit 25.

12 MR. YALE: Did we submit it? No. Those were the
13 tables.

14 JUDGE HUNT: It is identified.

15 MR. YALE: No. Those are just the tables. We
16 just submitted the tables originally. The addendum is 26.
17 Now, what we could do is substitute the two books.

18 JUDGE HUNT: Twenty-five is just the tables?

19 MR. YALE: Yes.

20 JUDGE HUNT: I see.

21 MR. YALE: We could substitute 25 that we
22 presented to you with the whole book that includes the
23 tables and the testimony.

24 JUDGE HUNT: Well, you would have to tear it apart
25 then.

1 MR. YALE: No. I've got them. I can just hand it
2 in. With Your Honor's permission, we would just resubmit 25
3 as being the entire bound book that everybody was presented
4 with, which was the tables and the testimony.

5 JUDGE HUNT: He's offering 25 then. That is the
6 complete book that he gave you. Any objections to that
7 being made part of the record in this proceeding?

8 No objections. Exhibit 25 will be received in
9 evidence.

10 (The document referred to,
11 previously identified as
12 Exhibit No. 25, was received
13 in evidence.)

14 MR. YALE: Very well. Your Honor, we would then
15 move that 25 and 26 be admitted into evidence.

16 JUDGE HUNT: And 26 I think Mr. Rosenbaum has an
17 objection to.

18 MR. ROSENBAUM: Your Honor, I have no objection to
19 Exhibit 25, which I think has already come in, which is his
20 testimony. I do object to the entirety of Exhibit 26.

21 JUDGE HUNT: The entirety of 26?

22 MR. ROSENBAUM: Yes, I do, Your Honor. In both
23 cases, they consist of either studies or testimony done by
24 someone other than the witness, and I don't believe it's
25 appropriate in the hearing setting to have substantive

1 evidence come in in this fashion.

2 JUDGE HUNT: Mr. Beshore?

3 MR. BESHORE: Just an observation. I take that to
4 be a hearsay objection. It's objecting to material being in
5 the record coming from persons who are not testifying. The
6 bulk of Dr. Yonkers' testimony related to information
7 provided by people, to persons in a firm that he hired who
8 in turn provided information to him.

9 MR. ROSENBAUM: Well, number one, it's too late.
10 Number two, Dr. Yonkers directed and supervised that survey,
11 wrote the survey form. It's his members who participated in
12 it. That is wholly different from this witness saying
13 here's a copy of what Dr. Cropp had to say a few years ago.

14 JUDGE HUNT: Well, actually 26 has two different
15 kinds of documents. One is the reports from Cornell and
16 also the copy of the testimony of Mr. Cropp or Dr. Cropp.

17 MR. COOPER: There's also something from the
18 California Department of Food and Agriculture in there in
19 the middle

20 JUDGE HUNT: Okay. All right.

21 MR. YALE: The first two, the Cornell studies, I
22 believe, and I could be corrected on this, but I believe the
23 final rule actually references them, and they are documents
24 that are available. They are publications that have been
25 used in the Federal Order in discussions on various plan

1 allowances. I think they're appropriate for use for the
2 value that they are, Your Honor.

3 I mean, it's a situation that we have provided the
4 raw data on which he's based his opinion. They can question
5 him on it. That's part of that exhibit. The one of CDFA is
6 a government report.

7 JUDGE HUNT: And they can cross-examine him. If
8 he's relying on those documents, then they can cross-examine
9 him on his reliance on those Cornell studies and the
10 California study.

11 MR. BERDE: Your Honor?

12 JUDGE HUNT: Mr. Berde?

13 MR. BERDE: The rules, the evidentiary rules in
14 these kinds of proceedings, in administrative proceedings,
15 are very generous and state in substance that the kind of
16 evidence that may be received, that is hearsay evidence, is
17 the kind of evidence that may generally be relied upon by
18 persons in the daily conduct of their business. It's that
19 broad.

20 Certainly what has been presented here is the kind
21 of evidence that persons in the dairy business certainly,
22 which is what we're involved in here, would certainly rely
23 upon in judging how they should conduct their business, so I
24 don't see any basis for objecting to that kind of evidence
25 even though it may be unusual that testimony from another

1 hearing is offered as evidence in this proceeding, yet if it
2 contains material that might generally be referred to and
3 relied upon and has an inherent reliability, it certainly
4 may be received and it has been received in these kinds of
5 proceedings.

6 JUDGE HUNT: Thank you, Mr. Berde.

7 Mr. Cooper?

8 MR. COOPER: The rules of practice here provide
9 that every witness shall before proceeding to testify be
10 sworn or make an affirmation. On the other hand, it also
11 provides that the Judge may take official notice of matters
12 as are judicially noticed by the Courts of the United States
13 or of any other matter of technical, scientific or
14 commercial fact of established character.

15 It would seem that we might well notice the
16 published document by Dr. Stephenson and Novacavick and the
17 actions of the California Department of Agriculture, which
18 appears to be some sort of an announcement of their findings
19 or their prices. I really didn't read the thing.

20 The third item, the testimony at a different
21 hearing, seems to be something that goes beyond the scope of
22 the type of things that would be officially noticed in the
23 Courts of the United States. Dr. Cropp wasn't under oath in
24 this proceeding or subject to cross-examination in this
25 proceeding. This wasn't some sort of a published study that

1 was subject to any sort of review or peer review or
2 whatever, so I don't see where it should be received.

3 JUDGE HUNT: Mr. Rosenbaum?

4 MR. ROSENBAUM: Your Honor, I had not realized
5 this California document was in these materials. I have no
6 objection to that coming in. I think an official
7 publication of a government agency of this nature should
8 come in. I have no objection to that of the three
9 documents.

10 I strongly object to Dr. Cropp's testimony coming
11 in, and I guess Mr. Cooper is on my side, so I'll say no
12 more on that issue.

13 On the third issue of the study, I think that
14 needs a witness. With all due respect to Mr. Berde, I have
15 a copy of the procedural rules, and I see no reflection of
16 any rule that says if it's something that people in the
17 dairy industry rely upon that it's admissible. I just don't
18 see any language remotely like that.

19 JUDGE HUNT: Thank you. All right. I'm going to
20 make a bifurcated ruling, and I'm going to allow the first
21 part of 26, the Cornell studies, to be admitted and the
22 reference to the California. That will be admitted together
23 as Exhibit 26.

24 //

25 //

1 (The document referred to,
2 previously identified as
3 Exhibit No. 26, was received
4 in evidence.)

5 JUDGE HUNT: As to the testimony of Professor
6 Cropp, to me that's a roundabout way of getting his
7 testimony here in the record without having him subject to
8 cross-examination, and that is the ground rule here; that if
9 you want to testify and have your testimony considered, you
10 have to be subject to cross-examination. He's not here, so
11 I will not admit --

12 MALE VOICE: He is.

13 JUDGE HUNT: Oh, he is here? Oh, well. I take
14 that back. I apologize. If he wishes to be cross-examined
15 on that statement, I will --

16 MR. YALE: Proponents No. 1 call to the stand Dr.
17 Cropp. No.

18 JUDGE HUNT: That's your option. If you want to
19 call him on that basis and have him examined, I'll allow
20 this information. Otherwise I will not.

21 MR. YALE: All right. Thank you, Your Honor. We
22 would request, though, that our objection be noted, that it
23 accompany the record and also our proffered exhibit
24 accompany the record for further consideration by the
25 Secretary.

1 JUDGE HUNT: It will be as an offer of proof.

2 MR. YALE: Thank you.

3 JUDGE HUNT: It will accompany the record, yes.

4 MR. YALE: Thank you, Your Honor.

5 JUDGE HUNT: The Secretary may reverse me or the
6 Administrator.

7 MR. ROSENBAUM: Your Honor, as a technical matter,
8 we have a problem in that we have one exhibit, some of which
9 has been admitted and some of which has not. I wonder if we
10 can --

11 JUDGE HUNT: Just separate the two.

12 MR. ROSENBAUM: -- separate that?

13 JUDGE HUNT: Separate the two.

14 MR. ROSENBAUM: Have perhaps the testimony of Dr.
15 Cropp be Exhibit 26-A or something of that nature?

16 JUDGE HUNT: Well, it's an offer of proof.

17 MR. ROSENBAUM: I see.

18 JUDGE HUNT: It will just accompany it as an offer
19 of proof.

20 MR. ROSENBAUM: Very well.

21 JUDGE HUNT: The rejected portion of 26.

22 Have you given the copies yet to the court
23 reporter, Mr. Yale? Mr. Yale?

24 MR. YALE: Yes. Yes.

25 JUDGE HUNT: Have you given the copies to the

1 reporter?

2 MR. YALE: Yes, we have.

3 JUDGE HUNT: If you separate those as I indicated?

4 MR. YALE: We can do that.

5 JUDGE HUNT: In the part that is separated, Ms.

6 Court Reporter, put that as a separate file and not accepted

7 as evidence, but as offer of proof. It will accompany the

8 record. That is Dr. Cropp's testimony.

9 All right. I will admit that part of Exhibit 26
10 as indicated.

11 MR. YALE: Then with that, Your Honor, at this
12 point our direct examination is ended, and we'll make Mr.
13 VandenHeuvel available for very limited cross-examination.

14 JUDGE HUNT: Good luck. Good luck. All right.

15 Mr. Rosenbaum? Oh, I'm sorry. Mr. Marshall?
16 Well, Mr. Marshall is already there. I'll let you go first.

17 MR. MARSHALL: Thank you.

18 CROSS-EXAMINATION

19 BY MR. MARSHALL:

20 Q Good afternoon, Mr. VandenHeuvel.

21 A Hello, Doug.

22 Q Before I get into what I was preparing to do,
23 could I ask a clarifying question that may be procedurally
24 awkward? Could you refer to Exhibit 26 and tell me where it
25 now ends?

1 Really my question is did Dr. Cropp's testimony
2 that's not part of Exhibit 26 any more include all the
3 tables at the end and the graphs?

4 A Yes. Those were part of Dr. Cropp's testimony.

5 Q Okay. So it now ends after something called --

6 A Yes.

7 Q After the CDFA document?

8 A Yes. That's where it ends.

9 JUDGE HUNT: Is that the extent of your cross-
10 examination?

11 MR. MARSHALL: No.

12 JUDGE HUNT: Wishful thinking. Somehow I figured
13 it wasn't.

14 MR. MARSHALL: Mr. VandenHeuvel, Your Honor has
15 been kind enough to allow me to use him as an expert on
16 California to put one minor point into evidence, so what I'm
17 going to do is ask the assistance of others here to pass out
18 these documents. Let me take six up, and I'll ask it be
19 marked.

20 JUDGE HUNT: You are offering this as a proposed
21 exhibit or marked for identification?

22 MR. MARSHALL: Yes.

23 JUDGE HUNT: It will be 27 then. We'll have those
24 available for the reporter.

25 //

1 (The document referred to was
2 marked for identification as
3 Exhibit No. 27.)

4 JUDGE HUNT: The document that you were must given
5 by Mr. Marshall will be marked for identification as Exhibit
6 27.

7 BY MR. MARSHALL:

8 Q Mr. VandenHeuvel, I believe you testified earlier
9 that you've not missed many California hearings over the
10 years and want to ask if you recognize this document?

11 A Yes. I generally recognize this document as being
12 a cheddar cheese processing cost document that is published
13 on a regular basis by the Dairy Market Branch of CDFA.

14 Q I notice the lower left-hand corner of the
15 document has a date. Would this be part of a series of
16 reports and particularly the version of that series that was
17 issued with data as of August of 1989?

18 A It certainly appears that way. Yes.

19 Q We had earlier in this hearing some metaphysical
20 discussions about the difference between simple averages and
21 weighted averages, and I was wondering if there's anything
22 insightful that you find here in this exhibit that might be
23 useful for purposes of pursuing these metaphysics?

24 A Yes. It appears from this chart that in the
25 August, 1989, report from CDFA the weighted average was

1 higher than the simple average.

2 Q More interestingly, do you recall the
3 circumstances of the 1989 hearing and why there might have
4 been such a result?

5 A I don't know that this -- the publication of these
6 reports does not necessarily coincide with a hearing, but
7 when they publish this report, and the time frame under
8 which this report covers seems to indicate that there were
9 one or more large volume plants in this cheddar cheese
10 survey which had obviously significantly higher costs than
11 the average.

12 Q Okay. Departing then from the specific exhibit
13 and the numbers, can you discuss generally how the State of
14 California in their hearing process deals with the numbers
15 that are developed through these kinds of studies in
16 determining the make allowance?

17 A Yes. California keeps very good -- at least
18 that's my perception of it -- audited data on processing
19 costs, but it has -- the State of California as a policy
20 matter has been adamant about refusing to outline a specific
21 policy as to how they derive make allowances.

22 They obviously include these costs. These cost
23 studies weigh heavily in their decision making process, but
24 the level actually of the make allowance does not bear at
25 least to any of us who try to read the tea leaves on what

1 they're trying to do. There's no discernable pattern
2 between the level of costs and what the actual make
3 allowance is.

4 Q Do you mean, sir, that they do not automatically
5 use the weighted average price or cost?

6 A They do not. They do not.

7 Q And in fact use judgement, independent judgement,
8 as near as you can tell, in setting the amounts?

9 A That is certainly the case.

10 Q In your prepared testimony, I believe in
11 discussing make allowances you suggested that if there are
12 policy considerations that USDA would want to consider that
13 the make allowance would be the place to do that. Did I
14 recall that correctly?

15 A Yes.

16 Q And is that essentially what the State of
17 California does?

18 A Yes. Let me finish the yes. They do use policy
19 considerations in the make allowance. That's not by
20 inference to conclude that they've got the other parts of
21 their formula right.

22 Q I understand. I understand that clarification to
23 your answer.

24 Back to the circumstance then at which you recall
25 this one particular plant, high cost plant, being out of

1 line. Do you have a recollection as to how the State of
2 California went about establishing a make allowance at that
3 time of approximately 1989 to determine whether this
4 particular high cost plant would be covered and indeed what
5 other plants would or would not be covered?

6 A To be honest with you, I can't exactly recall the
7 exact number that they came up with, but they came up with a
8 number that was less than 20 cents for the make allowance,
9 and I don't -- it's been awhile since I've actually looked
10 at it to refresh my memory what the actual make allowance
11 was when they established a make allowance that would have
12 been, you know, somewhat based on these costs.

13 MR. MARSHALL: I think we'll have other evidence
14 from which that can be generated.

15 All right. Your Honor, at this point I would ask
16 that this Exhibit No. 27 be received.

17 JUDGE HUNT: Is there objection to Exhibit 27
18 being entered into evidence?

19 Hearing no objections, Exhibit 27 will be admitted
20 into evidence.

21 (The document referred to,
22 previously identified as
23 Exhibit No. 27, was received
24 in evidence.)

25 MR. MARSHALL: Continuing on along that same

1 line --

2 JUDGE HUNT: Mr. Marshall, at this point I
3 understand the snack bar closes at 5:00. Since we'll be
4 going on beyond that, somebody might want to get a snack so
5 we'll take a 20 minute break at this point.

6 (Pause.)

7 MR. ROSENBAUM: (**MISSING TESTIMONY**) with
8 respect to a one page article that he wrote, which we would
9 like him not to have to read into the record. Therefore, I
10 will put copies on the back table, and then he can take the
11 stand and be questioned about it, but he won't have to read
12 the whole thing.

13 JUDGE HUNT: No. That's not a requirement. They
14 have an opportunity to see his testimony in advance, so --

15 MR. ROSENBAUM: I just want to make sure everyone
16 knows they have that opportunity.

17 JUDGE HUNT: Sure. Thank you, Mr. Rosenbaum.

18 Anything else before we break? Okay. We now have
19 17 minutes for a break.

20 (Whereupon, a short recess was taken.)

21 JUDGE HUNT: We're back on the record, please.

22 BY MR. MARSHALL:

23 Q Mr. VandenHeuvel, before we broke we were talking
24 about some California process, administrative process, back
25 in 1989. You had mentioned earlier in your testimony that

1 you had participated in the original hearings at which the
2 IV-A and IV-B prices were established and the different
3 formulas.

4 Just to make the point for the benefit of people
5 who are looking to California for both good things and bad
6 things, did California come up at a certain point in time
7 with a formula by which the implicit conversion cost that
8 was allowed would increase as the price of cheese went up?

9 A Yes, it did. The original IV-B formula did
10 include for shorthand a rising make allowance. As the price
11 of cheese would increase on the market, the margin for the
12 plant would also increase.

13 Q And do you recall the policy consideration there?
14 Was that to encourage new investment in cheese plants at
15 that time?

16 A I tell you, I can't say what the policy
17 consideration was for doing that other than the obvious,
18 which was that as the market price for cheese went up, the
19 margin for -- you know, thereby the producer price going up
20 that the margin for the plant would also go up.

21 Q You referred to the California state philosophy as
22 being mercantilist, mercantilist being a reference to the
23 use of state power to expand the merchant class within the
24 state.

25 Do you recall what the impact of that much greater

1 make allowance because of the price adjustment, what that
2 did in terms of allowing California to expand its sales of
3 cheese across the nation?

4 A Actually, California's decision to move from a
5 make allowance and a pricing formula that essentially
6 mirrored the M-W to kind of going on their own took place
7 initially, the first steps to that, in 1982. They adopted a
8 make allowance that exceeded, you know, not only weighed
9 average cost, but it was a very, very generous make
10 allowance, and California set off on a course to expand
11 plant capacity.

12 If you'll recall, in 1982 the national dairy
13 industry was -- you know, warehouses around the country were
14 bursting with surplus butter powder and cheese, and
15 production was increasing. California increased the margin
16 to its plants to encourage plant capacity, but obviously
17 there was no increase in national demand for that product,
18 but the Commodity Credit Corporation was committed to buying
19 everything offered to it at the support price.

20 Q You have been at times both a critic and a
21 supporter of the California system. I assume you've just
22 given us one of the criticisms.

23 A Anyone who has ever followed any California
24 hearings probably couldn't miss my criticism.

25 Q The question that that poses then is the Secretary

1 of Agriculture has to make a decision about pricing in
2 non-Federal Order areas. At the one hand here you've just
3 provided what might be advice that you not see USDA get into
4 the same trap. On the other hand, you're noting that
5 there's a competitive reality there that those of us in the
6 western manufactured products industry under Federal Orders
7 have had to deal with.

8 A There's no doubt that western -- you know, the
9 Pacific Northwest has a problem, you know, and has had --
10 because of their ability to compete.

11 I think at least on the butter powder side I think
12 it's important to note that California has significantly
13 reduced its make allowance since 1982, you know, in no small
14 part due to the pressure that, you know, my colleagues and I
15 and other producers have put on the system and also, you
16 know, cooperatives too have, you know, supported from time
17 to time reductions in, and I'm talking manufacturing
18 cooperatives. Reductions in the butter powder make
19 allowance.

20 Q That reminds me. I was going to ask if you recall
21 the reason why the former Class IV-B formula for milk used
22 to produce cheese was modified to take out that factor that
23 I had asked about by which the implicit make allowance would
24 increase as the price of cheese went up. Do you recall why
25 they reversed that policy?

1 A I don't have any -- I would have to go and re-read
2 the findings to refresh my memory about why they exactly
3 took it out.

4 Q Suffice it to say either things changed or the
5 philosophy was found to be inappropriate, right?

6 A (Non-verbal response.)

7 Q All right. Let's shift gears to the part of
8 your -- well, let me just follow up on that last point.

9 With respect to your clients, the Western States
10 Dairy Producers, through their trade associations, would it
11 be your position that as a policy matter USDA should
12 consider price alignment with California as it establishes
13 pricing under Federal Orders?

14 A Our view is that they should not.

15 Q And the reason for that would be what?

16 A Because California -- if you want to catch
17 California, there's no guarantee that you'll catch them and
18 that they won't just go further, drop below.

19 If they are committed, if California is committed
20 to a policy that keeps their plants with an advantage,
21 lowering the federal prices to the California levels is no
22 guarantee that that so-called alignment will be achieved.

23 Q Is that your opinion, or is that the opinion of
24 the state trade associations in the west that you represent?

25 A Well, it certainly is my opinion, and I believe it

1 reflects pretty much the general consensus of the people we
2 represent.

3 We have worked hard, Mr. Marshall, inside of
4 California to seek to, you know, move California up and to
5 close that gap. You'll recall in 1997 we made quite a
6 valiant effort at that, and I can assure you that we haven't
7 ever wavered in our commitment to that, and we'll continue.

8 Q Turning to the other aspects of your testimony,
9 let me start with the general topic of CME versus NASS.
10 First of all, a technical question with respect to Figure 4
11 of your immediate table that's within Exhibit 25. You had a
12 graph that was up on the screen.

13 A Right.

14 Q I noted that you used the compared California
15 nonfat price to the central states NFDM report rather than
16 the western survey. Was there a reason for that that you
17 recall?

18 A Yes. The California plants, as I understand it,
19 were part of the western, so when you got a western report
20 it included some of the California data in the western
21 report, so what we were really looking for is the best
22 series to reflect the spot price, the current market price
23 of powder.

24 Q Do you have --

25 A That's why we picked the central states.

1 Q Do you have an understanding of the volume of
2 transactions of nonfat dry milk that are included typically
3 within that central states survey that appears in Dairy
4 Market News?

5 A No.

6 Q Are you aware that many times there's so few
7 trades reported that they will not report price, but simply
8 use the last week's price and not issue a new price?

9 A Well, that's certainly possible, but obviously
10 during this time frame there was quite a bit of price
11 movement. That was the purpose of the exercise was to
12 demonstrate -- it's very difficult when you have powder
13 prices that are flat for extended periods of time. Then the
14 difference between the NASS and the CME doesn't change.

15 I think we've had testimony earlier in this
16 hearing and talked about that, and so in order to
17 demonstrate the circularity you have to pick a period of
18 time that includes time when there is a market price for
19 powder that significantly moves, so we're seeking in the
20 central states price was the closest replication we could
21 get to an indication that there was a demand for powder.

22 Q I understand the --

23 A We were trying to track that demand and see what
24 happened. How did the California prices respond?

25 Q I understand that you have some statistical issues

1 you had to overcome in using this and understand why you
2 used it. You've indicated you don't have an understanding
3 as to whether the market was thin or widely traded as
4 reported in that central states survey.

5 Just pointing out to you that often it appears
6 that even when the California line is wiggling up and down
7 reflecting market movement, there are many times when, for
8 example, in 1997 there the central states is absolutely
9 flat.

10 Do you know whether that line being flat
11 represents a lack of trading activity in the central states
12 of nonfat dry milk, at least as reported to NASS?

13 A Well, I don't -- I won't pretend to characterize
14 volumes.

15 Q Do you have a knowledge of the percentage of
16 national nonfat dry milk production that's produced east of
17 the Rockies versus west of the Rockies or any other
18 geographic understanding of where powder is produced?

19 A I have a general knowledge that there's a lot
20 produced in the west, but I don't have any specific numbers.

21 Q Would you accept roughly 60 percent of the
22 nation's powder produced in the western states?

23 A I couldn't -- you know, if you say so; especially
24 if you, Doug Marshall, say so. I mean, you're a credible
25 source. The only problem I have is that I can't testify

1 just on that, but there's a lot of powder made in the west.

2 There isn't any doubt about it.

3 Q So the typical movement of that powder is towards
4 the central states, is it not?

5 A I would trust that if there's a lot of powder
6 produced on the west coast that some of it's got to move to
7 other parts of the country.

8 Q Have you evaluated the data in the exhibit we're
9 talking about with respect to transportation costs and
10 whether that would explain the difference between the
11 central states line and the California line?

12 A I haven't. I haven't analyzed the transportation,
13 but that wasn't the point of it. The point we picked the
14 central states was because we needed to pick a price series
15 that wasn't specifically influenced specifically.

16 It would be somewhat influenced because some of
17 those buyers I assume in the central states may be buying
18 western powder or even California powder so they would be
19 influenced by that, but we were trying to do the best job we
20 could of picking what would most closely replicate a spot
21 market price for powder and simply to compare what happened
22 to that spot market price powder to what happened to the
23 price of the California weekly average when we know that a
24 good chunk of that California weekly average price, the
25 survey volume, is index priced to the week before survey

1 price.

2 Q And I understand that that was the purpose and
3 that you're also trying to demonstrate slower rise and a
4 faster fall --

5 A Right.

6 Q -- than the central states rise.

7 A And that's really the whole point of the graph.

8 Q And your point is further then, I take it from
9 what you just said, that that is due to the circularity
10 rather than --

11 A Right.

12 Q -- to any other factor?

13 A Right.

14 Q If I remember, when I get to be a witness and if I
15 ever get to be a witness, I might be testifying to the
16 following effect, and my question will be do you have a
17 comment on this.

18 Do you have a comment on my theory that the slower
19 to move up and the faster to move down reflect market
20 saturation of a narrow market and the geographic barrier
21 that takes some time for powder to start moving after a
22 disequilibrium occurs in the central states?

23 A Well, my comment to that, having lived through
24 these periods of time and having watched the California
25 powder price and knowing it was going to set my IV-A milk

1 price and watching it just really drag behind, we knew
2 powder was short, and we knew powder -- I mean, you know,
3 powder got up to about \$1.30, and then you've got a
4 California weekly price when it's at \$1.30 of \$1.17.

5 Okay. If you look at the line that's on 6-23-96,
6 that was a week after my birthday. I was really feeling
7 blue. I'm not kidding you. This was a subject of
8 conversation amongst producers. You know, we're not stupid.
9 We look at these price relationships, and so there was a lot
10 of pressure on our own cooperative managers who sell this
11 powder. They had to figure out a way to get that price up.

12 I'm not going to go into any details about how
13 they might have been able to do that, but some way or
14 another they figured out a way to get that actual price to
15 move from \$1.17 to it looks like about \$1.26 over about, you
16 know, a month or month and a half, but it's a tough thing.

17 You know, there's an inherent problem, and the
18 real problem with the NASS is that actually for California
19 powder makers, all of whom are my friends, so this isn't
20 personal, but this is a no lose deal. If you can get your
21 milk -- if you can get your end product sold at the NASS
22 price and your milk price is based on the NASS price and
23 there's enough in the make allowance to cover your margin,
24 you're taken care of, so if you can get all your product
25 sold at that NASS price and end powder, you know, from what

1 I understand there are powder plants that are able to
2 contract for almost all of their powder, if not all of their
3 powder, at these index type prices.

4 Q Are you aware of any indexed to NASS?

5 A None that I know of.

6 Q It's common in California --

7 A I'm talking about in California, okay? My big
8 fear and our big fear is it's in the cheese plant, the
9 butter plants' financial interest if they can lock in their
10 product price, and that's directly tied to the price they
11 need to pay producers and there's a sufficient make
12 allowance.

13 We're not arguing there shouldn't be a sufficient
14 make allowance, but if we've inoculated the plants from any
15 real motivation to move prices how will these things move?
16 Yes, the economic purists will say well, eventually there
17 won't be enough milk and somehow or another they'll have to
18 move the price up.

19 Someone has to be first, and it's a question, like
20 we said in our testimony, of when and how. That's why we
21 see the CME as being such a much more preferable alternative
22 and --

23 Q Let's talk about --

24 A And in listening to some of the problems,
25 especially Mr. Rosenbaum continues to bring it up about, you

1 know, you've got the NASS price setting your product price,
2 and you've got the make allowance, and the producer gets
3 everything that's left.

4 Well, I guess in that scenario you're stuck as a
5 processor if the make allowance isn't covered, whereas in
6 the CME you have the opportunity. That NASS price -- the
7 CME price you can negotiate, you know, above the CME price,
8 and you have that opportunity. You have more flexibility.
9 It's another flaw in going with the NASS product price
10 series to set milk prices.

11 Q Have you ever examined the correlation between
12 California prices and the CME price?

13 A For what product?

14 Q I'm sorry. For nonfat dry milk powder.

15 A I haven't done a specific study of that one.

16 Q I think you've find there probably isn't much
17 trading in nonfat. That's the problem.

18 A Well, why should there be?

19 Q Yes.

20 A I mean, there hasn't really been any market
21 movement. Let's face it. We make an awful lot more nonfat
22 dry milk than what we have domestic sales of nonfat dry
23 milk.

24 Q Are you proposing that a CME index be used or CME
25 trading price be used for nonfat dry milk?

1 A Yes, we are.

2 Q Let's explore just nonfat for a moment, though I
3 think it applies to other products. Let's explore how this
4 would work in a market in Chicago where 60 percent of what's
5 made is in I'll call say the west coast. The CME price
6 reflects the value of in this case nonfat dry milk at
7 Chicago, does it not?

8 A To be honest with you, I don't know the exact
9 delivery requirements of the CME.

10 Q Okay. Do you know what they are for cheese or for
11 butter?

12 A I don't have any specific knowledge of what the
13 delivery requirements for CME are.

14 Q I'm going to represent to you that when, for
15 example, a cheese plant at Sunnyside, Washington, sells
16 cheese on the Chicago Mercantile Exchange at a given price
17 it does not receive that given price, but instead receives a
18 lesser price reflecting a transportation adjustment. Are
19 you familiar with that at all?

20 A I'm really not familiar with the transportation
21 adjustment, and I would assume that probably depends on
22 where you deliver the cheese to.

23 Q That is correct. Location of the cheese. Right.

24 A I would assume that if there is some kind of
25 adjustment, it's somehow tied to that.

1 Q Well, the way it works then, as you would
2 logically deduce, it is whether it's picked up FOB Sunnyside
3 and suffers that location adjustment or whether we deliver
4 it closer to Chicago, there's a freight cost that reduces
5 our net price.

6 I want you to assume that since you're not
7 independently aware of it and ask you how a CME price would
8 work in valuing powder at its location value in Chicago when
9 all of it has to be -- I shouldn't say that; when 60 percent
10 of the powder -- let's use a round number of 60 percent --
11 is produced in the west?

12 A I don't know that the delivery point for CME
13 powder is in Chicago. Is it? You're not a witness. I
14 don't know where the delivery point for CME powder is.

15 Q You would acknowledge that if the delivery point
16 were in Chicago that that would be a problem then with
17 making this work, would you not?

18 A I don't know that it would be a problem in making
19 it work, but it's an issue.

20 Q I have the same issue with respect to cheese.
21 I'll represent to you that with the Chicago Mercantile
22 Exchange the delivery area or the target delivery point is
23 within 300 miles of Green Bay, Wisconsin, and that the
24 freight adjustment that I hypothetically described or asked
25 you to hypothetically consider -- it's not a hypothetical,

1 but you have to consider it hypothetically; that that
2 adjustment from Sunnyside to Chicago takes let's just use a
3 round number of four cents off of our net price.

4 How does a western cheese or, for that matter,
5 butter or powder manufacturer play, to use one of your
6 suggestions in your testimony? How would we play at Chicago
7 and make that system of price discovery work?

8 A You would -- you're assuming I know things I don't
9 know, which --

10 Q Maybe I should withdraw the line of questioning.

11 A Which is the whole freight adjustment. We're
12 looking at the CME as an indicator of price.

13 Q You're familiar with freight adjustment in the
14 California state Order, are you not?

15 A There is a freight adjustment on cheese and on
16 butter.

17 Q And why is there a freight adjustment? Is that an
18 adjustment from the CME price?

19 A Yes.

20 Q And why is there a freight adjustment or
21 transportation adjustment from the CME price? Do you know
22 the theory of that?

23 A Well, the theory on cheese was that CDFA did a
24 survey of what plants said they were paying for -- what they
25 were getting for cheese, and it showed that they were

1 getting over the period in their survey, which is about a 15
2 month survey, about a penny less or 1.2 cents less than the
3 CME for their cheese, so they adopted CME minus 1.2 cents in
4 the IV-A formula.

5 On the butter, it used to be five cents. They
6 lowered it to 4.5 cents. That was a subject of the 1997
7 hearing. There was some testimony to lower it to three.
8 They decided to keep it at 4.5, and they -- you know, that's
9 been in there in various forms for a long time.

10 Q Could you look at page 14 of your testimony, which
11 is Exhibit 25? The CME is open and honest, the third
12 sentence, I guess, fourth sentence there. "There are many
13 players on all sides of the transaction, and any one of them
14 can play."

15 A Right.

16 Q Were there not a transportation allowance in the
17 California Order, could a California cheese or butter plant
18 play at Chicago?

19 A They can play on the CME. Sure. They do it all
20 the time.

21 Q What would the economics be for them if there were
22 no transportation credit or adjustment lowering their price
23 in the California state Order?

24 A I don't know. That's another issue. I mean, the
25 issue here on the CME is can they play, and the answer is

1 yes, they can. They can be buyers. They can be sellers.
2 The issue of what they pay for their milk is another
3 question.

4 Q Well, I submit to you and give you one last chance
5 to address the subject, if you wish, that without some kind
6 of a credit to get the milk to Chicago, you play on a
7 different playing field if you're from the west.

8 A If you're trying to move your product into
9 Chicago, there is some validity to that concern.

10 Q Okay. Thank you. Let's talk about I thought you
11 guys did some interesting work there on the implicit
12 conversion cost allowance that's built into the historical
13 relationship between the CME prices and the Class III or BFP
14 price.

15 I refer I think to Table -- well, it's the series,
16 I guess, of pages, including some nice color charts, in
17 Table 2, 1 and 2, of the appendix to your prepared
18 testimony.

19 A Yes.

20 Q It seems to me, looking particularly at the graph
21 that has a horizontal orange line and shows deviations from
22 that, that the point you're making is that the BFP became a
23 more and more unreliable indicator of value and that the
24 Chicago Mercantile Exchange price would be a more valid
25 indicator of value such that it leads you to conclude that

1 what is a fair price would be judged by the CME rather than
2 by historical BFP numbers. Is that correct?

3 A No. I think the -- you know, I thought that Mr.
4 Yonkers did an interesting -- a nice job of describing in
5 his testimony. He said for decades the Class III price was
6 exactly equal to the market price. I'm sorry. I don't have
7 page numbers on Mr. Yonkers' testimony. It's probably about
8 a third of the way in.

9 For decades, the Class III price was exactly equal
10 to the market price as established by the price paid for
11 unregulated Grade B milk in Minnesota and Wisconsin. In
12 other words, market forces did not merely play a
13 significant, but a determinative role in setting
14 manufactured milk prices.

15 What we've graphed out here is what the market
16 produced in the way of a conversion margin when you take --

17 Q Excuse me. The market being the Chicago market?

18 A No. The market being the difference between the
19 commodity values that were established in the market for
20 cheese as expressed in either the Green Bay Cheese Exchange
21 or the CME and what those market prices for product, by the
22 time they went through all the competitive things that went
23 through in determining the BFP or the M-W price, what it
24 produced in the way of an implied conversion margin.

25 What you see there in this data series from

1 January 1, 1991, until into 1998, yes, you had a deviation
2 from the mean, but you had a fairly consistent conversion
3 margin.

4 Q Is that a sign to you it was working then?

5 A It was. Well, that -- I mean, for a period of
6 seven and a half years that's what folks were paying for
7 milk, and that's what the cheese prices were on the CME or
8 the National Cheese Exchange, and that's what they were
9 paying for milk, so there's a -- somehow or another if you
10 buy all the, you know, economic theory put out by folks is
11 that over time you can't pay more for milk than what you
12 could get out of the marketplace.

13 For a period of seven and half years here, and we
14 didn't go back further than January, 1991, but I suspect it
15 wouldn't be a whole lot different. That was about the
16 implied conversion margin.

17 The question on the reliability of the data came
18 in, and I think maybe we're going to hear from Mr.
19 Stephenson, Dr. Stephenson, you know, and there's others who
20 can speak to this more -- in a better fashion than I, but
21 the quantity of Grade B unregulated milk was getting so low
22 that it was no -- there was starting to become a question
23 about its statistic validity.

24 Q Okay. Because of that then didn't I hear you say
25 in your earlier testimony that the result that that produced

1 in 1999 was somehow wrong; that when you compare the BFP
2 that was used under the Order system, because of these
3 frailties it was inappropriately aligned with the CME?

4 A Well, what happened, in our view, is that you're
5 going along with the M-W type price, a competitive pay
6 price. It needed to be updated. There was an interim BFP
7 that was put in, whereas NASS was an updater. You still
8 maintain that base milk price, and you put these NASS prices
9 in as an updater to that, and then you had some wild swings
10 in commodity prices.

11 What appears to us is that as those commodity
12 prices moved up and the NASS assumed that that price would
13 be passed along to producers, it didn't get all passed along
14 to producers. The Grade B producers were not getting all of
15 the full value that NASS was predicting, and then when the
16 prices dropped those margins increased, so the --

17 Q Isn't that another way of saying that the CME
18 would have allowed for a greater price for producers than --

19 A It probably would have.

20 Q -- the Federal Order system generated through the
21 BFP?

22 A That the CME would have? Well, yes. We have
23 acknowledged in our testimony, even though in the
24 development of this final rule our position was that we
25 needed to stay with a competitive pay price, the lack of a

1 place to find a competitive pay price.

2 We have acknowledged that we need to go to an end
3 product pricing system, but when we look at the results of
4 that end product pricing system it cannot greatly deviate
5 from the implied conversion margins that existed when we had
6 a competitive situation.

7 Q Well, that's where I was trying to head, and
8 that's what gets me to my question, which is have you
9 examined how your formula would or wouldn't compare to those
10 traditional --

11 A Our formula will get us back into that range.

12 Q You've presented no numbers trying to compare, for
13 example, historical BFP against the formulas that you've
14 laid out here, --

15 A Right.

16 Q -- unless I missed them.

17 A No. We didn't. I think Dr. Yonkers was asked,
18 and others have been asked. It requires quite a
19 sophisticated model to be able to do that because you've got
20 a lot of different factors that are going in to trying to
21 calculate out blend prices and all of the others, so we have
22 not specifically tried to guess exactly what that BFP price
23 would be, but we are pretty confident that we're getting
24 back into that implied conversion margin.

25 Q If it's out of that range, would you agree that

1 your formula isn't right?

2 A Well, it all depends on degree of out of the range
3 and what direction.

4 Q And what direction?

5 A We think these formulas miss quite a bit, and we
6 think we've provided some pretty solid data and proposals to
7 get us back into that range.

8 Q I appreciate the fact that you've done a lot of
9 work here, and I think that that is your goal, but I look at
10 the numbers, and a quick calculation on the protein price
11 indicated that it would go up something like 20 cents a
12 pound just at first blush as you look at the formula, and if
13 you assume three pounds of protein that right there by
14 itself is about 60 cents a hundredweight.

15 A Yes, and that's about what we're short.

16 Q Well, then you go on with the solids on the powder
17 side, and you get another two and a half cents times what,
18 eight, so 16 or 20 cents?

19 A Well, we don't have -- you know, obviously the
20 implied conversion here was an M-W BFP, which is very
21 heavily cheese weighted, so we don't have a powder
22 equivalent so that we don't have a standard there, but I
23 think we made a pretty compelling case about the inaccuracy
24 of that nonfat dry milk yield dividing by 1.02.

25 Q I don't think I want to spend a lot of time on

1 make allowances with you. I think others will. I just
2 wanted to make kind of a philosophical -- draw a
3 philosophical point out of your testimony and talk about the
4 interrelationship between what we do use in terms of yield
5 factors and so forth relative to the make allowance.

6 You've indicated at the bottom of page 31 that the
7 formulas that you advocated are based on industry standards
8 and current state of technology, and I guess I would ask you
9 if you would agree with me that similarly the make allowance
10 surveys to reflect only state of the art equipment as a
11 result.

12 A Well, I'm not -- you know, I listened to Dr. Ling,
13 and I thought that he did an admirable job of explaining the
14 survey that he did. Frankly, I thought Dr. Yonkers did an
15 admiral job of explaining how he got to his numbers. We've
16 also got the California numbers. I have a lot of respect
17 for the staff that puts those numbers together.

18 So I think, you know, USDA is going to have a bit
19 of a -- you know, a little bit of a challenge to try to
20 interpret from the information that's going to be into this
21 record where the appropriate place is to come on those make
22 allowances.

23 What we're advocating for is a policy, and if you
24 have a different view, you know, you'll be taking the
25 witness stand. You can put in your point of view.

1 Q I understand that. I'm more interested in your
2 point at the moment. Dealing with whey cream and assuming
3 that it all in effect can be reutilized, there's an
4 equipment cost and a technology cost.

5 A We did not say all. We did account for a two
6 percent loss.

7 Q Would you agree with me to get the higher
8 recoveries that it takes additional investment in technology
9 that somehow ought to be reflected in the make allowance?

10 A I don't have any particular reason to oppose that.

11 MR. MARSHALL: On that positive note, I think
12 perhaps it's somebody else's turn. Thanks, Jeff.

13 JUDGE HUNT: Mr. Rosenbaum?

14 BY MR. ROSENBAUM:

15 Q As I understand it, there are three cooperatives
16 who are joining in your testimony, Select Milk Producers,
17 Elite Milk Producers and Continental Dairy Products, Inc.
18 Is that correct?

19 A Yes.

20 Q Am I also correct that none of these three own any
21 processing facilities?

22 A I'm getting signals that they do.

23 Q Well, do any of them make cheese?

24 A Do any of them make cheese?

25 Q Do you have any cheese processing facilities that

1 are owned by any of those three?

2 A No.

3 Q Do you have any butter processing facilities that
4 are owned by any of those three?

5 A No.

6 Q And do you have any nonfat dry milk facilities
7 that are owned by those three?

8 A No.

9 Q The answer is no as to all of those?

10 A That's correct.

11 Q You are aware that 40 percent of the cheese in the
12 country is made by co-ops and even a higher percentage of
13 butter and nonfat dry milk?

14 A I couldn't vouch for those exact numbers, but it
15 wouldn't surprise me.

16 Q I think Dr. Ling had some figures on that, if you
17 recall.

18 A Okay.

19 Q Did you make an effort to seek out support for
20 your proposal by any cooperatives that actually have
21 processing facilities of their own?

22 A We represent those three marketing cooperatives
23 and trade associations, and that's who developed and
24 presents this testimony.

25 Q But my question was a little different; whether

1 you had sought support for your proposals from any
2 cooperatives that actually have processing facilities.

3 A I can't recall that we actually specifically went
4 in and tried to do anything other than just participate in
5 various industry meetings that were leading up and making
6 various points, but we didn't really go out and seek any
7 specific support for this proposal from those types of
8 cooperatives.

9 Q At those meetings, did you, for example, support
10 the switch over from NASS to CME?

11 A Did we support that?

12 Q Yes. Did you advocate that as a position that you
13 thought was correct and you hoped others would support?

14 A We've been advocating that pretty consistently
15 wherever we -- you know, wherever we've been.

16 Q Okay. All right. But for whatever reason, none
17 of the cooperatives in the whole country that own any types
18 of those processing facilities have seen fit to support your
19 proposal?

20 A Well, they're going to have to speak for
21 themselves. I'm not going to speak for them.

22 Q Well --

23 A Whether they do or whether -- I mean, how many
24 cooperatives? We've heard from the cooperative
25 representative of a cooperative trade association, but I

1 don't know that we've heard from any other cooperatives.

2 Q Okay. As of this point in the testimony at least,
3 there's been none supporting your proposal?

4 A There have been very few people get to this stand.

5 Q The answer to that was yes or no? The answer to
6 my question was yes or no?

7 A Of the people who have been on the stand? As far
8 as I know, we're the first group that has supported the
9 CME --

10 Q Okay.

11 A -- as opposed to NASS.

12 Q Well, there are no cooperatives other than the
13 three that are listed here, so far as you know, that support
14 any of your proposals?

15 A Well, we haven't heard from them. You may be
16 right.

17 Q Okay. Now, I assume that when you talk about how
18 you have -- let me back up. How many producers does Select
19 Milk have?

20 A I don't know for sure.

21 Q Less than 20?

22 A I'm getting signals that it's more than 20.

23 Q Less than 50? You're not getting a signal.

24 A The signal went dead.

25 Q I'm sorry? I didn't hear that. I'm sorry.

1 A The signal went dead.

2 Q I see. Well, I take that as a yes. And how about
3 Elite? Fewer than ten?

4 A I don't know.

5 Q And Continental also?

6 A I do not know on Continental.

7 Q All right. Now, because you mentioned that your
8 members of these cooperatives market milk in ten of the 12
9 Federal Orders or something to that effect, --

10 A Right.

11 Q -- but I take it -- or they're pooled on. Excuse
12 me. They're pooled on.

13 A Right.

14 Q Market is not the right word. They're pooled on
15 ten of the 12 Federal Orders?

16 A That's what I'm told.

17 Q But to be pooled on a Federal Order only takes one
18 load of milk?

19 A That could very well be.

20 Q All right. Now I want to ask you a question about
21 your contention on page 5 of your testimony regarding a
22 comparison between the current system and the new system and
23 the old system.

24 What I'm referring to specifically is your
25 statement on page 5, "The final rule does result in prices

1 that deviate greatly from the general level of the previous
2 M-W and BFP." Do you see that?

3 A Yes.

4 Q All right. The final rule, of course, is based on
5 these NASS surveys, correct?

6 A The final rule uses NASS price surveys to move its
7 product value formulas.

8 Q Those NASS price surveys first began in September,
9 1998, correct?

10 A Around that time.

11 Q Now, do you read Horde's Dairyman?

12 A Do you mean generally? I subscribe to it.

13 Q Okay. I want to read you a statement from there
14 and just ask you whether you would dispute this or not.

15 "Since the final rule was published, we have NASS
16 data for all months of 1999. Under the actual survey data
17 that is being used, the calculation of the new Class III
18 price during the year just finished would have averaged
19 about three cents higher than the BFP actually did."

20 That is to say that had the new rule been in
21 effect in 1999, the Class III price would actually have been
22 three cents higher than it was under the old rule. Do you
23 dispute that?

24 A I don't dispute that as being accurate. I have no
25 way of knowing independently whether that's accurate, but I

1 trust you're reading from an article by Dr. Stephenson, who
2 is certainly a credible man.

3 Q But I just want to make clear. You are not in
4 this section --

5 A We're not disputing that the BFP for 1999 tracked
6 what the final rule would have been for 1999. What we're
7 disputing is that that is the correct standard for which to
8 compare.

9 Q Okay. You're not disputing that for the entire
10 period from when the NASS data first became available in
11 September, 1998, through the present that there is any
12 substantial difference between what the price would have
13 been had the new approach been in place than what the price
14 was under the old system?

15 A No. In fact, I think we make that point ourselves
16 in one of these tables.

17 Q Okay. So that if one is concerned about comparing
18 the old rule and the new rule for all periods for which we
19 have data available from a NASS product price perspective,
20 the new rule is doing a pretty darned good job of tracking
21 what the old rule would have done?

22 A The new rule is doing a good job of maintaining
23 the high conversion margins that became embedded in late
24 1998 and 1999.

25 Q I'm wondering. That's based entirely on this

1 table, on this calculation, Table 1, right, your implied
2 conversion margin, NCE CME to BFP, 1991 through 1999?

3 A Uh-huh.

4 Q Is that right?

5 A Well, that's just a reflection of those implied
6 conversion rates.

7 Q Well, that's where -- you draw the conclusion
8 you've drawn from the figures in this table, correct?

9 A Essentially.

10 Q Who did this table?

11 A This table was done by a group of folks, but
12 actually Ben Yale helped us develop this set of data based
13 on the data that was available from sources during that time
14 frame.

15 Q I wonder if you could turn -- and your point is,
16 if I understand you correctly, that you think that the
17 relationship between the margin under the NCE CME versus the
18 BFP is large in 1999. That's one of your points?

19 A Could you repeat that question?

20 Q Yes. You said the margin was large in 1999
21 compared to previous periods?

22 A Yes.

23 Q Isn't there a big mistake in this table for
24 December, 1999?

25 A I don't know. Is there?

1 Q I think there is. I mean, the cheese price didn't
2 jump from \$1.18 to \$1.51 between November and December,
3 1991.

4 A 1991?

5 Q 1999. Excuse me.

6 A I would have to check to be able to independently
7 confirm that.

8 Q I'm going to do that for you. Just a second.

9 (Pause.)

10 Q That's an excerpt from dairy market statistics,
11 which have been officially noticed, so I'm not going to make
12 it a separate exhibit, but could you tell me what the price
13 really was that was reported by the CME for December, 1999?

14 A The 40 pound block price for December of 1999 was,
15 according to this chart here, \$1.1545 cents.

16 Q Okay. So your chart overstates that by -- well,
17 by a lot. By 35 cents, right?

18 A It does.

19 Q And that had the effect of driving up the
20 difference between the NCE CME -- well, you show that the
21 comparison of the margin of NCE CME versus BFP for December,
22 1999, was \$5.72, correct?

23 A Right.

24 Q And that's overstated by what, a factor of four?

25 A Yes, it is.

1 Q Okay. Which that had the impact of driving up the
2 1999 number by a considerable amount?

3 A It did. You're right. You're right.

4 Q You testified as to the existence of these alleged
5 long-term contracts that require farmers in the west to
6 provide milk at the minimum federal price, correct?

7 A I am told that those contracts exist. Yes.

8 Q Since you're the only witness so far on this, I
9 want to focus on that. Of course, I take it your milk is
10 not federally regulated, is it?

11 A It is not.

12 Q Okay.

13 A It's regulated. Just not federally.

14 Q Yes, but you don't have -- you obviously are not
15 yourself in a long-term contract at a federal minimum price?

16 A That is correct.

17 Q Do you personally know whether Select is in such a
18 contract?

19 A I am told that --

20 Q Well, no. This is a personal question, you know.
21 I mean, if somebody else wants to take the stand they can,
22 but, I mean, --

23 A I do not have --

24 Q -- there's a limit to how much you can look at
25 people in the crowd.

1 A It's my understanding that such a contract exists
2 in New Mexico.

3 Q Okay. But you yourself have not seen that
4 contract, I assume?

5 A I have not seen the contract.

6 Q Leaving aside New Mexico, I take it you have not
7 personally seen with your own eyes any such long-term
8 contract requiring people to sell milk at the federal
9 minimum price?

10 A I have not personally seen it with my own eyes,
11 no.

12 Q Okay. Let's talk about the CME versus the NASS
13 survey for purposes of determining wholesale prices. Just
14 to clarify, on page 7 you say that virtually every proposal
15 regarding the NASS survey either requested to be replaced or
16 that there be mandatory reporting and audits.

17 I just want to clarify. Yours is the only
18 proposal suggesting it be replaced, correct?

19 A To my knowledge, it's the only one in the record
20 that I know of that specifically asks for it to be replaced.

21 Q All right. And you're aware the question whether
22 the CME prices should be used was something that was
23 addressed in the final rule, correct?

24 A Yes. There was a passage on it.

25 Q And in fact there was no change from the proposed

1 rule to the final rule on that question, correct?

2 A Well, I hope this isn't a trick question. I
3 haven't thought about the proposed rule in awhile, so I
4 can't --

5 Q Okay.

6 A If you say that to be the case, I certainly
7 wouldn't disagree with you.

8 Q I'm trying to see whether this is something that
9 changed between January, 1998, and April, 1999.

10 A Do you mean when the proposed rule became the
11 final rule?

12 Q Yes. That's what I'm saying. I'm saying --

13 A There was a development of this NASS survey, and
14 there was an indication from USDA that that was the
15 direction they were headed.

16 Q That was in the proposed rule back in January,
17 1998?

18 A I believe you're correct. Yes.

19 Q Okay.

20 A We objected then, too.

21 Q Well, I understand, but there has been some notion
22 that the hearing should partly address the fact that there
23 were some differences between the proposed rule and the
24 final rule.

25 I just want to make clear that you agree with me

1 that the question whether the NASS survey would be used or
2 the CME prices would be used, that's not one of the changes,
3 correct?

4 A Between the proposed rule and the final rule?

5 Q Yes.

6 A The fact that it relied on a NASS price series?

7 Q Yes.

8 A That was not changed, I guess, between the
9 proposed rule. I would take your point on that that it was
10 not changed between the proposed rule and the final rule.

11 MR. ROSENBAUM: All right. Now on the CME. On
12 the CME, I want to have marked as whatever the next number
13 is --

14 JUDGE HUNT: Twenty-eight.

15 (The document referred to was
16 marked for identification as
17 Exhibit No. 28.)

18 MR. ROSENBAUM: I'm having copies of this made
19 right now. This is drawn from the CME website that
20 describes what it takes to qualify as a CME price.

21 BY MR. ROSENBAUM:

22 Q There was some questioning from Mr. Marshall about
23 where the sale had to take place. I wonder if you could
24 just tell us for each of the three products covered what
25 that document shows us?

1 A Well, there's -- I apologize. I don't want to be
2 difficult, Mr. Rosenbaum, but I'm not at all familiar with
3 the document that you've given me, so some of the terms on
4 here and the abbreviations are things I'm not familiar with.

5 Q I'm not asking you to read the whole thing, but
6 there's a column for each of the three products, butter,
7 cheese and nonfat dry milk, that simply describes the
8 locations for delivery. I'm just asking you to read those.
9 A certain number of miles from --

10 A It says in a column headed Strike Price Interval/
11 Notes --

12 Q Okay.

13 A -- on spot butter it says, "Par delivery area,"
14 and I'm assuming par has some meaning in that sentence,
15 although it escapes me. "Approved facilities in Chicago."

16 Q All right. Could you do the next one?

17 A Is that what you want me to read?

18 Q Yes. And the next one, please, for cheese?

19 A Par delivery area within 300 miles of Green Bay,
20 Wisconsin," and on nonfat dry milk, "Par delivery area.
21 "Approved facilities within 300 miles of Chicago. Delivery
22 from other approved facilities in U.S. is made with a
23 freight allowance."

24 Q Okay. You do understand when the CME reports a
25 price it's reporting a price of a transaction that takes

1 place within those geographic regions?

2 A Well, if I extrapolate from what you've given me,
3 the delivery needs to be made in these areas as described.

4 Q Okay. All right. And it's the prices of those
5 transactions which in your approach would form the basis for
6 determining the national product price for calculating
7 minimum prices through the Federal Order system?

8 A That would be the --

9 JUDGE HUNT: Is that a fire alarm?

10 (Whereupon, a short recess was taken.)

11 JUDGE HUNT: Back on the record.

12 MR. ROSENBAUM: Your Honor, if I have not done so,
13 I'd like to move Exhibit 29 --

14 JUDGE HUNT: Twenty-eight.

15 MR. ROSENBAUM: Twenty-eight into evidence.

16 JUDGE HUNT: Any objections?

17 MR. ROSENBAUM: Copies are being made.

18 JUDGE HUNT: No objections.

19 (The document referred to,
20 previously identified as
21 Exhibit No. 28, was received
22 in evidence.)

23 BY MR. ROSENBAUM:

24 Q One of the products that you are proposing to be
25 priced off the CME for purposes of the federal formula is

1 nonfat dry milk, correct?

2 A Correct.

3 Q All right. Let me show you the document that's
4 previously been marked as Exhibit 6.

5 MR. ROSENBAUM: I now have extra copies of Exhibit
6 28, by the way, for anyone who wants one.

7 BY MR. ROSENBAUM:

8 Q Do you see that that exhibit reflects the quantity
9 of transactions on the Chicago Mercantile Exchange for
10 various products --

11 A Yes.

12 Q -- during 1999? And do you see that, for example,
13 for the months of -- well, do you see that for every month
14 during 1999 there are no sales actually shown as having
15 taken place on that Exchange?

16 A No sales for which product?

17 Q Nonfat dry milk.

18 A Yes, I see that.

19 Q Okay. And yet that would be the Exchange that
20 would set the price that would have to be paid to farmers
21 for milk going into the products for which the nonfat dry
22 milk finished product price has a role to play?

23 A Right.

24 Q Now, I assume that that's not because there
25 weren't any sales taking place anywhere in the country of

1 that product during that time frame?

2 A I imagine there was an awful lot of that product
3 that was being sold.

4 Q Let me show you the NASS statistics, dairy product
5 prices, which have been officially noticed, and let me just
6 have you tell us what the sales volume was of nonfat dry
7 milk during the weeks from March 13, 1999, through April 10,
8 1999.

9 A Is there something you'd like me to read, Steve?

10 Q Yes. The quantity of nonfat dry milk sold for
11 each of the weeks shown on that piece of paper.

12 A Okay. That would be 19 million give or take, 18.7
13 million, 19.5 million, 20 million, 19.2 million.

14 Q Those numbers reflect how much was sold each week
15 that are reflected in that document, correct?

16 A It certainly appears that way.

17 Q And these are sales taking place during April and
18 March of 1999, correct?

19 A It appears that way, yes.

20 Q And notwithstanding the quantity of nonfat dry
21 milk being sold, none of that was being sold on the Chicago
22 Mercantile Exchange, correct?

23 A It didn't need to be. The price wasn't moving.
24 There wasn't anything happening, and it just was -- it was
25 just rolling out at pretty low prices.

1 Q None of it was being sold on the Chicago
2 Mercantile Exchange? Is that right?

3 A According to the CME numbers that you gave me
4 earlier, none of it was being sold on the CME.

5 Q Okay. Would you say that that is perhaps the
6 extremist case of thinness of trading one could imagine?

7 A Well, I'm not going to buy your characterization
8 of extreme. I don't see a great deviation between the
9 prices for extra grade on the CME and the prices that you
10 reported in the -- that were reported in NASS.

11 If you've got a product that's in chronic surplus,
12 it's stuck at the lowest price pretty much it can get to, I
13 don't think it should surprise anybody that nobody is going
14 to go to the CME to try to trade it because that's where
15 it's stuck, but the CME price I think is interesting. The
16 CME price during that time frame was right in the range of
17 the prices that you showed me.

18 Q And one could have bought one -- how does nonfat
19 dry milk trade, carloads?

20 A Pardon?

21 Q A carload? What's the methodology for trading
22 nonfat dry milk?

23 A Well, I think that was on that chart you gave me.

24 Q You're right. It was.

25 A You're getting me trained. It looks like

1 commodity size is 42,000 to 45,000 pounds.

2 Q Okay. And one could have, if one had wanted to,
3 simply by trading one such quantity at a price a nickel
4 higher than the actual price have through that one
5 transaction set the CME price?

6 A Well, that's assuming someone would buy it at the
7 higher price or sell it at the higher price or lower price.
8 You know, I suspect that --

9 Q Well, I'm sure someone would have --

10 A We can speculate about what might have happened.
11 You've made it pretty -- you know, you're laying out some
12 pretty good evidence about what happened.

13 There was a lot of product that was reported to
14 NASS. There weren't any sales on the CME. If you want to
15 get into a speculation exercise, we can do that all night.

16 Q I'm trying simply to establish the ease with which
17 one could manipulate the CME price, given the thinness of
18 trading, which was the principal --

19 A Oh, no. No.

20 Q The question is I'm sure if someone were willing
21 to buy nonfat dry milk for \$1.05 --

22 A Why would he go to the CME? If he wanted to buy a
23 load for \$1.05 he could have called any one of these people
24 who were selling 20 million pounds a week and offered them
25 \$1.05 and had it delivered.

1 Q Because by buying on the CME he's going to set the
2 CME price, and if you set the CME price you've now set the
3 price for raw milk under your proposal?

4 A It depends on who he was, whether he would want
5 the price to move up or not to move up.

6 Q And the quantity that it would take to do so,
7 given the thinness of trading on the CME, is leaps and
8 bounds different from the quantity you have to buy or sell
9 to effect the NASS survey price. Isn't that true?

10 A Well, but the point is that anybody can trade at
11 the CME, and it isn't the thinness or the thickness
12 so-called of the volume that's going through that market.
13 It's the fact that it's an open trade, that it has set rules
14 and that lots of others can play in it, whereas the NASS is
15 simply being reported by the plants.

16 It's the sellers of the product who are setting
17 those prices, who are reporting those prices into the NASS.
18 Those are the ones who are moving that product, --

19 Q Well, let me --

20 A -- and those are the ones that are setting the
21 NASS price.

22 Q Let me just ask the simple question. Do you agree
23 with me that if someone had offered to buy non-fat dry milk
24 in one of those weeks for \$1.05 and someone else were to
25 have accepted that price, that would have set the CME price

1 that week?

2 A It might have, depending on how long they were
3 open as others rushed to grab that higher price.

4 Q I'm not saying that anyone else is going to. I'm
5 not saying that a person is going to buy another quantity at
6 that price.

7 A Well, then it seems to me that the price would go
8 right back down.

9 MR. ROSENBAUM: One second.

10 THE WITNESS: If I might at this point, Your
11 Honor, I'd just say that the table that Steve, Mr.
12 Rosenbaum, pointed out as having an error in it will be
13 corrected.

14 I appreciate you pointing that error out and
15 apologize for it. I don't think it changes our underlying
16 point, and we will address that, but I just wanted to
17 acknowledge that for the record.

18 JUDGE HUNT: All right.

19 BY MR. ROSENBAUM:

20 Q By the way, the price on the CME would not in fact
21 go down unless there was another transaction that took place
22 on the CME?

23 A Depending on, you know, they move on sales, bids,
24 offers. There's a certain amount of minutia. I haven't
25 thought recently about how that works, so I would have to

1 think about it and have the rules laid out and refresh my
2 memory on that one.

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

4 JUDGE HUNT: Anyone else have questions of Mr.
5 VandenHeuvel?

6 MR. VETNE: (Inaudible.)

7 JUDGE HUNT: Pardon me? Would it matter?

8 BY MR. VETNE:

9 Q Mr. VandenHeuvel, the conversion criteria, the
10 factors that contribute to the conversion margin that you
11 discuss on page 3 --

12 A Would you mind? Maybe if you could raise that
13 microphone it would be easier for me to hear.

14 Q Is that better?

15 A Put a couple of books under there or something.
16 It would probably be more comfortable for you, too. I
17 notice you have to stoop to reach that microphone.

18 Q Let me rely on my technical expert here.

19 The factors that go into a conversion margin --

20 A Yes.

21 A -- that you describe on page 3. Not included
22 there, and I assume that it is intentional, is a factor that
23 you do discuss on page 8, and that is a reasonable profit.
24 Was that omission intentional?

25 A No. The conversion margin looks primarily --

1 that's the key word, primarily -- at the gross dollars
2 implicitly incorporating other essential factors. I don't
3 want you to assume that because we didn't include profit
4 that that wasn't another essential factor.

5 Profit, and the point I made earlier is when we
6 look at this price -- I think it was with Mr. Marshall --
7 over a long period of time our basic premise is that both
8 the producers and the processors need to be profitable over
9 time and so we took a long time, the January, 1991, data all
10 the way through to 1998. You know, you would have to assume
11 that there was some profitability there that is embedded in
12 the conversion margin.

13 Q Like embedded in utility costs or labor costs?

14 A This is not -- Mr. Vetne, this conversion margin
15 is not -- this is an implied margin that came when comparing
16 the value of products that were being produced by cheese
17 plants and what they were in a competitive marketplace
18 paying for milk over time.

19 The assumption here is that their costs needed to
20 be in that conversion margin and a profit and whatever they
21 needed to exist is in that conversion margin. It's an
22 implied conversion margin. It's not like the engineered
23 system we are proposing now with this end product pricing
24 system where we have to now try to pick all of those things.
25 The conversion margin we're talking about that you referred

1 to me was the implied conversion margin.

2 Q That's referring to the former M-W or BFP --

3 A That's the basis of that implied conversion
4 margin.

5 Q -- and some sales price reference. Now we're
6 working backwards, as you indicated. You're working
7 backwards to an implied producer price.

8 To get back to the implied producer price, what we
9 have are specific conversion margin factors to look at.
10 We've had a lot of testimony, and those include identifiable
11 line item costs. Your proposal, looking at the RBCS
12 data, --

13 A Yes.

14 Q -- and you've added also some things that are not
15 included in that data. I mean, RBCS is an apples to apples
16 comparison of some of the costs, not all of them, so you've
17 added administrative costs, cost of marketing. Is that
18 correct?

19 A I believe they're in that, those conclusions that
20 we came to.

21 Q But now we're tying the producer very closely to a
22 product price, and it becomes something less than implied
23 when you're starting to add those lines that make up part of
24 the line item.

25 Would it be your recommendation that although not

1 stated that in a make allowance, a line for reasonable
2 profit be included as a matter of administrative judgement
3 in the make allowance?

4 A Well, I think a return on investment is a
5 reflection of profit.

6 You know, maybe I can short circuit a whole line
7 of questioning here on a make allowance. You know, we've
8 laid out some principles. We've put some numbers there, but
9 I think we demonstrated in answers to Mr. Marshall and
10 others that we understand that USDA has a lot of information
11 to evaluate.

12 If you have a position on the make allowance or
13 your firm does, you know, you'll have every opportunity to
14 put that into the record. We can argue all night about make
15 allowance, but we have I think demonstrated as much as we
16 can at this point a position, but flexibility.

17 I don't know how much you want to beat that one
18 up. I guess you're free to do whatever you want to do, but
19 in the interest of time I was hoping to save you a little.

20 Q I was hoping to elicit a flexibility response.
21 Thank you.

22 A You got it. Anything else?

23 Q At the top of page 24, the very first line and
24 continuing through the fourth line, you indicate that the
25 most common approach by cheese plants is to incorporate whey

1 butter into the vat, and later on you say that more
2 accurately reflects industry practice.

3 A Right.

4 Q What knowledge do you have --

5 A That comes from a knowledge of discussing this
6 with Dr. Barbano, and I think you heard his answer on the
7 record earlier today, and also in discussions that I have
8 personally had with some of the CDFA cost accounting people,
9 who actually get into the plants, about what happens to
10 whey.

11 This has been a subject of quite a bit of
12 conversation and study in the California program, and then
13 when you look at, you know, where does this butterfat come
14 from, when you look at the vat fat in California on cheddar
15 cheese, you get a vat fat of 3.92. You've got a farm milk
16 value of butterfat of 3.64, and there just isn't enough
17 additional cream out there if you ignore this whey cream to
18 be able to buy enough fresh cream to get that extra three
19 points of butterfat into those cheddar cheese vats.

20 Q Okay.

21 A So there's some evidence -- not direct evidence,
22 but there's some evidence -- that when you talk to people
23 who know about cheese making and you see this type of thing
24 showing up, it's a reasonable assumption that this is where
25 whey cream, a lot of whey cream, is probably going.

1 Q Okay. Do you have any firsthand, secondhand or
2 thirdhand knowledge of the common practice of plants, for
3 example, in Wisconsin versus the plants in California that
4 CDFA told you about?

5 A Yes. In various conversations with people that
6 had some familiarity with Wisconsin, they indicated that
7 this was a practice in Wisconsin as well.

8 In fact, I was told, and I guess this is hearsay,
9 but I was told that there were some Wisconsin regulations
10 about this that were changed sometime in the not too distant
11 past which made this practice -- you know, facilitated this
12 practice.

13 Q Okay. So you were told by somebody, not a cheese
14 maker? Am I correct? Somebody who knew something about
15 Wisconsin who apparently had --

16 A Yes. To my knowledge, they specifically weren't a
17 cheese maker, but they were certainly in a position to know
18 about Wisconsin practices.

19 Q Do you know enough or do you have any information
20 enough to indicate one way or the other whether that is the
21 most common approach by plants in Wisconsin?

22 A Well, your hook is the. You know, I told you the
23 basis of my knowledge. You know, if you want to take me to
24 an absolute position you'll get me to say no, I can't prove
25 that every plant does that, but we've gotten testimony on

1 the record from Dr. Barbano saying many do.

2 Q Okay.

3 A And what we, you know, can probably surmise is
4 that nobody is throwing it away.

5 Q Would it be correct to say that with respect to
6 the plants in the Federal Order system which are proposed to
7 be regulated or whose milk receipts are proposed to be
8 regulated, you do not have any hard information on whether
9 that is or is not the most common approach?

10 A Well, you know what I found interesting, Mr.
11 Vetne, and I wasn't going to bring it up in my own
12 testimony, but I thought it was interesting when Paul Christ
13 this morning, who had Dr. Barbano on the stand, and he
14 referred to one of these documents, this Federal Market
15 Order market statistics document.

16 He was talking about I think he referred Dr.
17 Barbano -- he was trying to make the point about the 1.28,
18 and he did the math. I didn't do the math, but he came up
19 with a 3.92 percent butterfat in the cheese on Table 46 I
20 believe it was. Yes, Table 46.

21 Dr. or Paul Christ -- I don't know if he's a
22 doctor or not, but he's esteemable in my mind -- did the
23 math and came up with a 3.92 percent butterfat when
24 comparing the pounds of butterfat and the pounds of cheese
25 and doing it on a gross basis, 3.92, and then he asked Dr.

1 Barbano if that was 1.28. I don't know if you remember
2 that.

3 If you look at Table 14 --

4 Q Excuse me. Before we go on to a prolonged answer,
5 my question --

6 A I'm just about done. You asked me about Federal
7 Orders.

8 JUDGE HUNT: Let him answer the question.

9 THE WITNESS: You asked me about Federal Orders.
10 This document covers Federal Market Order market statistics.

11 JUDGE HUNT: Could you identify --

12 THE WITNESS: It's the 1998 Annual Summary,
13 Federal Market Order Market Statistics.

14 Table 14, the bottom right-hand, all market
15 average butterfat fat, content of total producer deliveries
16 of milk, 3.65. I found that interesting. You've got 3.65
17 in the all market average, and then when Paul Christ did the
18 math he came up with 3.92. Those just happen to be the same
19 numbers that the California data came up with with 3.92
20 butterfat in the vat and 3.65 in the milk.

21 BY MR. VETNE:

22 Q Okay. My question related to most common
23 practice. If I didn't indicate, the question was intended
24 to refer to plants, number of plants and proportion of
25 plants that engage in that practice.

1 Do you have any information that would answer my
2 question as more specifically articulated?

3 A I think I've done as good a job as I can do.

4 Q Thank you. Would it be correct to say that in the
5 1980s, as California milk production was growing, that there
6 was production looking for capacity in which to put that
7 production?

8 A That would be a very safe assumption.

9 Q Okay. And when that's the case, if there is no
10 capacity nearby, isn't that also true that you have to
11 transport the milk someplace, and the producer bears the
12 cost to transport it and gets a lower cost as a result of
13 transportation?

14 A That's a heck of an incentive not to produce that
15 extra milk.

16 Q If the milk is there, which was the premise of my
17 question, and there isn't adequate local capacity, would it
18 not be correct that either the producer takes a hit on
19 transportation, or he swallows whatever price he can get
20 locally?

21 A Or he cuts back production.

22 Q Well, please remember the premise of my question
23 is the production is there already.

24 A Well, but you're assuming that the producer has no
25 control on how much milk he produces, and I can assure you

1 from living through those times that lack of plant capacity
2 and the fact that in the creamery that I was shipping to we
3 got a base that we set in the spring, and we could ship that
4 -- we got a base we set in the fall, and we could ship that
5 in the spring and that the transportation costs of hauling
6 milk in the spring were going to be borne by whatever
7 production we exceeded in the spring of what we had in the
8 fall.

9 When you have -- I had months where I had 15 to 20
10 percent of my milk check that was withheld to pay for
11 transportation costs, and that last milk brought about \$6 or
12 \$7 a hundredweight. That's a heck of an incentive not to
13 produce it. I'll tell you.

14 You know, you asked me a question, and it's
15 something I actually know a little bit about, and you're
16 going to get a pretty complete answer because I'll tell you
17 something. When you look at California production over the
18 1980s, the only time there was any kind of a significant
19 slow down in pace of the increase of California production
20 was during those years before the make allowance actually --
21 the make allowance was raised in 1982. It was 1983, 1984,
22 1985. We'd run out of plant capacity in California. We had
23 no place else to go with the milk, and it was a tremendous
24 retardant on production increases.

25 Once those make allowance induced manufacturing

1 plant capacities came on line, then despite lowering milk
2 prices there was a pent up demand to produce milk, so
3 capacity has a huge -- has a lot to do with how much milk is
4 produced, and if you forget that and just want to take me
5 down some kind of a path other than that, that's not my
6 experience.

7 Q So we should infer that if we look back at the
8 California statistics that the absence of capacity resulted
9 in a decrease in the milk supply?

10 A I didn't say decrease. I said a very small
11 increase. I mean, it was relative to what had happened in
12 other times.

13 Because there was no plant capacity, all of the in
14 state plant capacity was taken once you put the cost of
15 hauling milk to Kansas, to Lynden, Washington, and to some
16 of the other places that we had to haul it to find a home.
17 It didn't return very much, and that sent a very powerful
18 signal not to produce that extra milk.

19 Q Okay. A few years ago, more than just a few,
20 there was a situation in the Federal Orders in the southeast
21 where there was inadequate capacity to process milk, and
22 milk had to be hauled from the southeast to Wisconsin. The
23 market place for regulated Class III milk received by
24 southeast cheese plants was \$1 under Class III.

25 Assuming that's true, would you compare that as

1 the same kind of situation that you experienced in
2 California?

3 A I'll tell you, John. I'd have to know more. You
4 know, you didn't give me a year. I might not have been
5 born.

6 Q That was 1982.

7 A 1982? Well, that's about the same time you had
8 the problem.

9 Q Yes.

10 A Okay. The point is, the nation didn't need any
11 more butter, powder and cheese, and yet California was able
12 to put a policy in place to encourage more plant capacity to
13 create more product for which there was no demand other than
14 the Commodity Credit Corporation.

15 Q You did testify to either firsthand or I guess
16 signal knowledge about a --

17 A Signal knowledge?

18 Q Yes. A situation in New Mexico, a long-term
19 contract at class price. Is it not true that in New Mexico
20 there is production in excess of local capacity at the
21 current time?

22 A Well, I cannot speak to that personally.

23 Q You don't know that? Do you know that milk moves
24 from New Mexico to cheese plants in Wisconsin?

25 A It very well may might, but what the financial

1 arrangements of that movement are I'm not aware of.

2 Q Okay. Are you aware that a cheese plant is being
3 built in New Mexico to take care of production in excess of
4 local capacity?

5 A Well, I don't know the way you characterize it.
6 Someone is building a cheese plant in New Mexico?

7 Q Yes.

8 A Well, I mean, that's great.

9 Q Okay.

10 A I don't know what the relevance is. If someone is
11 building a --

12 Q Or adding capacity in existing plants.

13 A And what's the question?

14 Q Well, you testified that there was a long-term
15 contract at class price --

16 A Right.

17 Q -- In New Mexico.

18 A That's what I understand to be the case.

19 Q Wouldn't class price be golly gee, I'm glad I got
20 that if there were inadequate capacity to handle local
21 production? Wouldn't you be pleased to get the Class III
22 price?

23 A You might. The point there was that the ability
24 -- I think Mr. Yonkers was making the point that it doesn't
25 matter if the make allowance is too high because, you know,

1 the plants will pay more for the milk.

2 The point we were making in that testimony was if
3 you're in a long-term contract at a minimum price and the
4 minimum price is too low, you don't have the ability to
5 recoup that in premiums because you're contractually
6 obligated for a long period of time at that minimum price.
7 That was the point of that whole exchange.

8 Q Okay. Are you familiar enough with Wisconsin to
9 know that capacity exceeds supply?

10 A I understand that. I don't have any particular
11 knowledge of that.

12 Q Are you familiar enough with Wisconsin to know
13 that there is substantial premiums as a result of bidding
14 for the supply that's more limited than capacity?

15 A Yes. I understand that's the case.

16 MR. VETNE: Okay. Thank you.

17 JUDGE HUNT: Mr. Berde? Any other questions? I'm
18 sorry. You did have a question?

19 BY MR. BERDE:

20 Q At the outset of the testimony, there was a
21 display which indicated and listed the Federal Milk Orders
22 into which those who you represent had either pooled or
23 marketed milk. Do you recall that?

24 A I recall that that was there, yes.

25 Q And one of the listed orders was the Arizona-Las

1 Vegas order. Did you see that?

2 A I don't recall looking directly at that, but I'll
3 take your word for it. Yes.

4 Q Do you actually have any knowledge of any milk
5 from any one of your constituents pooling milk in the
6 Arizona-Las Vegas order that you represent, one of the
7 organizations you represent?

8 A Does one of the organizations that I represent
9 have a member that pools milk in the Arizona-Nevada order?

10 Q Arizona-Las Vegas order.

11 A Arizona-Las Vegas order.

12 Q Yes.

13 A I believe we do, but I could double check that.

14 Q Could you identify that constituent, of whom
15 nobody else in the world is aware of?

16 A I'll take your point, and we'll take it off the
17 list pending further investigation. I know one of our board
18 members ships and his milk goes into Las Vegas, but whether
19 it's pooled on that order or not I don't know. I'd have to
20 check to find out.

21 We've got a number of our members at Milk
22 Producers Council whose milk is pooled, potentially pooled
23 in the Arizona-Las Vegas order, but I'm not sure. They do
24 have a new situation there. You know, the one dairy got
25 exempted out, and whether or not that --

1 Q Are you aware of a county called Clark County?

2 A I am aware of a Clark County, and I am aware that
3 there's a new rule, a new sheriff in town in Clark. They've
4 got a new deal, and it's real controversial. I will take
5 your point, and we can withdraw that --

6 Q Okay. Very good.

7 A -- and do it, you know, pending checking on that
8 other situation.

9 MR. BERDE: Thank you.

10 JUDGE HUNT: Yes, sir?

11 MR. SHAD: Good afternoon. My name is Dennis
12 Shad. I work for Land O'Lakes.

13 BY MR. SHAD:

14 Q Let me see. My questions are going to go to the
15 yield for nonfat dry milk.

16 A Okay.

17 Q Would you agree with me -- well, first of all, a
18 definition of your formula would be the powder price, either
19 defined by -- well, in your case the CME less a make
20 allowance of 14.6 cents, that quantity divided by .98?

21 A Right.

22 Q Okay. Would you agree with me that it is
23 equivalent to say that instead of dividing by .98 to
24 multiply that quantity by 1.02? Actually, 1.0204.

25 A Yes. That's the rough equivalent.

1 Q Okay. I'd like to go to your Exhibit 26, the
2 CDFA.

3 A Okay. I think that was in the addendum, wasn't
4 it?

5 Q Yes. That is 26.

6 A Okay.

7 Q Okay. Could you briefly explain what that is?

8 A That is a study that Dairy Marketing Branch did
9 and released in June of 1998.

10 Q Okay. Give me an idea. Is this audited numbers
11 from California?

12 A I think that the table explains -- I mean the
13 paper itself explains how it was done.

14 Q Okay. It talks about estimates, so I guess it
15 can't be audited numbers. Imputed numbers, I suppose.
16 Would you --

17 A I'm going to let the report stand on its own.

18 Q Okay. Go to the bottom of the first page.

19 A The bottom of the first page?

20 Q Yes.

21 A Okay.

22 Q Okay. It speaks at the bottom that seven of the
23 nine powder plants also produced buttermilk powder.

24 A Processed it, yes.

25 Q Okay. Two of the seven plants -- okay. We'll

1 leave it at that.

2 If we look at the first table --

3 A Okay.

4 Q -- we see nine powder plants being reported and
5 the averages of that nine, correct? Would you agree with
6 me?

7 A Yes.

8 Q Table 1. Okay. Given that only seven of those
9 produce nonfat dry milk and buttermilk powder, I'm at a loss
10 to understand. I look at the line for powder yield, which
11 is the sum of the individual nonfat dry milk and then the
12 buttermilk powder. Could you tell me how that number was
13 arrived?

14 A The nine plants and the powder yield?

15 Q Yes.

16 A I mean, I can't tell you any more than what's in
17 the study, Dennis. I mean, what's here is what's here. I
18 mean, you're asking me to explain, you know, the study, and
19 I can read it, you know, for you into the record if you'd
20 like me to do that, but I think that the study explains how
21 they got there and what plants were included and how they
22 did it.

23 Q Logically, if there's nine plants and only seven
24 of them produce both nonfat dry milk and buttermilk powder,
25 there must have been some assumption in there, so --

1 A Yes, Dennis, but look. You're assuming that
2 you've got -- when you look at Table 1, it says Number of
3 Plants. When you look at -- then you read across the
4 column. When you look at Weighted Average, you read across
5 to the right, the low, the high.

6 Your problem is coming in because you're trying to
7 trap me into saying well, there must be a problem here
8 because seven -- two of the nine didn't have buttermilk
9 powder. When you read right across the plants, you see it
10 says nine because there's nine powder plants.

11 Q That's correct.

12 A It's not necessarily true, and I'll tell you.
13 These people at CDFA are not stupid. This weighted average
14 was of the powder yield, but that doesn't necessarily mean
15 that there was no consideration of the fact that, you know,
16 they divided that by nine instead of by seven if that's what
17 you're implying.

18 Q Okay. Was this study generally accepted by the
19 industry as being valid?

20 A You know, the problem we've had in California is
21 that basically everything has been frozen since this Federal
22 Order process has gone through. Okay. We've had some
23 hearings mostly to deal with issues that had to be dealt
24 with on Class I.

25 On Class IV-A and IV-B there's been a general

1 consensus in the industry that we're just not going to --
2 we're going to sit tight until whatever happens in the
3 Federal Orders gets -- so there's a clear understanding of
4 where we're at in the Federal Orders, so this -- we have not
5 had a hearing on these issues since this study came out.

6 Yes, you know, at industry meetings there were
7 folks that were raising some eyebrows mostly because this
8 would impact the amount of money they'd have to pay for
9 their milk. We feel pretty confident that when we get into
10 a hearing we're going to start ferreting out, you know,
11 where the truth is at.

12 The powder yield in California hasn't been
13 adjusted in quite a while, and this was some pretty good
14 data, but it hasn't been tested yet in a hearing process.

15 Q Okay. Just to go on, at the bottom of page 1
16 again it speaks of the fact that the study questioned its
17 results because two of the seven plants that made buttermilk
18 powder had unusually high yields, and it assumed that was
19 because those plants also received cream, made butter and
20 had buttermilk powder coming from the cream.

21 Table 2 then goes and says okay, let's look at --
22 let's take those two plants out, and let's have an idea.
23 You circled the numbers down on -- the circling on Table 2 I
24 assume comes from you --

25 A Right.

1 Q -- to make your point. Did you look at the
2 buttermilk yield, for instance?

3 If you look at the difference between the higher
4 responder and the low responder, of those plants that the
5 Department said were representative, they've already thrown
6 out two. Do you see a difference? There's an 80 percent
7 difference between the highest and the lowest. Would you
8 question the validity of the report based on that?

9 A No.

10 Q Okay. Let's assume that the yield is right.
11 You're using the 1.02, which again you used the 1.02 in your
12 formula, correct?

13 A Correct.

14 Q So what the formula will do basically is someone
15 in the Federal Order system will pay for solids not fat in
16 producer milk based on these prices if it goes to Class IV.
17 Is that correct?

18 A That's the hope.

19 Q Right. Okay. So first of all, we're using a
20 1.02. We're assuming that all recoverable solids, both
21 buttermilk and nonfat dry milk, is being priced by this
22 formula obviously, the 1.02 yield here, the 1.02 in your
23 formula, and that includes buttermilk powder, correct?

24 A Yes.

25 Q Okay. The first line, the first factor, in the

1 formula is the powder price.

2 A Right.

3 Q Would you agree with me that there's a difference
4 in the price between buttermilk powder and nonfat dry milk?

5 A Yes.

6 Q Okay. Would you agree with me that there's a
7 difference between the cost of producing buttermilk powder
8 in a powder plant, as opposed to nonfat dry milk?

9 A That I couldn't necessarily agree to.

10 Q Could you tell me --

11 A There could be. I just don't know. I don't think
12 so. I don't think it's drastic, but I don't know is the
13 answer that I can give you.

14 Q Okay. If there were other -- well, think about if
15 we go back to still on Exhibit 26, two pages back, and look
16 at the theoretical from Professor Stephenson, et al., the
17 theoretical yield from 100 pounds of milk, of nonfat dry
18 milk and buttermilk powder. Do you see that there's a
19 difference in the amount?

20 A If you could point me to something specific,
21 Dennis, that would be helpful.

22 Q Page 10. It's at the bottom.

23 A Okay.

24 Q It is Figure 1, Theoretical Product Yields of a
25 Hundredweight of Raw Milk.

1 A Okay.

2 Q Theoretically, there's 8.69 pounds of nonfat dry
3 milk coming from a hundredweight of milk, and there's .44
4 buttermilk.

5 A Uh-huh.

6 Q If you're a butter powder plant and you're making
7 powder, would you assume if there was a 19 to one
8 relationship between the pounds of powder and the pounds of
9 buttermilk from that hundredweight of milk, obviously you
10 won't be running as much?

11 Would you agree with me that your production runs
12 on nonfat dry milk would be longer than they are in
13 buttermilk?

14 A Boy, I'm missing your point. I mean, if you have
15 the facilities, from my understanding powder is -- whether
16 it's buttermilk powder or nonfat dry milk powder, it's
17 running through the same facilities. It's a matter of
18 scheduling. I really don't get your point.

19 Q Okay. We'll do it better on direct.

20 What we end up with, whether you agree with me
21 that there is a difference in the manufacturing costs, and
22 we could get to that, but at this point your formula would
23 account for buttermilk powder at the same powder price as
24 the CME powder nonfat price?

25 A Well, I mean, I think what you have here, Dennis,

1 is 1.252 if we took the weighted average yield in the
2 California study, and if you do the theoretical I think it
3 even comes out a little higher than that.

4 In fact, I think if I were a guessing man that
5 USDA in their proposed rule had to divide by .968 as the
6 divisor in the proposed rule. We're not proposing going
7 back to .968. We're recognizing that the buttermilk powder
8 is a little less valuable than the nonfat dry milk, but to
9 take it all the way to dividing by 1.02 is just ridiculous.

10 Q Well, my question doesn't go to that. It goes to
11 your proposal, and it goes to the fact --

12 A Right, and we think that the .98 is a reasonable
13 compromise.

14 Q Would you agree with me that a 1.02 yield, which
15 is basically the numbers that you show in front of us as the
16 yield from a -- this would necessarily mean that both the
17 nonfat dry milk will be priced at the nonfat dry milk price,
18 as well as the buttermilk powder?

19 A Well, the buttermilk powder, but we're lowering
20 the yield or we're moving the yield to account for the fact
21 that the buttermilk value is a little bit less than the
22 nonfat dry milk value, so rather than proposing either the
23 96.8, which was in the proposed rule, or the 97.5, we went
24 to 98.

25 You can disagree with that, and you'll have your

1 opportunity to make your case, but I think there's some real
2 validity to that argument.

3 MR. SHAD: Thank you.

4 JUDGE HUNT: Mr. Beshore?

5 BY MR. BESHORE:

6 Q Just one follow up on that, Geoff. Your .98 is
7 mathematically the same as the 1.02 in Exhibit 26. Isn't
8 that correct? Dividing by .98 is the same as multiplying by
9 1.02. They're the same numbers, correct?

10 A Yes, but the weighted average in the California
11 survey --

12 Q Is 1.0252.

13 A Right, and so if we were to --

14 Q Which is mathematically the same as dividing by
15 .98.

16 A No, it is not.

17 Q I think Dennis established that in the first
18 question --

19 A No. Dennis --

20 Q -- to you.

21 A No. No. He did not say it was the same as 1.252.
22 It was 1.203 or something like that.

23 MR. SHAD: 1.0204 is the number I get.

24 THE WITNESS: Yes. 1.0. 1.2.

25 MR. SHAD: No. I'm sorry. 1.0204 is

1 equivalent --

2 THE WITNESS: Right. 1.204. 1.0204 --

3 MR. SHAD: Right.

4 THE WITNESS: -- as opposed to 1.0252, so half a
5 percentage point.

6 BY MR. BESHORE:

7 Q Do you mean a half a percentage point?

8 A Right.

9 Q And that's your discount for the five pounds of
10 buttermilk powder in that? For the half a pound of
11 buttermilk powder in that 1.02?

12 A Well, that --

13 Q Your discount is that .48? Well, wait.

14 A Okay.

15 Q You said it was a compromise.

16 A It is.

17 Q You said you put some judgement in here to get the
18 credit.

19 A Right.

20 Q You've got the buttermilk powder, --

21 A That's right.

22 Q -- which is not as valuable. It's indisputably
23 not as valuable as the nonfat dry milk, correct?

24 A Right.

25 Q And you're saying that's your discount, the .48,

1 the forty-eight, what, thousandths of a pound of powder
2 there or the .48 off the 1.0252? That's your discount,
3 right?

4 A What's the question, Marty?

5 Q Is that your discount --

6 A No.

7 Q -- for the reduced value of the five pounds of
8 buttermilk powder?

9 A You have the Cornell work showing a 3.2 percent
10 moisture in powder, which corresponds nicely with the
11 proposed rule divisor of .968. You have the California work
12 that shows a 1.0252, and we are proposing dividing by .98 or
13 1.0203.

14 You know, in our judgement that is a compromise.
15 Really, you know, the compromise from the proposed rule is
16 the proposed rule was divide by .968, and we're going --

17 Q Whose proposed rule?

18 A What's that?

19 Q Whose proposed rule?

20 A USDA's proposed rule, the solids nonfat yield
21 divided by .968. We're not going back to dividing by .968.
22 We're saying it's more appropriately divided by .98 as a
23 recognition that the buttermilk value is a little bit less
24 than the nonfat dry milk. It does vary, and there are times
25 in history when it's even more, but as a rule it is less

1 valuable.

2 MR. BESHORE: Thank you.

3 JUDGE HUNT: Anyone else? Mr. Marshall?

4 MR. MARSHALL: Your Honor, I simply have a
5 request. I understand that Mr. VandenHeuvel will be
6 supplying a new version of a certain table, a corrected
7 version, and we would want the opportunity to cross-examine
8 on that if necessary.

9 JUDGE HUNT: All right. No one else?

10 All right. Thank you very much.

11 Oh, I'm sorry. Mr. Rosenbaum?

12 MR. ROSENBAUM: I have one thing before he goes.
13 I just want to state that tomorrow we will submit the
14 corrected table, and I'm glad that on the record it
15 indicates who made the error. It was me.

16 We will have that corrected table tomorrow
17 available, and I think to the limited degree that somebody
18 has a question about the changes to the table --

19 JUDGE HUNT: All right.

20 MR. ROSENBAUM: -- that we will make him
21 available, but beyond that we would like to have him
22 released at this point.

23 JUDGE HUNT: Okay. Thank you very much, Mr.
24 VandenHeuvel.

25 THE WITNESS: Thank you, Your Honor.

1 (Witness excused.)

2 JUDGE HUNT: Connie, do you have a question?

3 MS. BRENNER: No. I was just wondering if Mr.
4 Rosenbaum did.

5 MR. ROSENBAUM: No, no. I have no more questions
6 of the witness.

7 MS. BRENNER: Okay.

8 MR. ROSENBAUM: We have Dr. Stephenson in the
9 back, and I think he's next on the list. We're getting
10 close to the end. He has a flight tonight, so --

11 JUDGE HUNT: All right.

12 MR. ROSENBAUM: -- we'd like to have him come
13 forward if we could.

14 Whereupon,

15 MARK STEPHENSON

16 having been duly sworn, was called as a witness
17 and was examined and testified as follows:

18 JUDGE HUNT: Would you state and spell your name,
19 please, Mr. Stephenson?

20 THE WITNESS: My name is Mark Stephenson. That's
21 M-A-R-K, S-T-E-P-H-E-N-S-O-N.

22 DIRECT EXAMINATION

23 BY MR. ROSENBAUM:

24 Q Dr. Stephenson, you are a professor where?

25 A I'm a professor at Cornell University in our

1 Cornell program on Dairy Markets and Policy.

2 Q And your professional degree is in what?

3 A I have professional degrees in Animal Science, a
4 Bachelor's and Master's. I have a second Master's and Ph.D.
5 in Agricultural Economics.

6 Q And how long have you been at Cornell?

7 A I've been at Cornell about seven years.

8 Q All right. Dr. Stephenson, you're not being paid
9 by International Dairy Foods Association to be here, are
10 you?

11 A No. I'm being paid by no one. I'm not here to
12 represent any particular client.

13 Q Okay. We didn't pay your expenses or anything,
14 correct?

15 A No.

16 MR. ROSENBAUM: I've put before you Exhibit 28, or
17 I've put before you a document I'd like to have marked as
18 Exhibit 28.

19 JUDGE HUNT: It's 29.

20 MR. ROSENBAUM: Twenty-nine. Excuse me. Does the
21 reporter have copies of that, or not yet? Okay. We'll
22 bring some copies of Exhibit 29 to the reporter.

23 (The document referred to was
24 marked for identification as
25 Exhibit No. 29.)

1 BY MR. ROSENBAUM:

2 Q Dr. Stephenson, is this an article that you wrote
3 that was published in the February 25, 2000, Horde's
4 Dairymen?

5 A Yes, it is.

6 Q And you wrote this article under the understanding
7 that USDA was shortly going to have the hearings we're now
8 in, correct?

9 A That's correct.

10 Q And you were trying to in that article talk about
11 what some of the issues that you saw as being important?

12 A Yes, I did. There have been a number of issues,
13 of course, since Federal Order reform and prior to that that
14 myself and a few other people have been trying to write
15 about.

16 Q Okay. Because this has been available for people
17 to look at for quite some time, I'm not going to have you
18 read the whole thing, but I do want to have you read the two
19 paragraphs that start in the middle at the very bottom, "At
20 the risk of generating..."

21 Could you just read that one and the next one into
22 the record for us, please?

23 A In the middle of the very -- oh, yes. "At the
24 risk of generating many letters to the editor, I suggest
25 that the real danger in regulating minimum prices is to

1 regulate a price that is too high. Processors paying a
2 regulated price which is lower than a market clearing level
3 will not be able to attract as much milk into their plant.

4 "Under this situation over order premiums are paid
5 to producers as is the case in most orders today. If
6 processors must pay more than a market clearing price, they
7 will not want to buy as much milk as is available. Farmers
8 then may be left with unsold milk, or their cooperatives
9 will be forced to find outlets for distressed sales of milk.
10 This would constitute one form of disorderly marketing,
11 something Federal Orders are supposed to prevent."

12 Q All right. One other item I want to point out in
13 the article, which is the comparison you made between what
14 the price would have been had the new rule been in effect
15 during 1999, as compared to what the price actually was for
16 that year since we were under the old system for all of
17 1999. Could you tell us what the result was of that
18 investigation?

19 A Yes. Those were results that had used the NASS
20 survey prices for all of 1999 to calculate what the new
21 Class III and Class IV prices would have been had the
22 Federal Order reforms been in place. This is just math, so
23 it's not subject to speculation, and it did compare with the
24 actual BFP prices that were announced during that full
25 course of 1999.

1 The result was that there were some months when
2 the Class III price was a bit higher than the BFP and some
3 months when it was a little bit lower, but over the course
4 of that year it was remarkably similar on average.

5 Q Okay. Tell us what the number was.

6 A I believe it was three cents higher. The new
7 Class III price would have been three cents higher than the
8 BFP.

9 Q Okay. Dr. Stephenson, do you stand by the
10 statements that are made in the article that's been marked
11 as Exhibit 29?

12 A Yes, I do.

13 MR. ROSENBAUM: All right. Your Honor, I would
14 move Exhibit 29 into evidence, and Dr. Stephenson is
15 available if others want to ask questions.

16 JUDGE HUNT: It's offered as if read. Any
17 objection to its admission?

18 All right. No objections. Exhibit 29 will be
19 received in evidence.

20 (The document referred to,
21 previously identified as
22 Exhibit No. 29, was received
23 in evidence.)

24 JUDGE HUNT: Mr. Shad?

25 //

1 CROSS-EXAMINATION

2 BY MR. SHAD:

3 Q Good afternoon, Mark. Mark, my question goes to
4 an exhibit that was entered, Exhibit No. 26, and it includes
5 a paper written by you and Professor Novacavick. It's
6 called, "The Manufacturing Costs in Ten Butter Powder
7 Plants." Are you familiar with that?

8 A Yes, although it's been quite a few years.

9 Q Okay. I just have one question about it. On page
10 38 you list assumptions, and one of --

11 A Dennis, I don't have that in front of me.

12 JUDGE HUNT: Do you wish to refresh --

13 MR. COOPER: I have a copy.

14 JUDGE HUNT: Thank you, Mr. Cooper.

15 THE WITNESS: Page 38.

16 MR. SHAD: Yes. It would be about the fourth page
17 in.

18 THE WITNESS: Yes.

19 MR. SHAD: It is 38 of your paper.

20 THE WITNESS: Appendix B?

21 MR. SHAD: Appendix B

22 BY MR. SHAD:

23 Q The second one down lists assumptions. Would you
24 like to read that?

25 A The second assumption?

1 Q Yes, sir.

2 A "It costs the same..." --

3 JUDGE HUNT: It's already an offer. Do you mean
4 just to read it to refresh his memory?

5 MR. SHAD: Yes.

6 JUDGE HUNT: Do you just want to read it to
7 yourself?

8 THE WITNESS: Okay.

9 (Pause.)

10 THE WITNESS: Okay.

11 BY MR. SHAD:

12 Q Okay. The gist of it is you're assuming in your
13 paper that it costs the same to dry 100 pounds of skim
14 buttermilk as it does to dry 100 pounds of nonfat skim milk.
15 Is that your assumption?

16 A Yes. That was a simplifying assumption.

17 Q Okay. In a butter powder plant that is operating
18 and running where you have to schedule drying time and, as I
19 pointed out before, you have a 19 to one relationship
20 between the amount of powder that is produced and the amount
21 of buttermilk and scheduling times and realizing that
22 buttermilk comes off the churn at 50 degrees, it has to be
23 cooled down and stored until there's enough to run and then
24 it's run through the system again, again being repasteurized
25 and then heated up to be dried, would you say that that

1 assumption is valid in an operating butter powder plant?

2 A Dennis, I had indicated that that was a
3 simplifying assumption for these calculations of a cost per
4 hundredweight in here. I am aware of the things that you
5 had just pointed out about the handling of various products,
6 including buttermilk in a butter powder plant and the drying
7 of that, but we didn't have enough information at the time
8 to be able to separate that price to really indicate that
9 the price was fundamentally different.

10 My conjecture would be that it probably cost you
11 somewhat more to dry a pound of buttermilk powder simply
12 because of the things that you indicated -- scheduling,
13 collection, repasteurization, small lots and so forth.

14 MR. SHAD: Thank you very much.

15 JUDGE HUNT: Any other questions of Dr.
16 Stephenson? Yes, Mr. Pacheco?

17 BY MR. PACHECO:

18 Q I have a question concerning the article that was
19 submitted. I can't remember what exhibit number it was --

20 A Twenty-nine.

21 Q Twenty-nine. -- where it says processors paying a
22 regulated price which is too low, then the market clearing
23 level will not be able to attract enough milk to their plant
24 under this situation if all the premiums are paid to the
25 producers. It goes on to say if processors have to pay more

1 than the market premium price then they will not want to buy
2 as much.

3 I guess to summarize this, the closing line kind
4 of does it. "This would constitute one form of disorderly
5 marketing." Is that the gist of these sentences here?

6 A Of just those few that you read?

7 Q Yes. Yes, because I understand --

8 A It's one way of drawing a conclusion from those
9 two different things. Disorderly marketing would have many
10 different forms, but one of them could be that there's milk
11 that's having a difficult time finding a home except at
12 distressed prices.

13 Q I would like to use these same scenarios here, but
14 just put a different light on it. Processors not paying a
15 regular price is too low causes cash flow problems on the
16 dairy.

17 One of the easiest ways to improve cash flow on a
18 dairy is because you have a fixed overhead, a fixed
19 facility. If you're milking 100 cows through this facility,
20 you might as well milk 120 cows through this facility, okay,
21 to maintain the same cash flow because your margins have
22 decreased from a lower milk price. Now, wouldn't this
23 generate, I mean, a disorderly marketing function?

24 A Yes. This is not part of the testimony I have
25 written here, but that was Master's thesis number two. I

1 did look at the effects of cash flow during low milk prices
2 and farmers' response to that, and there was a very weak
3 evidence, but some evidence. Very weak evidence that some
4 farms would increase milk production under low milk price
5 situations.

6 Q It dictates just over the last three months
7 currently that look how low the milk prices are currently
8 and milk production is increasing, so to say that low milk
9 prices are going to drive the production down, look at the
10 current situation. It dictates that that's not true.

11 A In the aggregate, whenever we've looked at changes
12 in milk prices, and if I believed anything at all about
13 economics, and I do, we would have to think that lower
14 prices, all other things being equal, would mean that
15 producers would not respond with as much milk production.

16 I believe that Geoff VandenHeuvel also indicated
17 that under low prices he had the ability and the desire not
18 to produce as much milk.

19 Q Well, that was when there was not manufacturing
20 capacity available. That was a deterrent. They had to ship
21 that milk out of the state.

22 A And he indicated that it was the low price that
23 caused him to do that.

24 Q The reason the milk left the state was simply
25 because there was no capacity for manufacturing it at that

1 time in California.

2 A Would you care to rephrase your question?

3 Q My question is under these same comments here,
4 disorderly function of marketing functions can be also used
5 on the exact opposite philosophy of what these statements
6 mean as far as if the price is too low then they will not be
7 able to attract enough milk. The plants will not. Right
8 now we see that that's not true. The last four months are
9 an indication of that.

10 The other example is that if processors must pay
11 more than market clearing prices, milk will be left unsold.
12 The cooperatives will be fined, and distressed milk will
13 need to be sold. Well, usually what will end up happening
14 is cull rates will go up. If there is no place to take this
15 milk, culling will happen on the herds, and the milk will
16 not be produced.

17 You know, there's two ways of looking at which way
18 we're going to have disorderly marketing; by not having
19 enough or by having too much. You know, I just wanted to
20 make the point that the comments written as put into the
21 exhibit necessarily cannot be said as book and, you know, as
22 clear as black and white. It's a very gray area. That's
23 just my point.

24 Thank you.

25 JUDGE HUNT: Yes, sir? Mr. Yale?

1 BY MR. YALE:

2 Q Good evening, Mark.

3 A Hello, Ben.

4 Q You had earlier indicated you weren't going to
5 testify. Is that correct? I mean, you and I had a
6 conversation.

7 A I didn't come down here with the intention of
8 testifying, no.

9 Q Okay. I'm glad because after the one mistake I'm
10 starting to think I can't read, so I thought I'd make sure
11 that we had that correct.

12 You've testified that if, as I understand it, the
13 make is higher than necessary, competition will bring it
14 back. You know, there will be an equilibrium that will be
15 established, and producers get their money in the end. Is
16 that right?

17 A Yes. I mean, the point here in this article was
18 that the real error in regulating a minimum price is
19 regulating one that's too high. Make allowances are one of
20 the things that could possibly cause it to do that. Yield
21 factors are as well. They are a number of things in the
22 formulas.

23 Q Okay. As I understand it, you say it can't get
24 too low?

25 A I'm suggesting to you that the real error in

1 market situations is to have a regulated price that's too
2 high. A regulated price that's too low would not cause
3 dairy products to not be on the store shelves.

4 The price could be low enough so that a Federal
5 Order would simply be -- really have no reason to exist. I
6 mean, why regulate a price that's \$2 or \$5 a hundredweight?
7 We'd have no need for the organization.

8 Q Let me walk through a situation. If you take a
9 Federal Order that say has a 40 percent Class I utilization,
10 and for the moment we're going to assume the rest of it is
11 cheese. Simplify the math. It's getting late.

12 If there's a change in the make allowance that
13 reduces the price by 20 cents -- we'll use that as an
14 example, so it's an increase in the make reduces the Class
15 III price and, thus, the Class I price by 20 cents. How
16 will producers get that money back in the marketplace?

17 A Ben, if the prices are such that competition
18 between processors would dictate that consumers want these
19 products, retailers are trying to buy their product that the
20 processors want, they have an incentive to try to purchase
21 more milk to make that product.

22 Q Okay.

23 A If they can't get enough milk in the doors of that
24 plant, they will pay voluntary premiums to get it there --

25 Q Okay.

1 A -- to the point that we again achieve a market
2 equilibrium.

3 Q Now, the milk, though, that goes to that Class III
4 plant, the Class III plant under the minimum Federal Order
5 only pays a minimum Class III, right?

6 A That's correct.

7 Q But the price that brings the milk to that plant
8 is that Class III price plus the blend for the Class I? Is
9 that correct?

10 A That's correct.

11 Q Now, if you're in that same market and that market
12 is such that due to some long-term contracts the Class III
13 plant cannot change the premiums --

14 A Contracts between whom, Ben?

15 Q Between the marketing cooperative or the
16 cooperative --

17 A Okay.

18 Q -- and the cheese plant, all right, cannot raise
19 the premiums. In order for the plant to or the cooperative
20 to maintain its producer base, you would agree that it needs
21 to get its price up, right, so that it can pay its producers
22 a decent price, right?

23 A The cooperative will do what it can --

24 Q Right.

25 A -- to bargain for the price.

1 Q And isn't it true that in most of those markets
2 they go to the Class I market and obtain -- they have an
3 opportunity to obtain premiums?

4 A We have premiums being paid in Class III markets,
5 as well as Class I markets.

6 Q I understand that, but in Class I markets my
7 question comes up to this. Is it doing a service if the
8 producers get their money back, but they do so by raising
9 the Class I premiums in the market to compensate for the
10 losses in the Class III?

11 A Ben, I'm not quite sure I follow the question.
12 You're assuming that all of the premiums are being paid out
13 of the Class I market?

14 Q That's right.

15 A That that is where the leverage exists?

16 Q That's right.

17 A I don't buy that. In many of the plants that have
18 contracts, long-term contracts with cooperatives, there are
19 arrangements that say over this period of time though shalt
20 deliver so many pounds of milk. Now, milk can get kind of
21 tight at those Class III plants if the cooperatives feel
22 that there is a reason to have premiums being paid.

23 Q You're not aware of the market conditions in the
24 southwest?

25 A I'm modestly aware, but am by no means an expert.

1 Q Are you aware of any Class III premiums in the
2 southwest milk marketing area?

3 A There have not been very many premiums paid in the
4 southwest, I believe, in quite some time.

5 Q Are you aware of any Class I premiums in the
6 southwest?

7 A I don't know that, Ben.

8 MR. YALE: I don't have any further questions.

9 JUDGE HUNT: Any others? Yes, Mr. Beshore?

10 BY MR. BESHORE:

11 Q Just one question, Mark. Would you agree that in
12 1999 the comparisons with the NASS prices and the non-used
13 but still reported BFP were affected by the performance of
14 that soon to be extinct price series, the BFP, in 1999?

15 A Well, in 1999 the BFP was not extinct, right?

16 Q No. It was soon to be extinct.

17 A Soon to be extinct. You know, we --

18 Q Known to be on its last legs.

19 A A lame duck, so to speak.

20 Q A lame duck.

21 A I presume that your question says do I think that
22 cheese, butter and nonfat dry milk prices would have been
23 the same if we'd had the Class III mover instead of the BFP
24 in place? Is that your question?

25 Q No, that wasn't my question.

1 A Okay. Forgive me. I read something into it.
2 Would you restate it then?

3 Q Yes. No. My question was you're comparing, as I
4 understood it in the article, which you were asked to read
5 by Mr. Rosenbaum, the hypothetically NASS generated prices?

6 A Those were not hypothetically NASS generated
7 prices. Those were NASS prices generated under the survey
8 in the same fashion that we have them generated today.

9 Q Okay. The prices that would have been in place in
10 1999 if the presently operating NASS generated end product
11 prices would have been in place in 1999. That's what you
12 were comparing to the actual BFP generated prices, correct?

13 A That's correct, but these were not hypothetical
14 NASS prices.

15 Q No. I understand.

16 A Okay.

17 Q They're hypothetical in the sense that the actual
18 Federal Order prices were not being calculated on the basis
19 of the presently, as of January 1, 2000, NASS derived end
20 product price formulas.

21 A That's correct, but the Class III price here is
22 just math. It's not open to things like blend and
23 utilization estimates and, you know, questions of that
24 nature.

25 Q Right.

1 A It's just a calculation.

2 Q I wasn't doing any of that, okay? Your math is
3 taking the formulas we have now --

4 A Exactly.

5 Q -- and projecting them backwards into 1999 --

6 A Yes.

7 Q -- and comparing to what the prices were on the
8 basis of the soon to be -- on the basis of the lame duck BFP
9 in 1999, correct?

10 A That's correct.

11 Q Okay. My question, what I was asking your view
12 on, is whether that lame duck BFP in 1999, based on the
13 declining, heavily eroding Grade B milk volumes in Minnesota
14 and Wisconsin, was not performing like a lame duck in 1999
15 and whether you aren't comparing, you know, these projecting
16 backwards the price series onto a non-performing lame duck.

17 A Marv, I think that probably you well know, but for
18 many years NASS has felt that the -- prior to 1999, NASS had
19 felt that the BRP was not a reliable, statistically reliable
20 estimate. That doesn't mean it was a bad price. It just
21 means that it was a statistically unreliable estimate in
22 their opinion.

23 Was 1999 a particularly bad year for that? I have
24 no way of knowing. I don't collect that data. I don't see
25 that data. That was collected by someone else entirely.

1 Q Okay. And you didn't do any observation, for
2 instance, of the relationship between that price series in
3 1999 and the product prices versus the relationship in prior
4 years?

5 A We didn't have NASS product prices with the
6 exception of cheese in previous years, so it's really not
7 possible to do that.

8 Q Or other product price series, CME, assembly point
9 prices or any of those prices as comparisons?

10 A I have looked at those comparisons. I didn't do
11 that in here.

12 There is a reference to what USDA had done going
13 back many years to try to estimate what they thought NASS
14 prices would have been using CME prices and others. Their
15 estimate was that the Class III price would have tracked
16 about 47 cents a hundredweight over -- I forgot what it
17 was -- some 60 month time period, I believe, using their
18 estimates of the NASS prices.

19 MR. BESHORE: Okay. Thank you.

20 JUDGE HUNT: Mr. Coughlin?

21 BY MR. COUGHLIN:

22 Q Since I haven't had an opportunity to get up here
23 before today, I figure since we're at the eleventh hour here
24 almost --

25 A You've got about minutes.

1 Q I've got about eight minutes and your plane
2 leaves? Okay.

3 A No.

4 Q I guess a couple of things. One, if I recollect
5 right I got a letter from you back about four or five months
6 ago. You were investigating doing some work investigating
7 cost of production in plants, were you?

8 A Yes.

9 Q Whatever happened to that?

10 A The project is still underway, but we don't have
11 data available at this time.

12 Q What kind of response are you getting in terms of
13 the willingness to participate?

14 A I've had very good response from folks indicating
15 that they would like to participate in this. We have not
16 started the actual collection and summarization of the data.
17 We are at the survey development and debugging mode.

18 Q As you're developing your survey, what costs are
19 you asking manufacturers to include when they submit data to
20 you?

21 A We're asking for many of the costs, which would
22 include everything from what we would call plant operating
23 costs through general and administrative costs. We have not
24 in the past looked at selling expenses, but it's something
25 that we are looking or considering doing at this point in

1 time.

2 Q When do you expect to be able to have some data
3 out of your study?

4 A In the fall.

5 Q In the fall? I guess just a final comment here.
6 I notice that at the end of your article you're predicting
7 that as long as we have Federal Order regulations we will
8 have product price formulas.

9 Is that a prediction of a demise of Federal
10 Orders, or do you think we'll ever get this issue
11 straightened out?

12 JUDGE HUNT: A rhetorical question.

13 Any other questions? Sir?

14 BY MR. SCHANBACK:

15 Q Good evening, Dr. Stephenson. I hope not to keep
16 you so long that you'll even come close to missing your
17 airplane.

18 My name is Martin Schanback. I'm a plant operator
19 in New York state. Since you are at Cornell, you're
20 probably quite familiar with the conditions of the northeast
21 market and particularly those conditions as they exist in
22 New York state.

23 Would you have any knowledge of the relative
24 relationship between milk supply and capacity in
25 manufacturing plants in New York state?

1 A It's been relatively well balanced for a number of
2 years.

3 Q And would you have any knowledge as to the
4 existence of or even if you know the amount of producer
5 price premiums that is currently being paid in New York
6 state?

7 A The premiums, as I understand it at this point in
8 time, are significantly higher than they were just a few
9 months ago. I had heard from three or four processors that
10 anywhere between 60 cents and \$1 was being paid, which is
11 really much higher than New York premiums have run in the
12 past many years.

13 Q And the same. Do you have general knowledge or
14 any knowledge of the lengths of contracts between
15 manufacturing plants and their producers?

16 A I don't particularly Mr. Schanback.

17 Q All right. Do you have any knowledge perhaps of
18 the length of the contract between cooperative associations
19 and manufacturing plants?

20 A I do for a couple of specific plants, but not in
21 general, no.

22 Q Would you care to comment as to the length of
23 contracts in one instance between manufacturing plants and
24 their producers or manufacturing plants and supply
25 cooperatives? Would you care to comment on the relative

1 length of time between the two?

2 A No, I don't. I really don't have enough data
3 points or enough confidence to feel like I could speak to
4 that. I'm sure that some of the other people who will be
5 witnesses would be able to better answer that question.

6 Q Okay. I guess I have one last question. Do you
7 have any knowledge as to the amount of premiums that are
8 being paid by cooperatives as compared to the amount of
9 premiums being paid to producers by independent plants?

10 A I don't at this point in time, no. The indication
11 that I had given you just a little bit earlier was from
12 independent or from plants who had secured a large portion
13 of their milk with independent supply.

14 Q All right. As an expert, would you conjecture on
15 the relative value to the extent that if one organization
16 pays more than the other organization there is a likelihood
17 that the two prices or the two premiums would seek a level
18 between the two?

19 A There should be some relationship between the two,
20 but I wouldn't necessarily expect them to be equal.

21 MR. SCHANBACK: All right, sir. That's the only
22 questions. Thank you.

23 JUDGE HUNT: Yes, Mr. Pacheco?

24 MR. PACHECO: It's Francis Pacheco.

25 JUDGE HUNT: Pacheco. I'm sorry, sir.

1 MR. PACHECO: We'll get it right before we're
2 done.

3 JUDGE HUNT: It's getting late.

4 MR. PACHECO: A real quick question.

5 JUDGE HUNT: From now on, I'm going to hold all
6 lawyers and everyone else to their word. If they say one
7 last question or one question, you're going to be confined
8 to that.

9 MR. PACHECO: This is. This is the last
10 question --

11 JUDGE HUNT: All right.

12 MR. PACHECO: -- from me today.

13 BY MR. PACHECO:

14 Q This is a scenario, okay? Now, the Federal Order
15 has an end product pricing system established in it. What
16 are the risks to the industry if the support price was not
17 here today? If the support price is eliminated with an end
18 product pricing system, can you give any predictions?

19 I'm basing this on a study that was written back
20 in 1978 out of Ohio Research from Jacobson. He said one of
21 the risks is that with an end product pricing system that
22 you have to have a support price to maintain some stability.
23 Do you feel that same way? That was my question.

24 A Well, we have a support price, but we haven't
25 particularly had stability in the marketplace in the past

1 ten years. In fact, very little evidence of that perhaps.

2 The two are really sort of unrelated, I believe,
3 and certainly I would think out of the scope of this hearing
4 because the Federal Order system can't do anything to
5 particularly influence the support price program.

6 I really couldn't comment on that. There are some
7 interactions obviously, but one program does not have an
8 impact on the other or can't necessarily dictate what the
9 impacts will be.

10 MR. PACHECO: Thank you.

11 JUDGE HUNT: Anyone else?

12 Thank you very much, Dr. Stephenson.

13 (Witness excused.)

14 JUDGE HUNT: We said 7:30, but in order to
15 accommodate Mr. Vetne, he indicated he had a witness who is
16 on a time constraint. Do you want to take him tonight?

17 MR. VETNE: He's indicated a willingness to be
18 first on tomorrow.

19 JUDGE HUNT: Thank you, Mr. Vetne. We'll see you
20 all at 8:00 in the morning with Mr. Vetne's witness then.

21 (Whereupon, at 7:30 p.m. the hearing in the
22 above-entitled matter was adjourned, to reconvene at
23 8:00 a.m. on Thursday, May 11, 2000.)

24 //

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2 Milk in the Northeast and Other Marketing Areas

3 Name of Hearing or Event

4 A0-14-A69, et al., DA-00-03

5 Docket No.

6 Alexandria, Virginia

7 Place of Hearing

8 May 10, 2000

9 Date of Hearing

10 We, the undersigned, do hereby certify that the
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