

1 THE UNITED STATES DEPARTMENT OF AGRICULTURE
2 In the Matter of:)
3 MILK IN THE NORTHEAST AND)
4 OTHER MARKETING AREAS)
5 Virginia Room A
6 Embassy Suites Hotel
7 1900 Diagonal Road
8 Alexandria, Virginia 22319
9 Monday,
10 May 8, 2000
11 The hearing in the above-entitled matter was
12 convened, pursuant to notice, at 8:05 a.m.
13 BEFORE: HONORABLE JAMES W. HUNT
14 Administrative Law Judge
15 APPEARANCES:
16 On Behalf of the USDA:
17 GREGORY COOPER, Esquire
18 Office of General Counsel
19 CONSTANCE M. BRENNER
20 CAROL S. WARLICK
21 Dairy Marketing Specialist, Dairy Programs
22 Agricultural Marketing Service
23 HENRY H. SCHAEFER
24 Chief Agricultural Economist
25 Federal Milk Market Administration
26 Minneapolis, Minnesota

1	C O N T E N T S			
2				
3			Examination	Examination
4	WITNESSES:	Testimony	by USDA	by Participants
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3	Ex. 1	7	7	Hearing notice
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9	Ex. 5	7	7	Designation of judge
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16	Ex. 10	191	249	Dairy products
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19	Ex. 11	192	249	NMPF Class III and IV
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22				Federal Order Reform
23				Class IV and
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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 This is a hearing on proposed amendments to Class III and
5 Class IV milk formulas for all federal milk marketing
6 orders. The proposals were published in the Federal
7 Register on April the 14th in Volume 65, Number 73.

8 The purpose of this hearing today is to receive
9 information relating to those proposals. The information
10 you provide will be made into a written record and be used
11 by the Secretary of Agriculture and his representatives to
12 make a decision on the proposals. The decision will be
13 based on the record made at this hearing containing your
14 testimony, statements and exhibits.

15 My name is James Hunt. I am an administrative law
16 judge with the Department of Agriculture. My function here
17 is to conduct a hearing to prepare the record on these
18 proposals that the Secretary and his representatives will
19 consider. Any interested person may testify. The court
20 reporter will record everything said at the hearing and
21 prepare the record. The testimony, again, will be made part
22 of the record that the Secretary will consider.

23 The record will be maintained in the office of the
24 hearing clerk at Department of Agriculture in Washington,
25 D.C. If you would like to have your own copy of the written

1 transcript, please make arrangements with the reporter
2 during a break. The record will be available for public
3 inspection down at the hearing clerk's office.

4 The testimony -- the record will also be available
5 on the USDA website. I don't know how soon that will be, a
6 week, two weeks. But in any event, it will be available on
7 the website. It also is being telecast -- audio anyway is
8 being telecasted today via the Internet.

9 Also, we are going to circulate a sheet that you
10 can put your name and your organization to indicate that you
11 are present here today. When people do testify, if you
12 would like to ask a question, please raise your hand. I
13 will give everybody an opportunity to ask questions and to
14 testify.

15 The amendments as published consist of 32
16 proposals. The procedure is to first hear from the
17 proponent of the proposals and those supporting the
18 proposal. You can ask questions after a person testifies.
19 The person who testifies will be sworn in as a witness.

20 When the proponents have completed their
21 testimony, anyone in opposition to the proposal will then be
22 allowed to testify. When each side has completed their
23 testimony on a particular proposal, we will move on then to
24 the next one. At this time, Mr. Greg Cooper of the
25 Department of Agriculture I think has some documents he

1 would like to have made part of the record in the
2 proceeding. Mr. Cooper?

3 MR. COOPER: Yes, Your Honor. Gregory Cooper,
4 office of the general counsel, U.S. Department of
5 Agriculture. We have the notices to start with as exhibits.
6 The first exhibit would be the hearing notices published in
7 the Federal Register on April 14th, 2000. And it is Volume
8 65, pages 20094, et cetera. And it is marked as Exhibit 1.

9 The second exhibit to be offered is the
10 certificate of officials notified, which is the certificate
11 that is sent that notice has been given to all of the
12 governors. And it has been pre-marked as Exhibit Number 2.
13 The third document is the news release and the certificate
14 that it has been distributed to the press. And this has
15 been pre-marked as Exhibit Number 3.

16 The fourth document is a certification that a
17 notice has been given to interested person by the various
18 market administrators. And this has been pre-marked as
19 Exhibit Number 4. And the final preliminary document is the
20 designation of yourself as judge to hear on behalf of the
21 state of New Jersey. And that has been pre-marked as
22 Exhibit Number 5.

23 The last documents, because the state order runs
24 basically concurrent with the federal order and they used
25 the hearing to change the state order, also. I would ask

1 those five be received in evidence.

2 JUDGE HUNT: Does anyone have any objections to
3 those documents identified by Mr. Cooper being made part of
4 the official record in this proceeding? Hearing no
5 objections, Exhibits 1, 2, 3, 4, and 5 will be made part of
6 the record in this proceeding.

7 (The documents referred to
8 were marked for identification
9 as Exhibits Nos. 1 through 5
10 and received in evidence.)

11 MR. COOPER: Your Honor, we also have a fairly
12 extensive list of items that we want to have official notice
13 taken of. We have a few items that would be exhibits. And
14 in most instances, we have officials from the Department of
15 Agriculture who would be available to testify concerning
16 these documents if people have any questions about how they
17 are compiled or anything of this nature. So let me try and
18 put them in some order here and start asking for official
19 notice of the following documents:

20 The Annual Federal Milk Order market statistics
21 for 1996, 1997, 1998, and also 1999 if published before the
22 end of the briefing period. As most participants know, we
23 normally leave the record open until the end of the briefing
24 period in case any of these regular publications of the
25 Department are issued between now and then.

1 The second one would be the bimonthly federal milk
2 order market statistics for 1999 through 2000, again, until
3 the briefing date. This document basically updates the
4 Annual Federal Milk Order market statistics from when it
5 runs out until currently. And it is issued -- the bimonthly
6 has all the data for two months. So we only need it every
7 other month. I'm sorry. It is twice a month, isn't it?
8 It's every other. I was right the first time.

9 Okay. The third document we are seeking official
10 notice is the annual dairy market statistics, 1996 through
11 1999. The fourth document is Dairy Market News, the
12 weeklies for the year 2000 until the briefing date. The
13 fifth document are monthly price announcements for January
14 2000 until the briefing date. And the sixth document are
15 advanced price announcements from January 2000 until the
16 briefing date. And these are all federal order statistics.

17 And if anyone has any question regarding these
18 statistics, Mr. John Rourke, chief of the market information
19 branch, is available to testify. Otherwise, we have no
20 questions for him so we wouldn't put him on the stand unless
21 somebody has some questions about these documents.

22 JUDGE HUNT: Does anyone like to have testimony
23 concerning any of these documents referred to by Mr. Cooper,
24 statistical information?

25 MR. ROSENBAUM: Are we going to do that at this

1 time?

2 MR. COOPER: Pardon me?

3 MR. ROSENBAUM: Are we going to do those at this
4 time?

5 MR. COOPER: Yes.

6 UNIDENTIFIED MALE SPEAKER: Is he going to be
7 available at another time?

8 MR. COOPER: Well, he is.

9 UNIDENTIFIED MALE SPEAKER: I mean at a later time
10 for any questions.

11 MR. COOPER: Well, we are trying to get through
12 here in order. I mean, these are publications we have been
13 dealing with for 20 years.

14 UNIDENTIFIED MALE SPEAKER: If there are questions
15 about them, I'll just ask him questions.

16 MR. COOPER: Oh, okay. I guess he could be
17 available this morning. But we could have him on later this
18 morning.

19 JUDGE HUNT: He won't be here throughout the
20 hearing, Mr. Cooper?

21 MR. COOPER: I mean, he is not going to be here
22 every day, no.

23 JUDGE HUNT: Yes, sir?

24 MR. ROSENBAUM: I have a question about the
25 hearing --

1 JUDGE HUNT: If you could for the purpose of the
2 court reporter, if you could give your name so that it will
3 be in the transcript.

4 MR. ROSENBAUM: Yes, Your Honor. Steve Rosenbaum
5 for International Dairy Foods Association. One of the
6 exhibits that was marked was the notice of hearing which
7 contains some economic analysis. I am wondering whether at
8 some point the government intends to put on the person who
9 performed that analysis.

10 MR. COOPER: Again, he will be available. The
11 person who did the model that was the basis for that
12 analysis is Mr. McDowell. And he will be available later
13 this morning.

14 MR. ROSENBAUM: Later this morning, all right. We
15 would like to ask some questions as to that topic.

16 JUDGE HUNT: Yes, sir?

17 MR. YALE: Ben Yale on behalf of Select Milk
18 Producers and Western States Dairy Producers Trade
19 Association. I do have a few questions of Mr. Rourke, if I
20 could.

21 JUDGE HUNT: Okay. Mr. Rourke, would you please
22 take the stand. Good morning.

23 Whereupon,

24 JOHN P. ROURKE

25 having been first duly sworn, was called as a

1 witness herein, was examined and testified as follows:

2 JUDGE HUNT: And would you state and spell your
3 name, please, and your title.

4 THE WITNESS: John Rourke, R-O-U-R-K-E. I am the
5 chief of the market information branch, dairy programs, AMS,
6 USDA.

7 MR. COOPER: Mr. Rourke is available for any
8 questions.

9 EXAMINATION BY PARTICIPANTS

10 BY MR. YALE:

11 Q Thank you. Mr. Rourke, under the -- you are
12 familiar with the various statistics that Mr. Cooper just
13 listed where they are asking for official notice?

14 A Yes.

15 Q What is your involvement with those statistics?

16 A The -- my position with the market information
17 branch, I have responsibility for the Federal Milk Order
18 statistics program and the dairy market -- National Dairy
19 Marketing News Service. And in that position, I am also
20 responsible for calculating and disseminating the basic
21 price information used to establish class prices under the
22 Federal Milk Order Program.

23 Q In those statistics that you announced or
24 indicated, is there anywhere in those statistics one could
25 determine the gross volume of raw product that goes into

1 manufacturing plants in the United States to compare it with
2 the gross finished product that comes out?

3 A For the Federal Milk Order Program, we do have
4 statistics in both the monthly and annual publication,
5 mainly more so in the annual, that shows the gross volume or
6 the volume of milk, skim milk, and cream used to produce
7 manufactured products from milk priced under the order
8 system. We do not have any information on what comes out of
9 the plants, just what goes into the plants.

10 The Federal Milk Order Program accounts for
11 approximately 70 percent of all the milk produced in the
12 United States. The -- some of this information on a monthly
13 basis and, therefore, an annual basis may be affected by
14 milk not pooled due to class price, lend price
15 relationships.

16 Q What about class -- well, in the past it would
17 have been Class IIIA plants? Are there any reports that
18 indicate the total milk received at those plants and the
19 total amount of nonfat dry milk and butter that went out of
20 those plants?

21 A For Class IIIA, the Federal Milk Order statistics
22 do -- does have -- include tables that shows producer milk
23 used in Class IIIA. It is a different type of statistic.
24 The manufactured product information generally is not broken
25 out by class.

1 Q Anywhere in these statistics indicate any
2 composite yields of dairy -- for dairy products, in other
3 words, composite yields for the amount of butter fat that
4 went into a plant that comes out in finished product?

5 A Not in Federal Milk Order statistics.

6 Q Anywhere in these statistics does it indicate any
7 manufacturing costs that are -- that plants report
8 indicating the cost of manufacturing product?

9 A There would be no such information in Federal Milk
10 Order statistics.

11 Q Okay. I want to change the subject to another
12 topic. In the Dairy Market News, there is information
13 listed regarding the Chicago Mercantile Exchange cash
14 prices. Is that correct?

15 A That's correct.

16 Q All right. Is -- what is the source of that data?

17 A The source of that information is the Chicago
18 Mercantile Exchange.

19 Q Okay. And how timely is that reported in Dairy
20 Market News?

21 A The Dairy Market News report is a -- it is a
22 weekly report that is printed and mailed on Fridays. The
23 actual results of trading are included in the case of
24 whether it is a daily-traded or three-times-a-week-traded
25 product. A report is generated and disseminated over the

1 Internet within, oh, I think probably an hour or two after
2 the end of trading.

3 Q So it is very timely.

4 A Yes.

5 Q Do you also in the Dairy Market News report the
6 NASS survey prices of certain dairy commodities?

7 A Yes, we do.

8 Q All right. And what is the timeliness of those
9 announcements?

10 A The NASS reports are issued on generally Friday
11 mornings. And the -- that week's -- what is released that
12 morning is carried in the report that is printed and
13 released on that Friday afternoon.

14 Q Okay. And the information that you received on
15 Friday, is that for that week or the previous week?

16 A The -- we carry one week's worth of information in
17 Market News. And the prices that are released on Friday
18 mornings are for the trading period ending the previous
19 Saturday.

20 MR. YALE: That is all the questions I have, Your
21 Honor. Thank you very much.

22 JUDGE HUNT: Any other questions for Mr. Rourke?

23 MR. ROSENBAUM: Yes, Your Honor. Right here.
24 Should I give a copy to the reporter?

25 JUDGE HUNT: Yes. You would like to offer that as

1 an exhibit?

2 MR. ROSENBAUM: Yes.

3 JUDGE HUNT: Let's make six copies available to
4 the reporter. Before we proceed, Mr. Rosenbaum, let's see,
5 of those -- the documents -- the statistics that Mr. Cooper
6 offered, let's make -- let's give them an exhibit number.
7 That annual order statistics, the first one you offered --
8 or mentioned.

9 MR. COOPER: Well, we aren't offering. We are
10 seeking official notice of that rather than making them
11 exhibits.

12 JUDGE HUNT: You don't want them marked as
13 exhibits for purposes of identification in the record or
14 just lump them all together?

15 MR. COOPER: No, we don't normally.

16 JUDGE HUNT: You don't want them marked as
17 exhibits. All right. All right. Mr. Rosenbaum, make your
18 document as proposed Exhibit 6.

19 (The document referred to was
20 marked for identification as
21 Exhibit No. 6.)

22 MR. ROSENBAUM: Thank you, Your Honor. Yes.

23 BY MR. ROSENBAUM:

24 Q In my -- do you recognize this as the April 2000
25 publication by the Agriculture Marketing Service that

1 includes the page at which the Chicago Mercantile Exchange
2 cash market monthly sales are compiled for the year 1999?

3 A Yes, sir. It looks like that table.

4 Q Okay. And is this derived from the information
5 received from the Chicago Mercantile Exchange that you were
6 referencing in response to Mr. Yale's questions?

7 A Yes, it is.

8 Q And the compilation reflects three categories of
9 information: butter, nonfat dry milk, and cheese. Correct?

10 A Correct.

11 Q And for nonfat dry milk, this document shows in
12 each month how many sales actually took place. Is that
13 right?

14 A That is correct.

15 Q So that taking nonfat dry milk, there were no
16 sales reported for extra grade in any month? Is that right?

17 A That is correct.

18 Q And there were no sales for Grade A either. Is
19 that also accurate?

20 A That is correct.

21 Q And those are the two kinds of nonfat dry milk
22 that are sold on the Chicago Mercantile Exchange?

23 A That is correct.

24 Q So that if one were to use the Chicago Mercantile
25 Exchange as a source of information as to what the market

1 price was of nonfat dry milk, the reality is there would not
2 be a single month in the year 1999 in which you had even one
3 sale to use for that information, is that accurate?

4 A That would be accurate.

5 Q Okay. And switching to cheese, the information
6 reported covers both barrels and 40-pound blocks, correct?

7 A Correct.

8 Q And in January of 1999, only five barrels of
9 cheese were reported as having been sold, correct?

10 A That is correct.

11 Q And only three in February?

12 A That is correct.

13 Q Fourteen in April, is that correct?

14 A Correct.

15 Q And I take it that you are sufficiently familiar
16 with the sale of cheese in this country and recognize that
17 is a minuscule representation of actual cheese sales,
18 barrels, is that right?

19 A That is correct.

20 Q And the -- eyeballing this, am I accurate -- let
21 me withdraw that. Take January. There are five barrel
22 sales reported and 125 forty-pound blocks reported, is that
23 correct?

24 A That is correct.

25 Q So roughly -- let me see if I can get my math

1 right. I'm sure I won't. Roughly 25 times as much -- as
2 many sales of 40-pound blocks as barrels in that month,
3 correct?

4 A I believe that is correct.

5 Q But if you skip over, let's say, to June, there
6 are 98 barrel sales and 93 forty-pound block sales, correct?

7 A Correct.

8 Q So we have gone from one month where there are 25
9 times more 40-pound block sales than barrel sales to four
10 months later there being actually slightly more barrel sales
11 than 40-pound block sales. Correct?

12 A Correct.

13 Q And are you sufficiently familiar with the
14 manufacturing and sale of cheese in this country to confirm
15 that that is not an accurate representation of the actual
16 trends in sales of these relative products over time?

17 A Yes. Based on the reported sales numbers that I
18 have seen, that would not be.

19 Q Okay. In other words, it doesn't reflect reality
20 to say that in a given year, in one month, there will be 25
21 times more 40-pound block sales in the country and in
22 another month, there actually will be more barrel sales.
23 That is not an accurate reflection of reality, is it?

24 A I would not think so.

25 MR. ROSENBAUM: Okay. That is all I have. Your

1 Honor, I would move this exhibit into evidence.

2 JUDGE HUNT: Is there any objections to Exhibit 6
3 being made part of the record? No objections. Then Exhibit
4 6 will be received into evidence. A gentleman back there I
5 think had a question. Again, Mr. Rosenthal [sic], did you
6 identify yourself for the record so that the reporter --

7 (The document marked for
8 identification as Exhibit No.
9 6 was received in evidence.)

10 MR. ROSENBAUM: By the way, it is Rosenbaum.

11 JUDGE HUNT: Oh, I'm sorry. Rosenbaum.

12 MR. ROSENBAUM: That is quite all right. Everyone
13 does it.

14 MR. ENGLISH: Good afternoon, Your Honor. My name
15 is Charles English. I represent Sweeza Foods Corporation
16 and Master Dairies, Inc.

17 BY MR. ENGLISH:

18 Q Mr. Rourke, with reference to some of the data
19 that is published from USDA and some of the discussions that
20 will be going on later here, is it true that NASS started
21 publishing Grade AA butter prices as of September '98?

22 MR. COOPER: I might interject that we are going
23 to have a witness available from NASS to talk about NASS
24 statistics later on if that would help.

25 MR. ENGLISH: If that is the case, I would just go

1 ahead and wait, if Mr. Rourke would prefer.

2 JUDGE HUNT: Unless you can answer the question.

3 THE WITNESS: I mean --

4 JUDGE HUNT: You would rather wait?

5 THE WITNESS: It is up to you. But, I mean -- he
6 is calling in now.

7 MR. ENGLISH: Sorry about that.

8 THE WITNESS: The most recent data series that
9 they are publishing started in September '98.

10 BY MR. ENGLISH:

11 Q And are you aware whether after the end of '98,
12 USDA revised the data, the monthly data for Grade AA butter
13 for the month of September through December?

14 A I believe as the data series was being developed,
15 they -- as more reports came in, some of those weeks may
16 have been revised. I don't believe that there was any
17 concerted effort after four months to go back and revise the
18 data.

19 MR. ENGLISH: I will wait for the NASS witness.

20 JUDGE HUNT: Does somebody over here have a --

21 MR. YALE: Just a follow-up if everybody else is
22 done.

23 JUDGE HUNT: All right.

24 MR. YALE: And for the record, this is Ben Yale.

25 BY MR. YALE:

1 Q Mr. Rourke, I want to go back and ask some follow-
2 ups from Mr. Rosenbaum's questions. When he talked about
3 five barrels and three blocks, he is talking about car
4 loads, right?

5 A That is correct.

6 Q Okay. And what is the role of the Chicago
7 Mercantile Exchange cash market? Is that to sell all the
8 cheese or to reflect a point for a buyer or a seller looking
9 to move or buy product as the market demands?

10 A The Chicago Mercantile Exchange serves a function
11 to -- as a market where you can go and sell product if you
12 wish to do that. It also is used as a mechanism to
13 establish price levels that the industry feels is accurate.

14 Q And do you have any knowledge as to how the
15 industry uses those CME prices that are reported?

16 A The cheese industry generally uses the CME prices
17 as the base price in pricing formulas on which they will
18 base their contract sales. I believe the cheese industry
19 for the most part has been using the weekly average price
20 that is computed by Dairy Market News.

21 The butter industry, when they went to three-day-
22 a-week trading, I don't think there has been as much
23 consensus as to what price to use for their long-term -- for
24 their contract sales. But generally, I think what is in
25 those contracts uses as a base price one of the CME butter

1 prices.

2 Q Either the daily price or the average of the week
3 or the three days?

4 A And it also depends. Some contracts I think are
5 set up on price on day of order or day of make. There is
6 still not much consensus in the butter industry as to what
7 price they use.

8 Q So in other words, although it may only list for a
9 particular month 5 blocks sold or 13 blocks or whatever the
10 number was, that, in fact -- that price is used by a large
11 portion of the cheese industry in pricing cheese for that
12 period. Isn't that correct?

13 A That is my understanding.

14 Q And most of the cheese?

15 A I don't have any direct evidence on that.

16 Q Are you aware of any other index used to price
17 cheese in the United States, cheddar cheese?

18 A No, I'm not.

19 Q Okay. What about cheeses other than cheddar:
20 provolone, mozzarella, and the like? Are those also indexed
21 to your knowledge off of the cheddar price reported on the
22 CME?

23 A Based on the information that we publish in Market
24 News and looking at week-to-week price changes, much other
25 cheese is based on the CME.

1 Q There was a question regarding the nonfat dry milk
2 contracts. For 1999 there were none. One of the other
3 statistics that you report in Dairy Market News is purchases
4 by the CCC, is it not?

5 A That is correct.

6 Q And has there been a period over the last couple
7 of years where there were no purchases reported by the CCC
8 of nonfat dry milk for a particular month?

9 A I don't recall for sure for all the 24 months in
10 the last couple of years. But that is a possibility.

11 Q But there is -- in recent time, has that price or
12 those sales increased --

13 A Yes.

14 Q -- of purchased?

15 A Yes, they have.

16 Q And what would be -- do you know what the
17 effective price is for nonfat dry milk per pound based on
18 the support price?

19 A The current support price is \$1.01 per pound. And
20 I think the most recent NASS prices have been slightly below
21 that. So a whole lot of the nonfat dry milk being traded,
22 at least that being sold to the government, obviously it is
23 all at \$1.01.

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

1 JUDGE HUNT: Yes, sir.

2 MR. COUGHLIN: Thank you. My name is Ed Coughlin.
3 I represent the National Milk Producers Federation.

4 BY MR. COUGHLIN:

5 Q John, beginning January 1, the USDA basis for
6 pricing of butter became the AA price --

7 A Correct.

8 Q -- per the NASS survey of AA prices of butter. In
9 -- prior to December 1, what was the basis for determining
10 the value of butter under the orders?

11 A Prior to January 1, we used an equivalent butter
12 price that was a Grade AA equivalent butter price.

13 Q And why was that necessary?

14 A The orders contained at that time in the butter
15 fat differential calculation -- contained the use of a Grade
16 A butter price. We used in the Chicago Mercantile Exchange
17 Grade A butter price. And trading of that product was
18 discontinued by the Chicago Mercantile Exchange in which
19 case we needed to determine an equivalent price using those
20 provisions of the orders.

21 Q Do you know why the Grade A butter price was
22 discontinued?

23 A The Grade A butter price was discontinued due to
24 lack of trading.

25 Q And did that represent a lack of Grade A butter

1 being produced?

2 A Yes, it would.

3 Q Is -- do you have any knowledge of approximately
4 the levels of AA butter versus A butter that is produced in
5 the United States?

6 A I have no direct knowledge, no.

7 Q But it would it -- is there some indication that
8 there is a lack of A butter if there was no basis to
9 establish a price?

10 A The dairy price -- under the price support
11 program, the purchase price for -- is for Grade A butter or
12 better. Back when the government was buying butter, we were
13 told that approximately 90 percent of the butter that the
14 government was buying was Grade AA. Whether or not that is
15 representative of production, I don't know.

16 Q And is it fair to say then if that would be the
17 case, then that the present basis for pricing represents
18 about 90 percent of the butter that is being produced? In
19 other words, using of the AA price.

20 A Given that that relationship hasn't changed since
21 then.

22 MR. COUGHLIN: Thank you.

23 MR. CHRIST: Your Honor?

24 JUDGE HUNT: Yes, sir.

25 MR. CHRIST: Your Honor, I am Paul Christ, a dairy

1 economist representing Land O' Lakes, Incorporated; Barden
2 Hills, Minnesota.

3 BY MR. CHRIST:

4 Q A couple of questions for you, Mr. Rourke. At the
5 time you -- the trading in Grade A butter was discontinued,
6 what was determined to be an equivalent butter price?

7 A The equivalent butter price is the Grade AA price
8 from the -- at that point was the Grade AA price minus 9
9 cents.

10 Q Has the Secretary made any further determinations
11 as to what constitutes an equivalent butter price to
12 Grade A?

13 A Not since that was determined, no.

14 MR. CHRIST: Thank you.

15 JUDGE HUNT: Mr. Rosenbaum?

16 BY MR. ROSENBAUM:

17 Q Mr. Rourke, I believe your testimony was that the
18 CME price is used as a basis for pricing cheese transaction.
19 Is that -- I think that is the phrase you used.

20 A Base price, yes.

21 Q Does that mean that actual prices may vary by
22 contract off of what the CME price is?

23 A That is correct.

24 Q And, in fact, they do vary.

25 A Well, yes.

1 Q I used the word, "may," but they actually do,
2 correct?

3 A Many do, yes.

4 Q Okay. And they do in terms of additions or
5 subtractions of the CME price, a penny off or a penny more
6 or something like that?

7 A That's correct.

8 Q Okay. And does the NASS survey actually capture
9 the price at which the transactions really took place?

10 A That is correct.

11 Q And does -- the CME by definition does not reflect
12 sales to the government; is that correct?

13 A That's correct.

14 MR. ROSENBAUM: Thank you.

15 JUDGE HUNT: Any other questions of Mr. Rourke?

16 MR. COOPER: I do have one follow-up here.

17 EXAMINATION BY THE USDA

18 BY MR. COOPER:

19 Q We took official notice of the Dairy Market News
20 statistics for this calendar year. Are those statistics
21 contained in another document for prior years?

22 A The annual dairy market statistics does include
23 weekly -- a summary of some of the weekly prices that are in
24 the weekly prices. The weekly -- all of the information
25 that is in the weeklies are only in the weeklies.

1 Q Okay. So all of the information in the weeklies
2 is not in the annuals?

3 A That's correct.

4 MR. COOPER: Okay. Then I would like the official
5 notice on that expanded to include the weeklies since the
6 beginning of 1998. I have no further questions.

7 JUDGE HUNT: Thank you very much, Mr. Rourke. And
8 any objections then to taking official notice of the
9 documents which Mr. Cooper offered and which Mr. Rourke
10 answered questions about? All right. We will take official
11 notice of those documents, the statistical reports, Mr.
12 Cooper.

13 MR. COOPER: Is Mr. Milton here? I hadn't noticed
14 him. Maybe he could come up and take the stand just so long
15 as he is going to have questions anyway.

16 MR. MILTON: Good morning.

17 JUDGE HUNT: Good morning.

18 Whereupon,

19 ROBERT MILTON

20 having been first duly sworn, was called as a
21 witness herein, was examined and testified as follows:

22 JUDGE HUNT: And would you state and spell your
23 name and give your job --

24 THE WITNESS: My name is Robert Milton. I am
25 chief of the livestock branch with the National Agriculture

1 Statistics Service. It is Robert Milton, M-I-L-T-O-N.

2 MR. COOPER: Okay. I have got a number of
3 publications of NASS that I am going to ask that official
4 notice be taken of. And then we have two exhibits that Mr.
5 Milton has prepared for the hearing that I will ask him
6 about after that. And then I will turn him over to the
7 lions.

8 The first document is one entitled "Milk
9 Production." And we would like to have official notice of
10 the February 16, 2000 issue which contains the monthly data
11 by state for 1998 and '99. We would also like official
12 notice of the March 16th, 2000 issue and the April 17th,
13 2000 issue and any future issues of Milk Production until
14 the end of the briefing period. I understand that between
15 March and April, we have covered the first quarter at least
16 of 2000. And it is a monthly publication. Other ones will
17 come out and cover a further period of time.

18 MR. YALE: One clarification. Is that the full
19 title?

20 MR. COOPER: Is that the full title, "Milk
21 Production"? I believe it is. Okay. The second document
22 is one called "Milk Production Disposition and Income."
23 This is a 1998 annual and a 1999 annual. We would like
24 official notice taken of both of those.

25 The third document is "Agriculture Prices." Since

1 the annual issues contain two years' worth of data, we are
2 asking for official notice of the 1990, '92, '94, '96, and
3 '98 annual issues. We are also asking for official notice
4 of the monthly issues from January 9 -- January 1999 to the
5 close of the briefing period. And it is Agriculture Prices.

6 The fourth document is "Dairy Products." We are
7 asking for official notice of the 1999 annual issue which
8 includes 1998 data. We are also asking official notice of
9 the April 3, 2000 issue which includes January through
10 February data of this year, the May 4th, 2000 issue which
11 includes February and March data, and any other issues that
12 are -- come out until the end of the briefing period. It is
13 Dairy Products.

14 The fifth document, the fifth publication is "Cold
15 Storage." We are asking official notice of the April 20,
16 2000 issue and any other issues that come out until the end
17 of the briefing period. The sixth document is "Milk Cows
18 and Production: Final Estimates 1993 through 1997." This is
19 all one publication. And we would like official notice
20 taken of that.

21 The seventh one is "Milk Disposition and Income:
22 Final Estimates 1993 through 1997." Again, this is one
23 publication. The eighth document is "Milk Final Estimates,
24 1988 through 1992." Again, this is one publication. And
25 the ninth category is "Weekly Dairy Products Prices." We

1 would like the May 5, 2000 issue and further issues until
2 the briefing date.

3 This document comes out weekly, as it is
4 indicated. And rather than submit all the weekly ones for
5 the past two years, roughly, we have had Mr. Milton prepare
6 an exhibit which contains the dairy products prices, the
7 weekly dairy products prices since September 5th, 1998 when
8 NASS first started issuing them. And do you have that with
9 you today?

10 THE WITNESS: Yes, I do.

11 MR. COOPER: And are copies available in the back
12 of the room?

13 THE WITNESS: Yes, they should be.

14 MR. COOPER: And I would like that marked as
15 Exhibit Number 7.

16 JUDGE HUNT: Okay.

17 (The document referred to was
18 marked for identification as
19 Exhibit No. 7.)

20 EXAMINATION BY THE USDA

21 BY MR. COOPER:

22 Q And is that how that was prepared, you went back
23 and pulled down the prices for each?

24 A That is correct.

25 Q And this --

1 UNIDENTIFIED MALE SPEAKER: Can you give the title
2 of that document again?

3 BY MR. COOPER:

4 Q What is the document entitled specifically on top
5 there?

6 A Specifically, at the top it states, "NASS Dairy
7 Products Weekly Prices from the Inception of the Nonfat Dry
8 Milk, Butter, and Dry Whey, Time of Collection to Current."

9 Q And that is just a convenience so we can follow
10 them there.

11 A Right.

12 Q Those data could be found if we took notice or had
13 copies of all the weekly dairy product prices?

14 A Right. These data are on the NASS website.

15 Q Did you prepare another exhibit?

16 A Yes, I have.

17 Q And this is a six-page exhibit. And the first
18 page is entitled, "Brief Summaries of NASS Data, Theory Data
19 Series"?

20 A That is true.

21 MR. COOPER: And I would like that marked as
22 Exhibit Number 8, Your Honor. I would like that marked
23 as --

24 JUDGE HUNT: So marked, yes.

25 MR. COOPER: -- as Exhibit No. 8.

1 JUDGE HUNT: Yes.

2 (The document referred to was
3 marked for identification as
4 Exhibit No. 8.)

5 BY MR. COOPER:

6 Q And could you explain what that exhibit is? In
7 fact, I don't know how many people have copies of that.
8 Have they been distributed? I think they were out there on
9 the table. Maybe you could go through it page by page and
10 explain what that is.

11 A Okay. To start with, I have a brief summary of
12 each one of the NASS data publications. Milk Production, as
13 you know, comes out monthly. It includes milk production
14 data for the 20 largest states plus the U.S. And then on a
15 quarterly basis, there is information for all 50 states plus
16 the U.S.

17 The second publication, Milk Production
18 Disposition and Income, comes out annually in April. It
19 shows any revisions in milk production annually by state as
20 well as the disposition and the income of receipts of milk
21 by state plus the U.S. Agricultural Prices comes out
22 monthly. It includes price data for all milk,
23 manufacturing-grade milk and fluid-grade milk, plus the fat
24 test in the U.S. on a current month basis and by state for
25 the prior months.

1 The fourth publication is Dairy Products. The
2 manufacturing and production of dairy products, the major
3 products. It comes out monthly. It includes all types of
4 cheeses, as well as butter, nonfat dry milk, dry whey,
5 frozen products as well.

6 Weekly -- we just stated we publish the volume and
7 the price for cheddar cheese, both 40-pound block, 500-pound
8 barrel plus butter, nonfat dry milk and dry whey prices.
9 The cheese series started in March of '97. The other three
10 products started with the first week of September.

11 Cold Storage Data comes out monthly. It includes
12 more than 100 different food items that are kept in
13 refrigerated warehouse storage. It includes American cheese
14 and butter in those storage holdings. And for the rest of
15 the exhibit, I have some charts that pertain strictly to the
16 weekly dairy product prices.

17 The first chart is titled "Weekly Dairy Product
18 Prices," gives an example or an overview of the coverage of
19 that price survey for the most part for the weekly dairy
20 product prices. Everyone manufacturing more than one
21 million pounds of product for each one of the products
22 yearly was included in the survey which includes about 99
23 percent of production for each one of the products.

24 Now, the people eligible for the survey, eligible
25 people are people that qualify for the -- that can meet the

1 price reporting specifications or standards. About 71
2 percent to more than 90 percent of the eligible firms, that
3 is the amount of production they accounted for. And then of
4 the firms reporting, of the eligible firms, then the firms
5 reporting account for roughly 70 to 90 percent of the
6 eligible production.

7 The second chart shows the volume of cheddar
8 cheese since the inception of that survey back to March '97.
9 It shows NASS has averaged roughly 14 to 15 million pounds
10 weekly with about a third of that being 40-pound blocks and
11 two-thirds being 500-pound barrels.

12 The third chart shows the NASS volume of 500-pound
13 barrels weekly compared to the CME. NASS has averaged eight
14 to ten million pounds weekly compared with the CME which was
15 for the most part I think they averaged between 300,000 and
16 400,000 pounds weekly.

17 Q And I take it CME is Chicago Mercantile Exchange?

18 A That is correct. The next chart shows similar
19 data for 40-pound blocks. NASS has averaged roughly 45
20 million pounds weekly compared with the CME also somewhere
21 on an average between 300,000 and 400,000 pounds weekly. A
22 couple of prices on charts -- excuse me, a couple of charts
23 on prices.

24 A comparison next of the NASS 500-pound barrel
25 price with the CME price. And you can see the correlation

1 is almost perfect, pretty much the same price. The NASS
2 price does lag the CME price by a week. The next chart on
3 40-pound blocks shows a similar price comparison between the
4 NASS data and the CME price. Here again, a very tight
5 correlation, pretty much the data -- two data series almost
6 marry each other.

7 The next chart shows butter volume. That is
8 picked up by NASS as compared to the CME. Since September
9 of '98, NASS has roughly averaged four to five million
10 pounds weekly and the CME, an average might be a half a
11 million pounds or so weekly with spikes up to probably close
12 to two million pounds.

13 The next chart shows the NASS butter price
14 compared with the CME price. And here again, this chart
15 doesn't show it real well, but those two data series almost
16 mirror each other exactly. The next to the last chart on
17 nonfat dry milk shows that NASS roughly picks up 15 to 20
18 million pounds of nonfat dry milk weekly which gives you
19 close to 800 million pounds yearly. And the price, as
20 someone indicated already, for the last year has been
21 roughly between \$1.00 and \$1.02 per pound.

22 The last chart shows the NASS dry whey volume and
23 price data since September '98. It shows roughly six to
24 eight million pounds picked up weekly. And the average
25 price over the last year or so has been between roughly 17

1 and 20 cents per pound. That completes the exhibit.

2 Q Were Exhibits 7 and 8 prepared in support of or
3 opposition to any particular proposal or for informational
4 purposes?

5 A For informational purposes only.

6 MR. COOPER: Okay. Thank you, Mr. Milton. And I
7 give you over to the questions of the participants.

8 EXAMINATION BY PARTICIPANTS

9 BY MR. YALE:

10 Q For the record, Ben Yale. Mr. Milton, you
11 indicated several times in there as you were showing some of
12 the charts in Exhibit 8 that the NASS and the CME mirrored
13 each other. Can you tell me whether the NASS reflects the
14 CME prices or the CME reflects the NASS prices?

15 A The only thing I can tell you is usually, like I
16 said, the NASS price data comes -- lags the CME data by a
17 week and it tends to mirror the CME data for a week later.

18 Q Isn't that a statement that the NASS reporting is
19 telling us that the CME price is used by most, if not all,
20 of the plants that report to NASS as a basis for the price
21 that they sell their cheese?

22 A It appears so.

23 Q In Exhibit 8 on the third page, you have a table
24 that shows a number of firms eligible, et cetera. Do you
25 see that?

1 A Yes.

2 Q Can you give us the number of plants that report
3 cheese to the NASS on a weekly basis?

4 A It would be pretty much the numbers you see here
5 for cheese, the 29 -- and I would say it is firms and not
6 plants because many firms have -- some have more than a half
7 dozen plants.

8 Q Does it change from week to week the numbers of
9 plants that report?

10 A Very little. On occasion, we do not receive a
11 report and have to update it the following week.

12 Q And how often do you -- how many weeks will you
13 revise your data?

14 A Only through the current month, four to five
15 weeks.

16 Q Is there any effort made by NASS to encourage
17 those eligible firms who are not reporting to report?

18 A Yes, there is. Once to twice a year, we try to
19 encourage the state offices. We just had someone recently
20 going out on a field trip to try to encourage a
21 participation in the weekly surveys.

22 Q Now, I -- as I understand it, this is the -- the
23 number of firms eligible for cheese is 49 and the number of
24 firms reporting is 29?

25 A Right.

1 Q Okay. Of the 20 firms that aren't reporting,
2 where are they located?

3 A They tend to be pretty much spread across the U.S.
4 And they tend for the most part to be smaller than firms
5 reporting.

6 Q Do you know -- do they tend to -- are more than --
7 is there a plurality in any one region?

8 A No, I do not believe there is.

9 Q Do you have that information available to show us
10 where the plants are located that are not reporting?

11 A Not right at the moment. But it could be -- I
12 guess it could be made available. NASS does not publicly
13 state that type of information with regard to its reporting
14 statutes, though.

15 Q Do you have a listing of the states and the number
16 of plants that are reporting from those states?

17 A I do not have that handy, no.

18 Q Is that information available?

19 A It could be.

20 Q Now, this information that you showed on Exhibit
21 Number 7, this reflects the most recent revision that would
22 have been on that weekly data?

23 A I would believe that to be correct.

24 Q Does the -- do those who report to NASS on 40-
25 pound blocks also report the moisture content of those 40-

1 pound blocks?

2 A We don't request the moisture percent on the 40-
3 pound blocks.

4 Q Is there any auditing done of these prices to
5 determine whether they are accurate or not?

6 A No, there isn't, not by NASS.

7 Q Is there any way that NASS can determine whether
8 or not the prices reported reflect the -- all of the real
9 price of that product FOB the plant?

10 A Based on what we know, NASS, about the production
11 of the products, then we believe that the price is
12 representative of cheese prices or the other product prices.

13 Q The plants that report, do you know -- for
14 example, a plant that reports 40-pound blocks, do you know
15 whether they produce any 40-pound cheddar that would not be
16 eligible for this report?

17 A Naturally, some of the volume is not eligible with
18 regard if you were speaking for -- cheese that has been held
19 for aging and so forth is not included in the survey or in
20 the company sales according to the price specifications.

21 Q Do you have any way of knowing whether the prices
22 reported for the 40-pound unaged blocks are part of a larger
23 contract of selling other cheese that is ineligible?

24 A I do not know that.

25 Q Do you know whether you would be able to determine

1 whether a plant in reporting to NASS ascribed a lower price
2 to the 40-pound blocks that weren't aged, for example, in a
3 higher price -- well, I wouldn't even have to ascribe it to
4 the other that was sold, but just simply ascribed the
5 portion that was unaged at a lower price to NASS? You would
6 have no way of knowing whether that was, in fact, what they
7 did?

8 A Well, we collect data on pounds sold and dollars
9 received. So whatever the sales were that they report to
10 us, then that is what is used that meet the pricing
11 specifications.

12 Q But if that number was incorrect by error or
13 design, you wouldn't have any way of knowing that.

14 A Well, we have a manual statistician edit as well
15 as a computerized edit. But we do compare all price data
16 within a region with other reports in a region to see if
17 data look atypical or not. If data appear to be atypical,
18 then we do call back and verify data when it looks unusual.

19 Q Do you in your department collect similar price
20 information for any other agricultural products?

21 A Other than the four --

22 Q Other than dairy.

23 A Yes. Routinely such as grain prices from grain
24 elevators or -- yes, NASS prices over 100 raw commodity
25 product prices, producer prices for the most part.

1 Q Okay. What about livestock?

2 A Livestock, yes.

3 Q Has there been an investigation by the office of
4 inspector general for the USDA for the inspection -- or the
5 data that was provided on the livestock prices in the last
6 several years?

7 A Not by NASS. My understanding, not by NASS.

8 Q Okay. Do you know if it has been investigated by
9 any agency?

10 A Well, I think we are all aware as far as the
11 mandatory price reporting as far as that data, if that is
12 what you are referring to.

13 Q It is now mandatory.

14 A As far as reporting of beef and pork prices.

15 Q And when did that begin?

16 A I think -- I'm getting into an area that I am not
17 familiar with now. But it is -- I think those final
18 regulations are in the process now, rules.

19 Q It was the reason -- do you know what the reason
20 is for the mandatory reporting?

21 A My understanding is to have absolutely sufficient
22 quantity representation for all sales being made.

23 Q There was no allegation that the prices that were
24 reported were lower than what sales actually were taking
25 place?

1 A That I don't know.

2 Q And by the way, those were prices that the plants
3 paid to producers, is it not, for livestock?

4 A Slaughter plants, right, auction markets. I guess
5 all types of transactions.

6 Q Are you aware of any other -- you know, in dairy,
7 you are aware of the fact that the NASS numbers reported are
8 used to compute minimum prices that producers will receive
9 under the Federal Order. Are you aware of that?

10 A Yes, I am.

11 Q All right. Are you aware of any of the other
12 numbers that you report for the other commodities, if any of
13 those are used in the same way?

14 A Yes. Over the years, especially with the grain
15 and cotton prices that were used to set deficiency payments
16 in a similar fashion.

17 Q Those were government programs?

18 A Right.

19 Q All right. Not what plants paid for the product
20 though, right, or processors or buyers of grain paid for the
21 product?

22 A What producers received for their products.

23 Q I want to change topics here. If you would look,
24 you've got -- do you -- and maybe you are aware of the
25 "Dairy Products 1999 Summary." Do you have a copy of that

1 in front of you?

2 A I am familiar with that, yes.

3 Q All right. That -- how do you gather this
4 information, the total pounds of products sold?

5 A Something like 1,340 manufacturing plants that we
6 collected data through our state offices. And I think in
7 the very back of that, it gives a summary. But we have
8 agreements with 32 state offices -- I mean state departments
9 of agriculture that help us collect some of that data, also.

10 Q How -- is there any testing of this data to
11 determine its accuracy? Any other surveys or census taken
12 from time to time to ascertain how close it is?

13 A I am not aware of that. But I do -- there are
14 lists by the industry of manufacturers that we know about
15 and use to update our own list. I am not aware of any
16 benchmark for those data, though, as far as I know, the
17 source.

18 Q But this is a fairly reliable number? If one
19 looked at the total volume of cheese that was listed in here
20 for 1999, that should fairly accurately report the amount of
21 cheese that was sold in that --

22 A We believe that it is accurate in doing that.

23 Q And how do you choose the products that -- you
24 have -- as you went through here, you have also got a
25 breakdown like, for example, of nonfat dry milk and

1 unsweetened condensed cream. How do you determine what
2 dairy products will be listed in that type of detail by
3 state?

4 A A lot of it evolves over time with regard to
5 industry requests for the specific data and at what levels,
6 say, state level data. But it also has to meet disclosure.
7 In other words, we can't print data that would disclose
8 individual operations.

9 Q But does the fact that it is listed in here
10 indicate that there is a significant trade in that
11 particular product?

12 A The fact that it is listed in there would indicate
13 that there is a significant interest in the data.

14 Q Fair enough. Look at your Milk Production
15 Disposition and Income 1990 Summary. You are familiar with
16 that report?

17 A Yes, I am familiar with that report.

18 Q How do you gather the information in terms of the
19 production of various states?

20 A A lot of it is -- of course, we have surveys where
21 we survey the plants on an annual basis. But we also depend
22 on the marketing orders to provide us information on the
23 production of milk. And then we get help from our state
24 people, too, the state departments of agriculture as far as
25 the production of milk in the various states.

1 MR. YALE: I have no more questions at this time.

2 Thank you.

3 JUDGE HUNT: Yes, sir.

4 MR. MARSHALL: Your Honor, my name is Doug
5 Marshall.

6 BY MR. MARSHALL:

7 Q Good morning, Mr. Milton.

8 A Good morning.

9 Q I would like to explore with you just a little bit
10 the consistency-of-data question that Ben was raising to
11 which, if I heard correctly, you said that typically aged
12 cheese is not reported. Is that accurate? Did I hear that
13 correctly?

14 A That is correct.

15 Q If one were to look in the publication titled
16 "Weekly Dairy Product Prices," would one find the criteria
17 for which types of cheese or which process methods are to be
18 reported and those which are not?

19 A I would have to -- let me think for a second. I
20 know it specifically -- on each form when we collect the
21 data, it is stated there. I think in our footnotes, we
22 explain what data are to be included.

23 Q Footnotes to what now, in the form?

24 A Let me -- if you don't mind, wait one second and
25 let me see.

1 Q Yes. Possibly I could rephrase the question to
2 simply say how would one determine from the exhibits in
3 evidence what is to be reported and what is not to be?

4 A Well, here again, they are a set of very detailed
5 includes, excludes, price specifications on each of the
6 reporting forms when it goes to the plants. In this release
7 itself, there are some footnotes that give less detail. For
8 instance, on cheese, it says, "Natural unaged cheddar
9 cheese."

10 Q And from what were you just reading?

11 A The release itself, the weekly release as it is
12 published by NASS.

13 Q Right. Thank you. Now, similarly, is there also
14 a clarification in the reporting rules with respect to dried
15 milk powder, and more specifically with respect to whole
16 milk powder versus nonfat dry milk powder?

17 A Yes, there is. Not -- here again though, not as
18 much detail as on the reporting form itself. For instance,
19 USDA -- for nonfat dry milk is USDA extra grade and USDA
20 Grade A nonfortified, nonfat dry milk. We don't have the
21 details though as far as the price specifications that are
22 included on the form itself used to collect the data.

23 Q From what you were just reading there, I didn't
24 hear a distinction drawn between high-heat powder and low-
25 heat powder, did I?

1 A No, you did not.

2 Q Do you -- is it -- let me rephrase this question.
3 Is a distinction drawn between high-heat powder and low-heat
4 powder in the gathering of NASS data on nonfat dry milk?

5 A Yes, it is.

6 Q And that is clear in the footnotes the form, is
7 it?

8 A That is clear in the price specifications to
9 exclude the high-heat price data and volume data.

10 Q And why is high heat to be excluded?

11 A My understanding is it normally trades, sells for
12 two to three cents more and is a higher cost in processing.

13 Q It has been rumored in industry that there is some
14 confusion about the term "packaging." And I was wondering
15 if you could describe the intent of the regulations in terms
16 of asking for packaging to be excluded from certain types of
17 reports?

18 A We do address packagings for cheese, here again,
19 on the form that collects the data. Very broadly, only
20 minimum packaging is included.

21 Q Do you personally have any knowledge of what
22 packaging costs might run --

23 A I do not.

24 Q -- for whatever minimum packaging might be?

25 A No, I do not.

1 MR. MARSHALL: All right. Thank you. I think
2 that covers my questions. I appreciate it.

3 JUDGE HUNT: Yes, Mr. Rosenbaum.

4 BY MR. ROSENBAUM:

5 Q Mr. Milton, Steve Rosenbaum. I have a few
6 questions about what has been marked as Exhibit 8, which is
7 this document "Brief Summaries of NASS Dairy Data Series,"
8 if you could pull that out again, please. And if you could
9 turn to the page please that starts, "Weekly Dairy Product
10 Prices." Let me start by asking you -- well, these are
11 the -- a reflection of the surveys that NASS conducts to
12 come up with the weekly dairy product prices for the four
13 dairy products listed here, correct?

14 A That is correct.

15 Q And am I correct that the plants that participate
16 in the survey are not necessarily regulated by the Federal
17 Order System?

18 A That is true.

19 Q For example, California plants would be included
20 as one example, correct?

21 A Exactly.

22 Q Okay. And I want to make sure I understand
23 exactly what you are representing here in the various
24 figures. Let me take cheese as an example. Forty-nine
25 cheese companies make a product that meets the reporting

1 specification. Is that correct?

2 A That is true.

3 Q Okay. By the way, do you have a copy of the forms
4 with you?

5 A No, but I can make them available.

6 Q Okay.

7 A We can gladly do that.

8 Q Okay. I would ask that that be done since there
9 have been some questions about what is excluded and excluded
10 in terms of aging, et cetera. And the forms would be the
11 best source of that information, I take it.

12 A That is true.

13 MR. ROSENBAUM: If that is all right with the
14 government, I would ask that NASS bring that in at some
15 point.

16 MR. COOPER: That will be fine. We will have them
17 later in the hearing, just blank forms for each of the
18 products.

19 BY MR. ROSENBAUM:

20 Q Now, the 49 cheese companies that make a product
21 that meets the specs for reporting collectively represent 71
22 percent of U.S. production, correct?

23 A That is true.

24 Q Now, 29 firms actually report it. Is that right?

25 A Right.

1 Q But am I correct that the 29 firms that report it
2 collectively represent 75 percent of the production of the
3 49 firms that were eligible?

4 A That is true.

5 Q Okay. So that the 20 firms that did not
6 participate collectively only make up 25 percent of the
7 eligible production, correct?

8 A That is true.

9 Q And is that the basis for your earlier statement
10 that the 20 that don't participate are smaller companies?

11 A On average, relatively small.

12 Q As a matter of mathematics, they would have to be,
13 correct?

14 A Right.

15 Q Now, is it possible that some of them don't engage
16 in weekly sales of cheese?

17 A I would say it is possible. I believe though if
18 the -- if they didn't have weekly sales -- they did not
19 engage in weekly sales though, they did not for the most
20 part qualify for the survey.

21 Q I see. Now, are you comfortable that the
22 participation level in each of these surveys is high enough
23 to make the price an accurate one?

24 A I believe the NASS price is representative of the
25 U.S. price.

1 Q Okay. And by saying that, the level of
2 participation is sufficient for you to reach that
3 conclusion.

4 A I think it is, yes.

5 Q And how many years have you been doing this kind
6 of work?

7 A I think I am in my 32nd year.

8 Q Okay. Are you a statistician or what is your
9 background?

10 A Yes, agricultural statistician.

11 Q Okay. And I take it, does NASS have a number of
12 statisticians on their staff?

13 A Yes. We have two statisticians devoted strictly
14 to the dairy product prices series, one to the cheese and
15 the other to the three other products.

16 Q Okay. And are you one of those two or are those
17 other people?

18 A No.

19 Q All right. And -- okay. Now, you mentioned --
20 what do you do if you have a plant that has reported a price
21 that seems out of line compared to what other plants are
22 reporting in that same area?

23 A We work through our state offices that are
24 responsible for collecting the data weekly and go back to
25 the plant to affirm the price data are correct or not

1 correct.

2 Q Okay. And what is your comfort level as to
3 whether that process has worked?

4 A We believe it has worked.

5 Q And the NASS price that you report is a weighted
6 average price; is that correct?

7 A That is true.

8 Q Weighted by volume, right?

9 A By volume of sales by plant.

10 Q Okay. So that a sale at a dollar of a million
11 pounds gets twice the weight, if you will, of a sale at
12 \$1.05 of half a million pounds, correct?

13 A That is true.

14 Q Okay. Now, does the CME price, is there any
15 weighting done in the reporting process there?

16 A The price data we showed as far as our exhibit is
17 an average price for the whole week.

18 Q The CME price.

19 A Right.

20 Q But there is no -- but it is not weighted by
21 volume of transactions at any given price; is that right?

22 A My recollection is it is a cash price unweighted.

23 Q I'm sorry.

24 A Not weighted.

25 Q Thank you. And there -- you perform a survey of

1 dry whey prices, correct?

2 A Yes, we do.

3 Q And I noted that there was no comparison between
4 what is covered by the NASS and CME for that. Is that
5 because there is no CME trading of that product?

6 A That is my understanding.

7 Q The CME price and the NASS price aren't exactly
8 the same even for a week, isn't that right?

9 A Not exactly. But they -- the correlation is very
10 close.

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

12 JUDGE HUNT: Any other questions? Mr. Coughlin.

13 BY MR. COUGHLIN:

14 Q One of the other proposals in this hearing would
15 use the price of 640-pound blocks. You don't collect that
16 information currently, do you?

17 A Not currently. We did at the beginning.

18 Q What was your experience when you collected that
19 information?

20 A It was relatively low volume compared to the rest
21 of the cheese sales we picked up weekly, mostly one to two
22 million pounds out of 15 to 17 total million pounds.

23 Q Did you have any other problems with collecting
24 that data with respect to the consistency of the products?

25 A Only that with fewer people reporting, there was

1 the possibility of having more disclosure problems with the
2 640-pound blocks.

3 MR. COUGHLIN: Thank you.

4 JUDGE HUNT: Mr. English.

5 BY MR. ENGLISH:

6 Q Again, Charles English. A question from Mr. Yale
7 to you asked whether or not there was disclosure by the
8 selling firm with respect to the moisture content on the
9 cheese from the blocks. And you said that there was, you
10 know, no requirement disclosing that. But there is a
11 standard range that is required, correct?

12 A Right.

13 Q And what is that standard range?

14 A Price specifications. I would have to check
15 quickly.

16 Q Would it be between 37.5 and 39 percent?

17 A I think that sounds correct.

18 Q And going to Exhibit 7 and, again, some of the
19 questions from Mr. Yale but also the question I was asking
20 earlier, these prices that are -- that you are showing,
21 these weekly prices are the final weekly prices if you go
22 back far enough, correct?

23 A That is true.

24 Q But a number of those prices have been revised
25 within a four- to five-week time frame from the time they

1 were originally announced, correct?

2 A That is true.

3 Q And similarly, when AMS announces or uses the
4 monthly average of the -- of the price, they are using the
5 monthly average of those prices and the weighted average as
6 of the time they make the announcement, correct?

7 A Right. The most current data available.

8 Q And to some extent, there have been revisions
9 subsequent to that monthly data that AMS announced that
10 cannot be reflected in the AMS because the AMS becomes a
11 static number that was announced on the 5th of the month,
12 correct?

13 A Yes, with regard to mostly the two-week -- the
14 forward pricing and the use of that data.

15 Q So to the extent in this hearing record we have
16 numbers that we wish to compare, we have to be careful that
17 we have got the right number based upon those potential
18 revisions, correct, because we may be comparing a number
19 that was later revised? For instance, going back to October
20 of '98, didn't AMS announce a price that then got revised
21 thereafter for the monthly average?

22 A That could be.

23 MR. ENGLISH: Thank you, sir.

24 JUDGE HUNT: Mr. Rosenbaum.

25 BY MR. ROSENBAUM:

1 Q Steve Rosenbaum. On the 640-pound block issue,
2 NASS started its survey of cheese prices in September '98,
3 is that right?

4 A Of what prices?

5 Q Cheese.

6 A Cheese prices started in March of '97.

7 Q Okay. When did you start collecting data on sales
8 of 640?

9 A March of '97. It was discontinued once that data
10 also was not used or needed by AMS, also.

11 Q How long has it been since you collected that
12 data?

13 A I believe we completed -- I might be wrong, but I
14 believe it goes through '98.

15 Q Has the participation rate in the surveys overall
16 improved over time?

17 A Has the participation improved? I would say it is
18 about the same. We actually picked up a little more volume
19 than we did initially.

20 Q Okay. That is what I mean. Is the percentage of
21 volume that you are collecting -- has that gone up?

22 A Maybe just, yes, a little bit.

23 MR. ROSENBAUM: Thank you.

24 JUDGE HUNT: Yes, sir?

25 MR. BESHORE: Marvin Beshore.

1 BY MR. BESHORE:

2 Q Mr. Milton, just I want to make sure I understand
3 the data on your chart for firms eligible and firms
4 reporting in the production they represent. When the
5 denominator of the equation for eligible firms percent of
6 U.S. production, the second column, can you tell me what
7 that is?

8 A That is the total production by those 49 firms
9 compared to total U.S. production.

10 Q Of what? U.S. production of?

11 A This is cheddar cheese.

12 Q Okay. So those -- okay. Now, the 75 percent in
13 the fourth column then represents -- what is the denominator
14 for that equation -- for that ratio?

15 A In other words, if you are taking total
16 production, it would be 71 percent of the total production.
17 And then it would be 75 percent of that number.

18 Q So what --

19 A Seventy-one percent by eligible firms and then 75
20 percent of that number by the reporting firm.

21 Q Seventy-five percent of the 71 percent is
22 actually --

23 A Right.

24 Q -- captured.

25 A Fifty-five or whatever it is, right.

1 MR. BESHORE: Very good. Thank you.

2 JUDGE HUNT: Mr. Yale.

3 BY MR. YALE:

4 Q I just want to make sure I understand the math.
5 So like on cheese, that is 53 percent. Seventy-five times
6 71 would mean that you are reporting 53 percent, right?

7 A Right.

8 Q Okay. Have you done any statistical analysis on
9 the revisions that come in after the report is made of the
10 NASS data and plants send in additional information to
11 determine whether it tends to statistically increase or
12 decrease the price?

13 A Yes. We have looked at what the additional data
14 would do as far as average cents per pound for product.

15 Q And what was the results of that?

16 A Probably the largest revisions we had were if you
17 want to go back to Christmas and New Year's recently for
18 cheese and butter. Naturally that time of year, some people
19 aren't around to report. And the following week, I think we
20 made revisions of one to two cents the very next week.
21 Mostly though over -- we looked at four or five weeks of
22 data and -- I mean four or five months of data. And the
23 average change on a weekly basis was about one-tenth of one
24 percent -- one-tenth of one cent for each of the products on
25 average using four or five months of data. And that

1 includes the two unusual circumstances I was talking about
2 with the holidays and the new millennium.

3 Q Any indication of what the average direction of
4 those revisions were, up or down?

5 A I do know they have been both ways looking at the
6 data.

7 Q But you don't know the --

8 A No, not offhand. The differences I gave you were
9 absolute differences without regard to up or down.

10 Q Do you have any indication of the percentage of
11 production -- or I want to rephrase that. Have you done any
12 effort to determine which of this milk is involved in the
13 Federal Order Program, which of this cheese or butter in any
14 way, whether the plant is pooled in the Federal Order
15 Program or not?

16 A We did not analyze it with regard to people
17 reporting whether or not the state was in the Federal Order
18 or not.

19 Q Do you have any statement in your regulations that
20 prohibit the reporting of product that was sold at a price
21 that was indexed off of the NASS prices?

22 A Repeat that again. What is --

23 Q Do you have any statement in there that prohibits
24 a plant to report sales in which the price of those --
25 involved in those sales was indexed off of the NASS prices?

1 A No. We strictly ask for the volume and the
2 dollars paid by product.

3 MR. YALE: I have no other questions, then.

4 JUDGE HUNT: Any other questions for Mr. Milton?

5 MS. BRENNER: I have a little clarification.

6 JUDGE HUNT: Yes.

7 BY MS. BRENNER:

8 Q Mr. Milton, you have been asked --

9 JUDGE HUNT: Would you identify yourself, please.

10 BY MS. BRENNER:

11 Q -- you have been asked for a little bit of
12 additional --

13 JUDGE HUNT: No, would you identify yourself.

14 MS. BRENNER: Oh. I am Connie Brenner with USDA
15 AMS.

16 FURTHER EXAMINATION BY THE USDA

17 BY MS. BRENNER:

18 Q You have been asked for a little bit of additional
19 information or data. For instance, the reporting forms for
20 the product prices. And I believe Mr. Yale earlier asked
21 for some information about the location of plants reporting.
22 Do you recall that you --

23 A NASS -- that is not the type of information NASS
24 normally allows with regard to the statutes of collecting
25 and publishing voluntary data.

1 Q So you wouldn't be able to supply that
2 information, is that -- that is --

3 A We would not want to publish -- I mean let that
4 information out or be available.

5 Q Okay. Would you be coming back with the reporting
6 forms then at some --

7 A Yes, yes.

8 MS. BRENNER: -- some later date in the hearing.
9 That's all I have.

10 MR. COOPER: I thought you were through.

11 MR. YALE: Well, I have a some follow-up
12 questions.

13 MR. COOPER: Go ahead.

14 JUDGE HUNT: Go ahead, Mr. Yale.

15 MR. COOPER: Go ahead. I am just trying close up
16 here.

17 BY MR. YALE:

18 Q Well, I am just trying to follow up on that
19 question dealing with the states. Can you give us by state
20 the number of plants in that state? We don't need to know
21 the town or the city. Can you tell us by state like six in
22 Wisconsin or five in California or whatever that number --

23 A We can do that with regard to -- if it does not
24 disclose -- say, if it is only one plant or two plants or
25 three plants, then I can't do it.

1 Q Maybe you can put joined states or something or
2 put other states.

3 A We would do that.

4 Q I mean, we would like to have that if possible.

5 A But here again, just because a plant is not
6 reporting, there is a lot of difference in size among these
7 plants. So --

8 Q I understand that, but there is some statistical
9 information on it.

10 A Okay.

11 MR. YALE: Thank you.

12 JUDGE HUNT: Mr. Cooper?

13 MR. COOPER: I was just going to first of all say
14 that what we had agreed to I thought was just to provide the
15 blank forms for each plant. That is all that was requested.
16 And --

17 MS. BRENNER: For each product.

18 MR. COOPER: For each product, the blank forms for
19 each of the products which contains the specifications and
20 what should be reported and what shouldn't. And I was going
21 to suggest that I don't see any reason for Mr. Milton to
22 come back with those forms. We could just take official
23 notice of them unless somebody thought that we had to go
24 into questions about them. I was just going to have him
25 send them over. And we would take -- and we would get

1 copies and we would just take official notice if that is
2 acceptable.

3 JUDGE HUNT: You will make them available for
4 viewing by anybody?

5 MR. COOPER: Yes.

6 JUDGE HUNT: Okay.

7 MR. COOPER: And then to notice or make them
8 exhibits or something like that. I didn't see any reason to
9 drag him back. The forms are sort of self-explanatory.

10 JUDGE HUNT: Is that acceptable? Does anybody
11 object to that?

12 MR. COOPER: Okay. And the nine categories of
13 documents that we ask for official notice, I would like
14 official notice formally taken. And Exhibits 7 and 8 I
15 would like admitted.

16 JUDGE HUNT: Any objections to taking official
17 notice of the documents that Mr. Cooper identified earlier?
18 Okay. We will take official notice of those documents. As
19 to proposed Exhibits 7 and 8 by Mr. Cooper, anyone object to
20 those being part of the record. No objection. Exhibits 7
21 and 8 will be admitted into evidence. We will take a ten-
22 minute break at this time.

23 (The documents marked for
24 identification as Exhibits
25 Nos. 7 and 8 were received in

1 evidence.)

2 JUDGE HUNT: Mr. Milton?

3 MR. COOPER: Yes.

4 JUDGE HUNT: Okay. Thank you. You are excused,
5 then. Thank you, sir.

6 (Witness excused.)

7 (Whereupon, a brief recess was taken.)

8 JUDGE HUNT: We are back on the record. And Mr.
9 Cooper?

10 MR. COOPER: Yes. If we can get Dr. Ling in from
11 out there. I see them all talking. Dr. Ling, would you
12 take the stand, please.

13 JUDGE HUNT: Would you raise your right hand,
14 please.

15 Whereupon,

16 CHARLES LING, Ph.D.

17 having been first duly sworn, was called as a
18 witness herein, was examined and testified as follows:

19 JUDGE HUNT: And would you state and spell your
20 name, please, and give your title.

21 THE WITNESS: Okay. It is in my prepared
22 statement.

23 JUDGE HUNT: Okay. Would you give your name,
24 please?

25 THE WITNESS: My name is Charles Ling. And I am

1 an agriculture economist with the Cooperative Service
2 Programs of USDA's Bureau of Business Cooperative Service.

3 MR. COOPER: Okay. Dr. Ling, have you brought
4 with you today a one-page table entitled, "1998 Dairy
5 Product Plant Costs, USDA/RBS/CS Technical Assistance
6 Project?"

7 THE WITNESS: Yes, sir.

8 MR. COOPER: I would like to have that one page
9 marked as Exhibit 9, Your Honor. I believe copies have been
10 made available. If Dr. Ling's statement is out there, it is
11 attached to the last page to his statement. I am not going
12 to have the statement received in evidence, but I am going
13 to have the exhibit that is attached to the statement, that
14 one page received. And Dr. Ling will read his statement.

15 (The document referred to was
16 marked for identification as
17 Exhibit No. 9.)

18 MR. COOPER: Now, did you prepare that one-page
19 table that I just described?

20 THE WITNESS: Yes, sir.

21 MR. COOPER: Did you prepare it in support of or
22 in opposition to any particular proposal or for
23 informational purposes?

24 THE WITNESS: Just for informational purposes.

25 MR. COOPER: And you also have a prepared

1 statement, Dr. Ling?

2 THE WITNESS: Yes, sir.

3 MR. COOPER: And would you care to read your
4 statement now?

5 THE WITNESS: Yes. My name is Charles Ling. I am
6 an agriculture economist with the Cooperative Services
7 Programs of USDA's Bureau of Business Cooperative Service.
8 I have served as its program leader for dairy, livestock,
9 and poultry since 1988. For about five years prior to
10 joining the Cooperative Services Program in 1978, I was an
11 agriculture economist with Federal New York Order Number 2,
12 market and traders office in New York.

13 I received my B.S. degree from National Taiwan
14 University and master's and Ph.D. from University of
15 Connecticut in agricultural economists. I am testifying for
16 the record at the request of the Agricultural Marketing
17 Service regarding the results of a technical assistance
18 study of the cost of manufacturing dairy products at a
19 number of dairy cooperative plants for 1998.

20 After publishing dairy products manufacturing
21 costs at cooperative plants, ACS Research Report Number 34
22 in 1983, a group of cooperatives requested the then-
23 Agricultural Cooperative Service to conduct an annual
24 confidential technical assistance project to help in their
25 cost comparisons. The cooperatives promised to provide data

1 from selected plans to ACS for use in developing a database
2 of cost information from large cooperative New York
3 plants -- manufacturing plants.

4 ACS would provide each cooperative with a report
5 comparing a particular cooperative plant with other similar
6 plants without disclosing individual plant data to others.
7 Participation in this study is voluntary and is open to all
8 dairy cooperatives.

9 In 1998, plant cost study was the sixteenth year
10 of the technical assistance project. Cooperative Services
11 is authorized by the Cooperative Marketing Act of 1926 to
12 conduct technical assistance studies.

13 Section 3(b) of the Act divested to make surveys
14 and analysis advisable of the accounts and business
15 practices of the representative cooperative associations
16 upon their request to report to the association so that --
17 the results thereof and with the consent of the associations
18 surveyed to publish summaries of the results of such surveys
19 together with similar facts for the guidance of cooperative
20 associations and for the purpose of assisting cooperative
21 associations in developing methods of business and market
22 analysis for the plant cost comparison technical assistance
23 project.

24 Dairy products studied are butter, nonfat dry milk
25 or powder, cheese and data available on whey and other dairy

1 products. Only in-plant costs are included.

2 The following instructions were given to the
3 cooperatives for reporting cost data on butter powder
4 plants:

5 1) Scope of cost information, in-plant costs of
6 moving milk from the receiving deck to the product delivery
7 deck; exclude milk procurement costs, transportation,
8 administrative costs. That includes plant office, plant
9 manager and corporate overhead, interest and costs
10 associated with facilities for prolonged storage or off-site
11 storage.

12 2) Milk received at the plant incurs a receiving
13 cost. Cream and skim separated in a plant incurs a cost of
14 receiving and separating milk. Condensed skim incurs an
15 additional evaporation cost. If milk, cream, skim, or
16 condensed was shipped out of the plant, please make sure
17 that the company receiving separation of evaporation and
18 shipping cost are taken out of the plant manufacturing cost.

19 3) By the same token, if cream, skim, or condensed
20 was received at the plant for further processing, allocate a
21 cost to that product as if it had been separated or
22 condensed at the plant. Cost incurred at the receiving bay
23 also should be noted.

24 4) For direct cost items such as direct labor,
25 electricity, and fuels, please make sure that dollars and

1 fiscal units reported correspond to each other.

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

4 1) If cream, skim, condensed skim, or condensed
5 whey or other intermediate products were received at or
6 shipped out of the plant, please make sure the products
7 allocated a processing cost. Cost incurred at a receiving
8 bay for receiving or shipping the product also should be
9 noted. 2) Do not include the cost of processing whey and
10 whey products in cheese manufacturing costs.

11 Ten cooperatives submitted 1998 cost data on 12
12 cheese plants, seven butter plants, and seven powder plants.
13 I have data for one plant in each product category for 1999.
14 A set of ten reports were prepared. Each participating
15 cooperative received a report comparing its plant cost with
16 the average of all plants making the same product.

17 This reports that all technical assistance reports
18 carry this disclaimer. "The technical assistance report was
19 prepared for the sole use of (name of cooperative), its
20 board or management may make any use of the report they deem
21 appropriate. But ABS Cooperative Services Program will
22 treat it as confidential to the extent provided for by law.

23 With the consent of the participating
24 cooperatives, the results of the study are summarized and
25 presented in the accompanying table. Since per average

1 plant costs were 14.22 cents per pound of cheese, 13.603
2 cents per pound of butter, and 14.723 cents per pound of
3 powder --

4 MR. COOPER: Could you state the cheese price
5 again.

6 THE WITNESS: 12.422 cents per pound of cheese.
7 Using each plant's product volume as weight, the weighted
8 average cost was 12.916 cents per pound of cheese, 10.622
9 cents per pound of butter, and 12.709 cents per pound of
10 powder. That table does not show the plant cost of drying
11 or condensing whey because fewer than three cooperatives
12 reported useful information on the cost of making either
13 product.

14 In reviewing this cost data, several factors have
15 to be kept in mind:

16 1) The cost analysis does not consider differences
17 in the product's quality. Products of higher quality
18 considerably would require higher quality ingredients and
19 more effort by labor.

20 2) The cost allocation procedure for a multiple
21 product plant may not be uniform among the participating
22 cooperatives. Therefore, two plants having exactly the same
23 operations and the same total cost may show up different
24 unit products manufacturing costs.

25 3) The nature of a plant might affect its

1 manufacturing cost. A plant used strictly for manufacturing
2 purposes tends to have a relatively constant milk -- and is
3 operated at a higher rate of capacity. It is likely to have
4 a lower cost than the plant for -- milk supply.

5 4) There are regional differences in input costs
6 such as wages, electricity, and fuel rates. It is possible
7 that an efficiently operating plant in one region might have
8 a higher per-unit manufacturing cost than a less efficient
9 one in another region. That concludes my statement.

10 EXAMINATION BY USDA

11 BY MR. COOPER:

12 Q Dr. Ling, I think you indicated that ten
13 cooperatives submitted data --

14 A Yes.

15 Q -- 1998 cost data. And then you said data for one
16 plant in each category was for '99. Does that still mean
17 there were ten cooperatives?

18 A Yes, sir.

19 Q Okay. And --

20 A Just --

21 Q And all the data in there was for '98 except for
22 that one plant?

23 A Yes, one cheese plant and one butter powder
24 plant --

25 Q Okay.

1 A -- said that they couldn't supply 1998 data.

2 Q So there is one plant that has '99 data mixed in
3 the table. Okay. And the ten cooperatives that gave you
4 this information, did you go out and audit them or anything
5 or did you just use the numbers they gave you?

6 A I just used the numbers they gave me.

7 MR. COOPER: Okay. I have no further questions.
8 And Dr. Ling is available for questioning.

9 JUDGE HUNT: Mr. Rosenbaum.

10 EXAMINATION BY PARTICIPANTS

11 BY MR. ROSENBAUM:

12 Q Dr. Ling, Steven Rosenbaum for the International
13 Dairy Foods Association. You have testified that this
14 survey has been done for a number of years. Is that
15 correct?

16 A Yes, 16 years.

17 Q And so it obviously was not designed for the
18 purpose of determining make allowances.

19 A That's correct. It is the in-plant cost only.

20 Q Okay.

21 A Although it can be a major component in the make
22 allowances calculation.

23 Q Okay. But this survey predates by many years the
24 use of make allowances for determining minimum prices under
25 the Federal Order System, correct?

1 A That's correct.

2 Q And that was not the purpose for which the
3 Department started conducting the survey, correct?

4 A That is correct.

5 Q And you have continued to utilize the same
6 fundamental methodology in the most recent survey as you did
7 in prior surveys, correct?

8 A That is correct.

9 Q You did not adjust your fundamental methodology
10 because there was a possibility that these costs would now
11 be used for conducting make allowances, is that true?

12 A That is correct.

13 Q Okay. And you would agree with me, I assume, that
14 this survey does not purport to reflect the entirety of the
15 costs that a cheese plant incurs in taking a given volume of
16 milk and turning it into a given volume of cheese. Is that
17 right?

18 A It is the cost inside the plant.

19 Q Well, but it is not even all the cost inside the
20 plant, right?

21 A I think I stated in the -- in my statement what is
22 included and what is not included.

23 Q Well, yes. And why don't we look at that if you
24 have a copy of your written statement. There is -- on page
25 2, there is a heading called "Scope of Cost Information."

1 Do you see that with me?

2 A Yes.

3 Q And this has the line "exclude," and some things
4 that follow, correct?

5 A Yes, that is correct.

6 Q And that is actually included in the written
7 instructions that go to the cooperatives that fill out this
8 form.

9 A Yes, sir.

10 Q And so they are told to exclude administrative
11 costs, correct?

12 A Yes.

13 Q And that is further defined as being plant office,
14 plant manager, and corporate overhead, correct?

15 A That is correct.

16 Q So that the plant office and plant manager are in-
17 plant costs, correct?

18 A Not in this study.

19 Q Well, I mean, they are -- in the real world --

20 A The reason it is excluded is because some plant
21 managers do more things than others. And so it is not a --
22 so it is difficult to standardize the cost. So that is why
23 it is excluded.

24 Q Let me let you -- they are excluded. That is
25 clear. Correct?

1 A Yes.

2 Q And there may be in some or more of these
3 cooperatives reporting a plant manager who performs certain
4 functions, correct?

5 A That is correct.

6 Q You certainly have no reason to think those are
7 inappropriate or unnecessary functions, do you?

8 A They are paid through their own -- I don't think
9 it is -- they would do anything inappropriate.

10 Q No, but my --

11 (Laughter.)

12 -- I am not casting dispersions on the plant
13 managers of the world. I assure you. I merely -- you did
14 not exclude this from your survey based upon some conclusion
15 that it is wrong for a plant to have a plant manager,
16 correct?

17 A That is correct.

18 Q And to the contrary, so far as you know, it is
19 legitimate for a plant to have a plant manger, correct?

20 A That is correct.

21 Q And one of the costs that plant incurs in taking a
22 volume of cheese -- excuse me. I'll start that again. One
23 of the costs that plant incurs in taking a volume of milk
24 and turning it into a volume of cheese is to pay his
25 salaries, correct?

1 A Part of it I think.

2 Q Yes. And similarly, the plant office, that is
3 part of the cost of making cheese, right?

4 A Maybe all, maybe part of it, yes.

5 Q Okay. But none of it is included in your survey,
6 right?

7 A That is correct.

8 Q And the same goes for corporate overhead, correct?

9 A That is correct.

10 Q I mean, I assume a corporate doesn't incur costs
11 unnecessarily. Do you agree with that operating assumption?

12 A Yes, that is correct.

13 Q And so if -- and so if you -- all right. And
14 similarly, procurement costs are excluded, correct?

15 A That is correct.

16 Q So that if the cooperative maintains field men who
17 go into the field, that is excluded. Is that right?

18 A That is correct.

19 Q All right. But you would agree with me that those
20 are necessary costs of the entire operation, right?

21 A That is correct.

22 Q And so if you were to add the raw milk costs
23 together with the costs that are reflected in your survey,
24 you would not have covered all the true costs, correct?

25 A What do you mean by raw milk cost? You mean the

1 procurement cost?

2 Q Yes.

3 A You say raw milk cost.

4 Q No, no, no. I don't mean that. If you were to
5 take the actual dollars that are paid to the farmer and add
6 to that the costs that are reflected in your survey, you
7 would not have captured procurement costs, correct?

8 A That's correct.

9 Q Okay. But you agree that procurement costs are a
10 necessary cost of the entire cheese operation.

11 A It is a necessary cost.

12 Q Now -- and marketing costs, are they included or
13 excluded?

14 A It is excluded.

15 Q Okay. And --

16 A As I say, it is just from the delivery plant milk
17 receiving bay to the product delivery bay.

18 Q Right. But if we were to make a make allowance
19 based solely upon your data, we would not have included
20 marketing costs, correct?

21 A That's correct.

22 Q Just like we would not have included
23 administrative costs, correct?

24 A That is correct.

25 Q Just as we would not have included procurement

1 costs, correct?

2 A That is correct.

3 Q But in all three cases, you have no reason to
4 question that those were legitimate costs necessarily
5 incurred as part of the cheese operation.

6 A Yes, there is a cost incurred, yes.

7 Q Those are all necessary costs, correct?

8 A That is correct.

9 Q Now, there is no capital cost reflected in your
10 survey either. Is that correct?

11 A That's correct.

12 Q Okay. If someone has to borrow or otherwise come
13 up with money build their facility, that is not in your
14 Exhibit 9, correct?

15 A That is correct.

16 Q Okay. Obviously, you do have to build facilities
17 to manufacture cheese, correct?

18 A That's correct.

19 Q You have to buy the equipment, correct?

20 A That's correct.

21 Q These are multimillion-dollar expenditures, right?

22 A That is correct.

23 Q And they are not reflected in your survey,
24 correct?

25 A That is correct.

1 Q As an economist do you agree that if you were to
2 take what you get for selling cheese and subtract what you
3 have to pay the farmer for milk, all these costs are costs
4 that you better be covering in the difference between the
5 two or you are in trouble as a cheese plant?

6 A Or you can give away your money, too.

7 Q You can do what?

8 A You can give away your products, too.

9 Q Well, yes. But if you are engaging in activities
10 as a rational economic actor, administrative costs,
11 procurement costs, costs of capital, these are all -- and
12 marketing costs, these are all costs that you are going to
13 have to cover by the difference between what you are selling
14 your cheese for and what you are paying for the raw milk,
15 correct?

16 A That is correct.

17 Q Otherwise, you are in -- strike that. And
18 obviously, you are not by definition covering the
19 proprietary plants in your survey, correct?

20 A That is correct.

21 Q It is just cooperatives, correct?

22 A That is correct.

23 Q You would agree with me that cooperatives are,
24 what, 40 percent of cheese production in the country?

25 A That is correct.

1 Q What would you do, if anything, if someone were
2 reporting a number that seemed out of whack compared to what
3 other participants had reported?

4 A I will get back to the manager or the reporter,
5 whoever reports the numbers, and try to get an explanation
6 for why it is out of whack, as you said.

7 Q Okay.

8 A And if it is -- if I -- if the explanation is
9 reasonable, I will accept it. If not, I probably will take
10 on a number. It is depending on my judgement.

11 Q Did you have a set or standard for determining
12 when a number was out of whack and deserving of further
13 attention of inquiry?

14 A Not a systematic method to determine that. To
15 answer your question, that question, this is a project
16 requested by cooperatives for developing management
17 information purposes. So I trust them to put in good-faith
18 efforts to give me the number. And so I would say that
19 numbers in this are very correct.

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

22 JUDGE HUNT: Mr. Coughlin.

23 BY MR. COUGHLIN:

24 Q Ed Coughlin with the National Milk Producers
25 Federation. Charlie, I just have one question. To

1 determine the total volume that the cheese -- that the 12
2 cheese plants included in the survey produced, would it be
3 correct to multiply the pounds of product per plant, which
4 is shown as \$52,761,901.00, by 12 to determine the total
5 volume that was included by all 12 cheese plants?

6 A That is correct.

7 Q And appropriate to do the same with the other
8 products?

9 A That is correct.

10 MR. COUGHLIN: Thank you.

11 JUDGE HUNT: Mr. Yale?

12 BY MR. YALE:

13 Q Good morning. This is Ben Yale. Dr. Ling, you --
14 there was a question that was asked -- or wasn't asked that
15 I want to address and want to put in your testimony
16 concerning what kind of cheese do these plants produce?

17 A It is mostly 40-pound block cheddar.

18 Q All right. Were you in the room earlier today as
19 Mr. Milton explained the requirements of the NASS survey for
20 the 40-pound block cheddar and what was reported?

21 A I was late coming in. I am not sure what part --

22 Q Well, let me ask you this question. Does the --
23 do the plants that you have listed, did they include plants
24 that had sold aged cheddar, for example?

25 A Yes, sir. Some of them do.

1 Q Would any of the plants in here include plants
2 that processed the cheese into a consumer product at the
3 plant or within one of their -- within their firm?

4 A Are you talking about --

5 Q It could be --

6 A When you say processed --

7 Q It could be cut and wrapped. It could be
8 processed into another cheese product, shredded, any of
9 those things that would be sold to the consumer.

10 A These plants are strictly manufacturing plants.
11 If they had cut and wrap operations, they are separate. So
12 those costs are not included in here.

13 Q But you didn't do a comparison to see if the NASS
14 type of cheese that was reported or the butter or the nonfat
15 dry milk corresponded to the products that were being
16 processed in these plants; is that right?

17 A That is correct.

18 Q And you indicated that sometimes that a higher
19 quality product had a higher labor cost. I think that is in
20 your report, something to that effect. Is that correct?

21 A Yes, it might.

22 Q All right. And that that higher product might be
23 sold as a higher end product.

24 A That is correct.

25 Q And we don't know if that higher end product price

1 shows up in the NASS price. Is that correct?

2 A That is correct.

3 Q One second. What about the handling of Grade B
4 butter in the cheddaring process? Was there any discussion
5 about --

6 A There is no distinction for any quality
7 variations.

8 Q All right. Let me back up a second. Are you
9 aware in the process of cheddar and making cheddar cheese
10 that there is some excess cream that is not recovered in the
11 cheese process initially? Are you aware of that?

12 A Yes.

13 Q Okay. And sometimes called whey cream. Do you --
14 does this -- do the costs of separating that whey cream --
15 is that included in this -- these costs?

16 A I asked them to separate it, yes.

17 Q It is separated, but it is included in the cost or
18 -- when you say separated, excluded or --

19 A Excluded.

20 Q Okay. What about the use of the whey cream that
21 comes off during the cheddaring process if it is reused in
22 the process to produce subsequent vats of cheese? Would it
23 be included in these costs?

24 A I am not sure whether they distinguish that or
25 not. It is based on the their own basic efforts.

1 Q One second, please. When these reports were put
2 together, did you take the total -- was this computed by
3 taking the total dollars of these costs added up and divided
4 by the total pounds of cheese that went out the plant?

5 A For the individual plant?

6 Q For the individual plant. Did they include the
7 cost? In other words, there are some things that you have
8 already indicated were not included. Of all the included
9 costs, were those added up in gross dollars and then divided
10 by the total pounds of cheese that was processed at that
11 plant?

12 A That is correct.

13 Q And that is where this number comes from.

14 A That is correct.

15 Q Did your research include any offsets for interest
16 income that -- would you agree that co-ops sometimes have
17 interest income while they have money on deposit awaiting
18 payables?

19 A This is strictly from the plant only.

20 Q Right. From the plant only. So there is no
21 offset. You didn't include the administrative costs, right?

22 A That is correct.

23 Q But you did include some of the incomes that might
24 be associated with the administration, right?

25 A I don't understand your question.

1 Q The -- then I will -- I will approach it a
2 different way. You only are focusing on the in-plant costs.
3 And you are not looking at any offsetting income that would
4 be associated with those in-plant costs. Is that correct?

5 A That is correct.

6 MR. YALE: I have no other questions.

7 JUDGE HUNT: Mr. Beshore.

8 BY MR. BESHORE:

9 Q Good morning, Dr. Ling. I am representing the
10 Association of Dairy Cooperatives in the Northeast and Dairy
11 Farmers of America here today, some of whom are participants
12 in your survey and have been for a number of years. I just
13 want to make sure that it is clear on the record the purpose
14 of the survey and how it works. As you described in your
15 direct testimony, under the law, USDA is authorized to
16 provide this kind of technical assistance to cooperatives at
17 their request. Is that correct?

18 A That is correct.

19 Q Okay. And you do it when they request it for
20 their business purposes.

21 A That is correct.

22 Q Okay. And so, therefore, in the 16 years that you
23 have been preparing this study, you have worked with the
24 organizations. And these are private documents unless they
25 are authorized to be released otherwise. You have worked

1 with these organizations to develop a study that is useful
2 to them internally for their business management purposes,
3 correct?

4 A That is correct.

5 Q And would you assume as a professional
6 agricultural economist and working with these organizations
7 for these purposes that because it is for their own internal
8 business purposes, they have every incentive to provide you
9 with the best possible data so that they can manage their
10 own resources in the best way?

11 A That is correct. As I said before, I trust
12 their -- they are putting their -- they provide the data in
13 good faith.

14 Q Okay. And their purpose for providing the data is
15 for you to return to them a product which will allow them to
16 evaluate their operations as against their peer group,
17 correct?

18 A That is correct.

19 Q Okay. And, in fact, the product that you return
20 to each organization, I think your testimony indicates,
21 shows that it compares that organization with the total
22 group.

23 A That is correct.

24 Q Okay. And they can determine, their managers can
25 determine, their owners can determine whether they are

1 through your analysis -- whether they are performing well in
2 their industry, correct?

3 A That is correct.

4 Q Okay. And to give a benchmark for good management
5 analysis, you have defined the information that is -- that
6 you request and that is provided to be cost information from
7 the milk received at the plant to the product on the
8 shipping dock, I think you said. Is that correct?

9 A That is correct.

10 Q All right. So if you are starting with milk
11 received at the plant, obviously procurement costs, the cost
12 of that milk whether the plant was -- well, in this case, it
13 is all cooperatives. The cost of the milk getting there was
14 not part of your study; isn't that correct?

15 A That is correct.

16 Q Okay. Your results, while they are based on
17 information provided you from the cooperative, your
18 calculations and your study is done by you and only by you.
19 Is that not correct?

20 A That is correct.

21 Q Okay. And it represents your best independent and
22 professional judgement with respect to the appropriateness
23 of the calculations and the costs as presented to you,
24 correct?

25 A That's correct.

1 Q Do the -- over the years, have you refined and --
2 the study, the information you ask for and has -- have you
3 learned from your experience over the years to make the
4 product better all the time, to the best of your ability?

5 A That is correct. Based on the responses to my
6 forms, I can -- I -- it is -- they told me how to ask
7 questions in a certain way so it can be better responded to.

8 Q Okay. So over the years, you have asked -- been
9 able to shape the form in a way to better get the data that
10 is most useful for its purpose.

11 A That's correct.

12 Q With respect to the question -- Mr. Yale's
13 question about aged products, is it not correct that you
14 exclude facilities for prolonged storage or aging of cheese
15 products?

16 A That is correct.

17 Q Okay.

18 MR. COOPER: Are you done? Sorry.

19 BY MR. BESHORE:

20 Q Just one final question. Now, in collecting and
21 analyzing the data, you have been employed solely by USDA,
22 by the government, and not by the organizations themselves
23 in doing it. Isn't that correct?

24 A That's correct.

25 MR. BESHORE: Thank you, Dr. Ling.

1 BY MR. BERDE:

2 Q My name is Sydney Berde representing United
3 Dairymen of Arizona. Dr. Ling, I just have one question.
4 What was the geographical dispersion of the plants that were
5 a part of your survey?

6 A Okay. If you will follow the NASS Dairy Products
7 Annual Summary 1998, the -- follow the geographical
8 divisions, there are two butter powder plants in the North
9 Atlantic, two butter powder plants in East North Central and
10 three butter powder plants in the West Region and two cheese
11 plants in the North Atlantic, four cheese plants in East
12 North Central, four cheese plants in West North Central, and
13 two in the West Region.

14 JUDGE HUNT: Yes, sir.

15 MR. MARSHALL: Thank you, Your Honor. Doug
16 Marshall once again.

17 BY MR. MARSHALL:

18 Q Dr. Ling, I want to cover a number of things with
19 you here this morning. And I preface my questions by saying
20 I appreciate your being here and I appreciate what you try
21 to do with your survey. And the purposes of my questions is
22 to help interpret it or help understand how it can be
23 interpreted.

24 During previous questions, you were asked about
25 the intent to exclude aging costs in a cheese plant.

1 Clearly, if there is a separate facility to which cheese
2 blocks might be transported for aging, those could be easily
3 segregated.

4 As you have answered the questions from
5 participating cooperative cheese plants, have you had
6 questions about large storage facilities adjacent to the
7 plant and how to allocate the costs of a warehouse as
8 between the cheese that goes into it and comes right back
9 out unaged versus the allocation of costs for aging cheese?

10 A Well, the instruction is to tell them to exclude
11 it, the cost for aging cheese. Whether they did it or not,
12 that is beyond my control. Now, the -- I have to explain to
13 you that that when we set up the project back in the 1980s,
14 a number of co-op economists and managers got together. And
15 we figured out what should be included and what should not
16 be included. And so they know what is a requirement of the
17 project. And based on that, I trust them to have their best
18 good-faith efforts.

19 Q All right. You say that group included the plant
20 managers. Would this have been their recommendation, by the
21 way, to exclude their costs, their salaries from the cost of
22 production?

23 A The economists and managers. Did I say plant
24 managers?

25 Q I thought you did, yes.

1 A Well, the economists and some managers, yes. That
2 is because -- what they want to do in my project is to
3 compare how they operate their own plant.

4 Q So you want as much commonality as possibility?
5 Is that what you --

6 A That is correct, yes.

7 Q Okay. In theory, if you had a cheese plant that
8 had a large warehouse and some of the cheese in that
9 warehouse was aged and some was not, should those -- should
10 that reporting plant be allocating those costs?

11 A I asked them to. And whether they did it or not,
12 that is --

13 Q Changing subjects, does the nonfat dry milk
14 portion of your survey draw any distinction between the
15 costs of processing high-heat powder versus low-heat powder,
16 to the best of your knowledge?

17 A No.

18 Q No distinction?

19 A No distinction.

20 Q I am confused a little bit with respect to the
21 instruction that is in number -- at the top of your prepared
22 testimony, item number 3, in this case I think referring
23 only to butter powder plants. "If cream, skim, or condensed
24 was received at the plant for further processing, allocate a
25 cost as if it had been condensed at the plant."

1 As you understand it, then, if there is extra
2 tankage involved to handle receipts because of incoming
3 product, would those extra tanks do you think be excluded by
4 the plant as it reports the data to you?

5 A Well, that is -- I rely on their judgment to --

6 Q You would hope they would.

7 A Yes.

8 Q Do you have any knowledge as to whether they
9 actually do?

10 A No.

11 Q The similar instruction I guess for cheese plants,
12 I must say I just don't quite understand it. So maybe you
13 could help us. If -- let's just take a situation where
14 whey, condensed whey is received at a plant that is not --
15 to be dried, let's say -- that is not the cheese plant, in
16 other words, a separate plant, you ask, "Please make sure
17 the product is allocated a processing cost." You mean you
18 should create a cost for the portion of the whey costs that
19 would have been incurred at the original cheese plant that
20 should have prepared the whey?

21 Q Well, I think the instruction is for the cheese
22 plant that has whey operations. And so if they receive
23 condensed whey, to dry it or do something else. And if they
24 report whey processing costs, then they should take care of
25 that cost of receiving that whey, too.

1 Q Okay. Let me see if I understand. Are you saying
2 that at a plant that has both a cheese vat and drying plant
3 operation, that they should allocate the receiving cost
4 between the two?

5 A That is correct. Now, the cost of receiving the
6 whey.

7 Q How about the cost of receiving the raw milk
8 coming in? Should that be allocated as between their report
9 of the whey cost and their report of the cheese cost?

10 A My understanding is that they report how -- the
11 receiving cost to the cheese plant.

12 Q Okay. So --

13 A Milk -- receiving cost to --

14 Q -- the plants that have raw milk coming in
15 allocates all the receiving cost to the cheese plant side.
16 And then if they receive additional whey from another plant,
17 how would they allocate the receiving cost to that whey?

18 A I would ask them to allocate that to whey. They
19 are a whey plant.

20 Q Okay. So in a plant that is exclusively a whey
21 dryer, they would have receiving costs allocated to the whey
22 portion. But a cheese plant that has its own dryer and
23 dries its own whey would not have any receiving costs
24 allocated towards whey, as you understand it.

25 A That is correct.

1 Q That instruction goes on to read, "Costs incurred
2 at the receiving bay for shipping or receiving the product
3 should be noted." Are those noted separately or are those
4 just included within the gross cost?

5 A That means if you received products, then you
6 should include it. If you shipped some products out, you
7 should exclude it from the cost data and report it to me.

8 Q I don't see in this any directions with respect to
9 packaging costs. From your interaction with reporting
10 plants, is there a wide degree of packaging types that is
11 included in what is reported to you?

12 A I have a cost item called packaging materials in
13 the form I sent to them. And it is noted on the table. And
14 I think it is Exhibit 9. That is also -- the product is for
15 cheddar cheese. But they had some -- most of it, it was for
16 40 pounds. But some are 640 and some are 500-pound barrels.
17 But the majority of the cheese is 40-pound cheddar.

18 Q Well, I think the point of my question was
19 intended to get at differences in costs of packaging. To
20 people have different costs related to different -- using
21 different containers or using different types of packaging
22 or different packaging items?

23 A Yes, that is correct.

24 Q In --

25 A Usually the smaller the package, the higher the

1 packaging cost.

2 Q The smaller the package, the higher the packaging
3 cost?

4 A Usually.

5 Q And are you just -- but you just in the case of
6 cheese are surveying two types of packages, right, 40-pound
7 blocks and -- are you -- excuse me, how many types are you
8 packaging? Excuse me, how many types of cheese sizes are
9 you surveying?

10 A The intent was to collect data only for the 40-
11 pound block cheddar.

12 Q Strictly 40s and this -- what you have reported in
13 Exhibit 9?

14 A But some co-ops, that is it -- you know, have
15 products other than 40-pound blocks.

16 Q Well, as they report to you the packaging number
17 that you have compiled to show in Exhibit 9, is there a high
18 degree of variation from high to low? What would be your
19 judgment of the range of packaging costs in your survey?

20 A I don't have -- I have to check the numbers.

21 Q Could you do that?

22 A Yes. Well, you want me to give you high and low?
23 When I prepared the statement here and the exhibit here, I
24 told the participating co-ops that the information which is
25 going to be released here is summary information. So if you

1 ask me to give you high and low, that will reveal individual
2 plant cost data. And I --

3 Q Okay. I understand.

4 A -- I have to decline that, I think.

5 Q Okay. I understand that you cannot give me exact
6 cost numbers from your survey for individual plants. Is
7 that your understanding of the agreement you have with the
8 participating cooperatives?

9 A That is correct.

10 Q Earlier though, you said in response to a question
11 that you would make a judgment about the reasonableness of
12 the numbers coming into the plant -- excuse me, coming into
13 your office from the plant. And if one looked odd, you
14 would go back and ask more questions. Right?

15 A That is correct.

16 Q So I am not asking you to talk about a specific
17 year's survey and the highest cost or the lowest cost of
18 packaging. I am asking you what is a range that you would
19 see as normal for a 40-pound block of cheddar cheese. From
20 plant to plant, what would be the lowest you would expect or
21 the highest you would expect that would cause you to go back
22 and ask for more data?

23 A I would look at the reasonableness of the number.
24 That is strictly based on my judgment.

25 Q I think you just told me that your practice is to

1 look at the reasonableness of the number, right?

2 A That is correct.

3 Q Okay. Well, suppose I were to suggest to you that
4 packaging costs for 40-pound blocks of cheddar might range
5 from half a cent a pound to 3.5 cents per pound. Would that
6 sound like a reasonable range to you?

7 A Say that again. What is that range?

8 Q A range for 40-pound block cheddar from half a
9 cent a pound to 3.5 cents a pound. Does that sound like
10 ballpark?

11 A That is probably too wide a range.

12 Q So if you had a report for as little as half a
13 cent a pound or as much as 3.5 cents, you would go back and
14 ask. Is that what you are telling us?

15 A Yes. Well, it is a -- if I know for a fact that
16 the plant is also making 640 pound, say, I might think it is
17 -- the low number is reasonable. So --

18 Q Okay. So in the packaging that they would submit,
19 they would be including both 640s and 40s?

20 A They might.

21 Q Would you want them to -- would you expect that
22 that would be within the guidelines that you have offered
23 for what should be reported?

24 A I would like them to have a perfect report to me.
25 But, you know, when you chase a number a couple of times and

1 the response is very cool. And you just make your own
2 judgment and run with the numbers.

3 Q Well, I can sympathize with you because I get the
4 same response from those guys, Charlie. When they are busy,
5 they are pretty busy, right?

6 A And they usually put this off, also.

7 Q Well, suppose that you saw a cost as high as 3.5
8 cents, then. I think you said -- I interpreted what you
9 just said is if you saw a report to you in the range of half
10 a cent, you might conclude that they had mixed in their
11 total packaging costs, which included the cheaper cost of
12 640s as opposed to 40s. What about if you saw -- is that
13 correct, what you were telling me?

14 A Yes, that is correct.

15 Q And what if you saw a 3.5 cents-per-pound number?
16 What would you think about that?

17 A I would try to get back to them to reconsider that
18 number. Whether they just purchase some equipment for
19 packaging purposes or like, you know, 640 or 40 pounds, you
20 have the -- if it is 640, you want to have the new -- how do
21 you call that, when you -- former -- if it is new.
22 Sometimes they will put the whole -- the total cost of
23 that --

24 Q Well, the machinery might be --

25 A No, no, no. The packaging, the -- how do you call

1 that, block former?

2 Q Yes, out of a block former in our operation, you
3 might have a plastic cover and then a cardboard cover over
4 the plastic. Is that what you are referring to?

5 A Yes. Well, sometimes they mistakenly, you know,
6 put the purchase cost of that former just in one year. And
7 it should be amortized.

8 Q Well, no. I am talking about the packaging
9 materials here. It is a separate line for packaging
10 materials as opposed to amortization of costs. Right? In
11 your survey, as I read your Exhibit 9, packaging materials
12 is separate from equipment cost, right?

13 A Supposed to be, yes.

14 Q But may not be. Okay. And that is -- I
15 understand you just deal with the numbers you are given and
16 you are not sure.

17 A Yes. I am just the messenger.

18 Q So suffice it to say then that if you had a range
19 between, say, half a cent a pound and 3.5 cents a pound,
20 there could be some errors in methodology that are at
21 least -- some inconsistencies between the instructions and
22 what was reported.

23 A That is correct.

24 Q Is there any concept that you used that would
25 involve the term "minimal packaging"? Does that term mean

1 anything to you?

2 A This is the first time that I have heard of that
3 term.

4 Q Today is the first day you have heard of this?

5 A Yes.

6 Q That is pretty interesting. Is it ever the -- as
7 you just testified earlier, the purpose of the survey going
8 back some years was to help plant managers control their
9 controllable costs inside the plant.

10 As you know, over the last year, there has been an
11 effort to compile this survey for this hearing. Is there
12 any effort made on your part, on your side of this survey
13 process to align what you are asking to be measured in cost
14 with the product that is being surveyed by NASS?

15 A Not whatsoever. Nobody told me that.

16 Q Well, let me go back to my -- to your comment that
17 if you saw a number out of range, out of what you thought
18 was a normal or expectable range, you might not accept it
19 readily. You might go back and ask more information.

20 Suppose you had a reported cost for the water and
21 sewer category of zero. What would you do with that? Would
22 you still think that was normal?

23 A Well, really, when it goes to the individual
24 items, I don't really -- I don't think we should read too
25 much into it because some clearly just numbered other things

1 in the survey, and some, other areas. So --

2 Q So for example, if we had a large plant complex
3 which was doing a lot of products to different plants and
4 they handled their waste -- plant waste -- let me rephrase
5 the question. If they were to handle their waste water from
6 the plant in a consolidated fashion, do you -- or is it
7 logical for you to assume then that they wouldn't allocate
8 those costs and that that would be why you were getting a
9 zero?

10 A I don't -- I'd have to look at the specific
11 numbers reported to answer that question.

12 MR. MARSHALL: Your Honor, can we go off the
13 record for a moment?

14 JUDGE HUNT: Yes.

15 (Off the record.)

16 BY MR. MARSHALL:

17 Q Well, let me continue this line of questioning
18 with respect to other items. Just assume hypothetically
19 that you were to see a butter plant report a cost of zero
20 for fuel.

21 JUDGE HUNT: Just a second, Mr. Marshall.

22 THE COURT REPORTER: Are we back on the record?

23 JUDGE HUNT: We are on the record, yes.

24 MR. MARSHALL: Oh, thank you, Your Honor.

25 JUDGE HUNT: Go ahead, Mr. Marshall.

1 BY MR. MARSHALL:

2 Q Suppose you were, Dr. Ling, to see a report from a
3 plant that showed a zero cost for fuel. Would that strike
4 you as out of range and worth following up on?

5 A Yes, that's correct.

6 Q Do you know of any plants that run entirely on
7 electricity and not other fuels? Are there possibly some?

8 A There might -- when they report a certain item as
9 zero, they might have that cost buried somewhere else.

10 Q I am still on butter. If you were to see
11 packaging range between, say, a cent a pound and five cents
12 a pound, would that strike you as unusual?

13 A No.

14 Q Do you think butter packaging costs range that
15 much, five to one cent a pound?

16 A It can be, yes, because when you take a -- the
17 cups and those very small ones, patties and so forth as
18 opposed to quarter pounds and one pounds with 26 pounds.

19 Q With respect to Exhibit 9, what sizes of butter
20 are surveyed as you direct the participants, what size
21 package?

22 A What size -- they reported all sizes. And that is
23 why I noted there that it is 53.3 percent of the butter
24 reported was for print (ph) butter. And that can be for any
25 kind of print (ph) butter.

1 Q So you have left -- or you assumed that the plants
2 have left that print (ph) butter packaging cost in their
3 reports to you, right?

4 A Yes, that is correct.

5 Q Are labor costs higher in plants that do print
6 butter, in your experience?

7 A I didn't pay attention -- particular attention to
8 that. So I am not sure.

9 Q I am sorry. Let me go back a step, Dr. Ling. Do
10 you have any numbers that would show the costs of packaging
11 for 40 -- excuse me, for what I will call a cube of butter
12 as opposed to print butter?

13 A Cube of butter?

14 Q Sixty-eight-pound cubes?

15 A I haven't heard of that before. Usually it is 26
16 pounds I think, one pound, a quarter pound, cups and patties
17 and that type of thing.

18 Q Well, let's go to something simple like a powder
19 plant. Most of the packaging for these powder plant surveys
20 would be bulk packaging, would it not, as opposed to
21 consumer --

22 A That is correct.

23 Q If you were to see a range of rates reported to
24 you for packaging of powder that range from a penny per
25 pound to two cents per pound, would you find those to be

1 within range?

2 A It depends on my understanding of the kind of
3 package they put it in.

4 Q Could you elaborate on that just a little bit?

5 A If a plant puts a powder into this tote, they
6 might have a lower packaging cost.

7 Q Can you explain what our tote operations look
8 like? Have you seen the totes?

9 A It is -- I have probably seen --

10 Q But would it be fair to say that a tote is like a
11 ton of powder?

12 A Yes, it is huge, yes, equipment.

13 Q Back to these categories, would it surprise you to
14 see a great range of -- from plant to plant in depreciation
15 costs? Or in your experience, is there quite a difference
16 in depreciation costs?

17 A I really don't pay much attention to it. So --

18 Q All right. This is in the abstract, then. If we
19 have a plant with data coming to you that is, let's say, 12
20 to 15 years old, would you simply be accepting the
21 depreciation schedule of the reporting plant?

22 A That is correct.

23 Q So if they use a 12-year -- if you have two
24 identically aged plants and one used a 12-year schedule and
25 another used a 15-year schedule, you would have different

1 numbers but you would accept them both, right?

2 A That is correct.

3 Q And if you had a 20-year-old plant that is fully
4 depreciated, you might have a very low depreciation number
5 versus a relatively new plant that is, of course, just in
6 the beginning of its depreciation cycle. Is that correct?

7 A That is correct.

8 Q Now, with respect to that issue, do you make any
9 attempt to adjust for the fact that the plant that might
10 have been built 15 years ago might be identical to the one
11 built today in many respects but, of course, would have much
12 higher cost of construction and, therefore, even though more
13 or less the same plant, would have different -- totally
14 different depreciation schedules? Any attempt to adjust for
15 that?

16 A No, sir.

17 Q You had some questioning earlier about office
18 costs, of plant office. Would you expect that the
19 computerized -- the computer systems that help a plant
20 manager manage his inventory and so forth would be part of
21 the plant cost or part of the office cost as you would
22 expect people to report --

23 A It can be both.

24 Q But if it is one, it is reported. And if it is
25 the other, it is not.

1 A We ask them not to report plant office cost.

2 Q You had a question earlier about whether you
3 reported marketing costs. And I believe you said no. Has
4 anyone ever asked you to survey marketing costs?

5 A No.

6 Q Looking at Exhibit 9 itself, I would just like to
7 talk to you about the methodology here. First of all, is it
8 fair to say that each of these line items represents an
9 average of that particular category?

10 A That is correct.

11 Q And so consequently then, as you look down these
12 three columns, there is no one plant that is going to have
13 those same numbers, right?

14 A Supposedly.

15 Q Right. It would be simply a coincidence if
16 that --

17 A That is correct.

18 MR. MARSHALL: -- were to have -- were to equate
19 to a specific plant. Well, Mr. Ling, I apologize for taking
20 so much of your time this morning. But it has been very
21 enlightening and I appreciate your help.

22 THE WITNESS: Yes.

23 JUDGE HUNT: Yes, sir?

24 BY MR. CHRIST:

25 Q I am Paul Christ from Land O' Lakes again. Dr.

1 Ling, I have two lines of questioning, one dealing with aged
2 cheese and the other dealing with capacity utilization.
3 With respect to aged cheese, would you agree that the major
4 costs would be storage and interest?

5 A That is correct.

6 Q Do your instructions for the survey specifically
7 exclude storage costs?

8 A I tell them to exclude the cost for long-term
9 storage.

10 Q Okay. And also, do your instructions also
11 specifically exclude interest costs?

12 A That is correct.

13 Q So the major costs associated with aged cheese
14 would be specifically excluded from your survey.

15 A I suppose so.

16 Q Okay. Thank you. With respect to capacity
17 utilization, your testimony shows average -- weighted
18 average cost for each major product. Could you tell me the
19 capacity utilization of the plants that you surveyed for
20 each of these products?

21 A I -- you mean the average?

22 Q Yes, the average.

23 A I don't have it here. I have to go back and check
24 it.

25 Q If I were to recite some numbers, could you tell

1 me if they were reasonably close? Let me try --

2 A I -- well, just don't hold me to it.

3 Q Okay. With respect to cheese, would a number of
4 88.8 percent sound reasonable?

5 A That is -- I think that comes to my mind as the
6 number I had.

7 Q That is a reasonable number.

8 A Yes.

9 Q With respect to butter, would 53.3 percent be a
10 reasonable number?

11 A I am not sure. Butter plants tend to be --
12 usually tend to be pretty low in their capacity utilization
13 for some reason.

14 Q With respect to nonfat dry milk, would -- again,
15 would 47 percent be a reasonable number?

16 A I have to check my own.

17 Q Okay.

18 A Yes.

19 MR. CHRIST: You don't have the data. Well, thank
20 you very much, Dr. Ling.

21 JUDGE HUNT: Yes, sir. Mr. English?

22 BY MR. ENGLISH:

23 Q Again, Charles English. Doctor, when did you
24 first learn that you would be asked to testify at this
25 hearing?

1 A I was requested to testify based on the data sent
2 to me dated March 24th from the administrator of AMS.

3 Q Did anybody in industry request that you testify,
4 to your knowledge?

5 A No, sir.

6 Q Have you had any conversations with anybody in
7 industry concerning your testimony?

8 A No, sir. This is a regular business transaction
9 in collecting the data and reporting to them and --

10 Q A question -- forgive me. A question from
11 Mr. Marshall suggested the possibility that this last year,
12 the data had been put together or had at least been
13 collected or disseminated in a way in order to make it more
14 available for this hearing. Is that correct?

15 A There was a -- can you -- say that again.

16 Q Was there any attempt by the cooperatives to speed
17 up the process this year in order to get the numbers out
18 from last year's survey for this hearing?

19 A Nothing out of the ordinary.

20 Q Does the report that you generate and send to the
21 cooperatives consist of more than the one page that is
22 Exhibit 9?

23 A Yes. It goes into a lot of details about their
24 operations.

25 Q Excluding pages that would be individual to an

1 individual cooperative, are there other pages for all ten
2 cooperatives?

3 A The pages on efficiencies. How many pounds of
4 products are made per hour of labor and per hour, per
5 kilowatt-hour electricity or per ton of fuel.

6 Q Going back to the letter from the administrator of
7 AMS -- was that the administrator of AMS that wrote you a
8 letter?

9 A The -- it is a letter from the administrator of
10 AMS to the administrator of Global Business Cooperative
11 Service.

12 Q Is that a document I can see?

13 A It is here.

14 Q I mean is it a public document?

15 A I suppose it -- with AMS people's consent, I think
16 it can be made public.

17 Q I will look at it in a moment. Is it your
18 understanding that you are appearing in support of any
19 proposal here today?

20 A No, sir.

21 Q I understand there are certain confidentiality
22 constraints, certain -- with this report. And these next
23 questions may get at that and I apologize. But I am trying
24 to understand to the extent to which we can use this
25 usefully. Can you tell me the names of the ten cooperatives

1 that participate?

2 A I can, yes. I think it is -- we -- whoever
3 receives assistance from us, the public has the right to
4 know. So I -- you want the names?

5 Q Yes, I would like the names.

6 A It is Agri-Mark Inc., Alto Dairy Cooperative,
7 Bongards Creameries, Dairy Farmers of America, Farmers Co-op
8 Creamery of McMinnville, Foremost Farms USA, Land O' Lakes,
9 Michigan Milk Producers Association, San Joaquin Valley
10 Dairymen Association, Tillamook County Creamery Association.

11 Q Now, the cooperatives can choose which plants, if
12 any, they want to participate in a given year, correct?

13 A That is correct. Now, they usually pick the ones
14 they -- it is uniform. What they understand the purpose of
15 the project is for, okay, so they tend to pick the one with
16 more uniform products with others.

17 Q But, in other words, they don't include all their
18 plants. If we had all the plants from these ten
19 cooperatives, we would have far more than 26 plants.

20 A That is correct. I think the reason for that is
21 because some plants have more products than just what is
22 included here. And it is required at the cost allocation.
23 And then it goes into a lot of guesswork and how to allocate
24 this. So they understand the purpose of the project and
25 they tend to exclude those plants.

1 Q Have you compared the results of your study or the
2 mechanics, may be a better way of looking at it, of your
3 study with the mechanics, say, of the manufacturing cost
4 study that is done by CDFA for --

5 A I took a look at it, yes. Now, the mechanics is
6 very different. They have the right to audit every plant's
7 financial data. Mine is voluntary participation.

8 Q And they include more costs in theirs, correct?
9 They include more categories of cost because we have already
10 discussed that there are certain categories that have been
11 excluded in the cooperative study, correct?

12 A I am not sure what they include or exclude. You
13 have to ask them what they include and then compare that to
14 mine and see what is included or excluded.

15 MR. ENGLISH: Could I take a look at that letter,
16 please? Thank you.

17 JUDGE HUNT: Yes, sir?

18 MR. VETNE: Your Honor, I will enter my
19 appearance. My name is John Vetne, V-E-T-N-E. I am an
20 attorney. I practice in Newburyport, Massachusetts. I am
21 here representing Kraft Foods.

22 BY MR. VETNE:

23 Q Good morning, Mr. Ling.

24 A Good morning.

25 Q Subsequent to your receipt of the March 24 letter

1 or subsequent to your superior's receipt of that letter,
2 someone received the consent of the participating
3 cooperatives. Is that correct?

4 A Say that again.

5 Q The March 24 letter from AMS requesting your
6 testimony --

7 A What is your question?

8 Q -- was followed by -- am I correct that that was
9 followed by an effort to solicit and receive the consent of
10 the participating cooperatives for you to present this data?

11 A Number one, the letter was dated March 24th. I
12 didn't receive it that day. That is -- it went through
13 various stages until it reached me. Okay. The letter just
14 asked me to be here, that's all.

15 Q Okay.

16 A You can take a look at it if you want to.

17 Q Okay. No, I am referring to the part of your
18 testimony that says that this data is being produced here
19 because the ten participating cooperatives have consented to
20 the data being produced.

21 A That is correct.

22 Q Okay. My question relates to how that consent was
23 secured. Can you please describe it? My question is
24 perhaps too specific. I will leave you wide open. Explain
25 how that consent was secured.

1 A Okay. It was a letter from my boss, deputy
2 administrator for Cooperative Services Programs to the ten
3 cooperatives saying that I had been requested by AMS to
4 testify for the record because several proposals had
5 proposed to use my numbers in this hearing. And then the
6 letter went on to request that -- to ask them to initial in
7 a separate letter that is either the -- to get permission
8 for me to use summary information with this project or they
9 don't want to give the permission for me to use it.

10 Q I see. So all of the participating co-ops sent a
11 letter back and checked the box that indicated their
12 consent, am I correct?

13 A That is correct.

14 Q Okay. And this occurred before you were asked to
15 testify or after?

16 A After.

17 Q So within the past couple of weeks.

18 A That's correct. The last one I received was May
19 4th.

20 Q Did you receive any phone calls questioning from
21 any of the co-ops that consented asking for information on
22 what would be included in the summary report?

23 A No.

24 Q Okay. Ordinarily when you prepare an annual
25 aggregation of data, that relates to a specific year. Let's

1 say, for 1997 or a typical year. When in relation to the
2 last day of that year do you send out your questionnaires?

3 A I usually send it out in May over the last few
4 years.

5 Q In the May of the following year.

6 A That is correct.

7 Q Okay. And how long do cooperatives have to
8 respond to your questionnaire? Is there a deadline?

9 A I ask them if they can respond by the end of the
10 August. That is usually what I ask them. But the process
11 is always very prolonged because a lot of other work is in
12 their own office that conflicts with this or they tend to
13 prolong it.

14 Q I see. So ordinarily, when would you have
15 received the last report to prepare both individual and
16 aggregate data for the prior year?

17 A I -- well, I -- for the last few years, the report
18 I -- I usually send out a report by the end of January of
19 the following year.

20 Q So the 1997 report would be mailed out to the
21 participants in January of 1999. Am I correct?

22 A That is about right, yes.

23 Q Okay. My question was about what -- during about
24 what month would all of the reports be on your desk? When
25 would the last procrastinator complete his report and send

1 it to you?

2 A January.

3 Q About the same time that you send out your
4 final --

5 A Well, it usually takes me about a week or two to
6 prepare that report.

7 Q Okay. When did you first become aware that a
8 proposal was submitted or was in the works to include RCBS's
9 survey as part of the Milk Order regulatory scheme?

10 A The written proposals or --

11 Q When did you first become aware that this was in
12 the air and in the works?

13 A In the air and --

14 Q Yes, in the air. If you -- when did you first
15 become aware that somebody was considering using RCBS plant
16 survey information for regulatory purposes?

17 A I would say the -- at the annual meeting of
18 national milk, they made efforts to ask members to send --
19 to participate.

20 Q Okay. And when did that annual meeting occur?

21 A This was November '99.

22 Q November '99. And you attended that meeting?

23 A Yes, sir.

24 Q Was the survey discussed during that meeting other
25 than asking members to participate?

1 A No, no discussion at all.

2 Q Okay. Was there any discussion between those
3 attending the meeting and you in an unofficial capacity,
4 conversational capacity?

5 A No.

6 Q Okay. When for any particular calendar year does
7 a cooperative have to commit to provide plant information to
8 be included in the aggregate report for that calendar year?

9 A It is -- we don't have a cut-off date if you are
10 referring to that. If the co-op managers say we are
11 participating, then I would wait for them to get the numbers
12 in.

13 Q Okay. So if in August of 1998 a cooperative that
14 had received from its auditors, its accounting data, wanted
15 to participate for 1997, that cooperative could give you a
16 call and say we want to be part of this report for the year
17 1997 and we will send you our reporting.

18 A That's correct.

19 Q Okay. In this particular survey of costs for --
20 well, for calendar year 1998, for plants participating in
21 that calendar year, when did you receive the last finished
22 questionnaire?

23 A Last Monday was what? May 1st?

24 Q May 1st for calendar year 1998.

25 A That's correct.

1 Q Okay. And there are in addition two plants -- let
2 me go back to that. The plants that submitted information
3 for calendar year 1998 that you received last week, are
4 those plants that had previously participated in the RCPS
5 plant survey?

6 A That is correct.

7 Q Okay. And they had so participated for the last
8 15 years or so?

9 A They -- some of the plants did -- were in there.
10 Some were not.

11 Q Some not. Okay. And there are some plants that
12 have from year-to-year dropped in and dropped out of the
13 survey. Am I correct?

14 A That is correct.

15 Q Okay. And some organizations that have from year-
16 to-year dropped in and dropped out of the survey, is that
17 correct?

18 A That is correct.

19 Q You indicate that this survey of costs includes
20 not only 1998 -- but for one cheese plant, one powder plant
21 and one butter plant includes 1999 data. How -- explain the
22 process by which 1999 cost data was included in the 1998
23 survey.

24 A The data is for 1998. But the co-op manager told
25 me that because of some certain reasons in their cost-

1 accounting systems, they couldn't give me the 1998 data.

2 And they wanted to send me the 1999 data instead. So I
3 accepted that. But there is no repetition. There is 1998
4 or '99 to that.

5 Q No, I understand. There are plants that have data
6 in here not for 1998, but instead for 1999.

7 A That's correct.

8 Q The plant is only in here once. But it is in
9 there for a different year, is that correct?

10 A It is not in here once. The plant has been maybe
11 in and out before.

12 Q No. I mean, it is in this report that is Exhibit
13 9, I understand, only once.

14 A No. They have been in the report in previous
15 studies before.

16 Q Okay.

17 A But, you know, sometimes a co-op can have a new
18 accountant or bookkeeper doing the work. And the --

19 Q Let me ask it this way. The plants that are in
20 here with 1999 cost data are not in here at all in any
21 respect concerning their 1998 cost data. Is that correct?

22 A That is correct.

23 Q When was the request made to you to include 1999
24 cost data with the 1998 report?

25 A When?

1 Q When.

2 A Well, when they send in the data, they told me
3 that they cannot provide '98, they have some problem with
4 their '98 data.

5 Q So it was when you received the questionnaire, you
6 learned that '98 data would not be included, but 1999 data
7 would be substituted. Correct?

8 A That's correct.

9 Q And with --

10 A Now, one told me before hand -- okay, what I say
11 there, actually, it is one cheese plant and one butter
12 powder plant. And the one butter powder plant told me
13 before hand that it --

14 Q Okay. And with respect to that 1999 cost data,
15 when did that information come across your desk?

16 A A couple of months ago.

17 Q A couple of months ago would be, what, early March
18 or late February or what?

19 A Somewhere around there. I have to check the -- I
20 mark it in every time it comes in. So I can go back and
21 check if you want me to.

22 Q Has your questionnaire -- you indicated that your
23 questionnaire has changed a bit. Has your questionnaire
24 changed from 1998 -- sorry. Has your questionnaire changed
25 for 1998 data --

1 A No, sir. That's --

2 Q -- to 1999 data?

3 A It has probably changed -- if I recall, it changed
4 during the earlier years and that has been pretty much the
5 same, yes. I didn't make any changes particularly for the
6 1998.

7 Q Okay. Now, you indicated that plants have
8 variable costs and that there are ranges and that you do not
9 want to give the high and low. All of those things are
10 true? There are variable costs. There are cost ranges.
11 And you don't want to give the high and low.

12 A That's correct.

13 Q All true. With respect to each product category,
14 without identifying where the low point is and where the
15 high point is, can you tell me what the range was in cents?

16 A For the average?

17 Q What the range -- the range from high to low. I
18 am not looking for eight cents to 15 cents. But if you can
19 tell me that the range was five cents, it wouldn't tell me
20 anything about where the high and low was. But it would
21 give me some idea of the range. Can you please do your best
22 based on your recollection of the data to tell me what the
23 range was, not the high and low, but the amount of the range
24 for each product category?

25 A I don't have the information with me. I don't

1 recollect. So I have to go back and check if you want me
2 to.

3 Q I would -- yes, are you able to come in the
4 ballpark?

5 A I wouldn't hazard to guess.

6 Q You would not hazard, okay. I am interested in
7 and would request that you provide that data for later use.
8 Are you willing to do that?

9 A Just the range.

10 Q The amount of the range.

11 A The amount of the range. I can provide that, yes.

12 Q Thank you. Now, with respect to differences in
13 plant costs which you identified in part due to uniform
14 receipts or seasonal receipts, okay, your costs include
15 plant costs for those plants that had extra costs because
16 they have a seasonal variation in their supply. The amount
17 of fixed costs, the amount of extra costs resulting from
18 seasonality --

19 A I don't know -- I don't see any seasonality coming
20 into play here because the data is for the entire year.

21 Q It is for a year. But you indicated in your
22 testimony that plants that receive seasonal milk or milk
23 that is received with a great seasonal variation tend to
24 have higher costs per pound of cheese, butter or powder.
25 Did I misunderstand? Is that correct?

1 A I said the -- A plant for the balancing purposes
2 would tend to have a higher cost.

3 Q And those higher costs are included in your
4 survey.

5 A That is correct.

6 Q Okay. And a plant that has more uniform receipts
7 sometimes pays a premium to gain those receipts and to gain
8 efficiency. Your survey does not include the cost incurred
9 by plants to secure a level supply of milk.

10 A That is correct.

11 Q Where a plant -- a cheese plant, for example, that
12 makes -- that takes the whey and transfers it in bulk to
13 another facility for processing, is the transportation cost
14 to the second facility included in these costs?

15 A No, sir. They are not supposed to be.

16 Q Not supposed to be. Okay. And the same would be
17 true for a powder plant that transferred cream to another
18 location for churning.

19 A That is correct.

20 Q Okay. And with respect to those kinds of
21 movements of milk, if -- well, strike that. Do your cost
22 surveys include, for example, butter plants that receive
23 cream that was separated elsewhere?

24 A Yes, they might.

25 Q Okay. And with respect to that kind of

1 transaction, when you have a number here for average yield
2 based on milk received, am I correct that the milk that you
3 are measuring yield from is what is in the tank at the
4 plant?

5 A Repeat that question again, please.

6 Q There is a line for each product -- well, actually
7 there is not a line for each product. There is only a line
8 for cheese that refers to yield. So do you have any data on
9 powder or butter yield on milk that is received in the
10 plant?

11 A No, because some plants, as you said, receive
12 cream and so it is -- it tries to cut the yield. I think it
13 is pretty minimized.

14 Q How is that? Why is that?

15 A Why they -- depending on what you want to define
16 the yield, if it is defined as milk received versus products
17 made.

18 Q Okay. Well, it is product made from milk
19 received. That is the way it is included here for cheese.

20 A For cheese, yes.

21 Q Is that right?

22 A Yes.

23 Q With respect to cheese yield, at what part of the
24 process are you measuring the milk? Is that milk received
25 in the silo or milk that goes into the vat?

1 A I ask them to tell me how many pounds of cheese is
2 made at the plant and how much milk goes into the cheese-
3 making.

4 Q Okay. For a plant that receives cream that goes
5 into the silo or into the vat to make cheese, do you know
6 how your respondents measured the milk?

7 A Okay. I ask them to report to me the pounds of
8 cheese made, the pounds of milk going into making cheese --

9 Q Right.

10 A -- also the pound of butterfat going into cheese.

11 Q All right.

12 A And I calculate the fat contents. Supposedly, it
13 is on those numbers. And those numbers are pretty much at
14 the standard identity range.

15 Q Okay. Would it be correct to say that you don't
16 know whether the pounds of raw fluid product that went into
17 cheese are -- include a portion of cream mixed with milk?

18 A In some cases, yes.

19 Q In some cases?

20 A In some cream. But not in -- in most cases, I
21 didn't see much cream going into cheese for what the plants
22 reported to me.

23 Q In order for you to calculate yield, what do you
24 do to convert the cream back to whole milk, back to producer
25 milk if anything?

1 A The cheese yield number here is strictly the milk
2 pounds going into cheese-making --

3 Q Does that mean --

4 A -- versus cheese pound.

5 Q Does that mean that the plants don't use cream in
6 the vat?

7 A As I said, some of them use --

8 Q Some of them use cream. And it may come from
9 their creamery or someone else's. In order to know yield,
10 would you not have to know the raw milk that was received by
11 somebody that went into making the cream that went into the
12 vat?

13 A If you want to be very perfect, that is correct.

14 Q Okay. And some of the plants also receive in the
15 silo or put in the vat in addition to producer milk,
16 condensed milk. What do you do, if anything, to convert
17 that condensed milk back to whole milk in calculating cheese
18 yield for milk?

19 A For this year, I don't recall seeing any print
20 putting condensed into cheese-making.

21 Q Okay. Does the cheese report any cheese plant in
22 California?

23 A No, sir.

24 Q Okay. Are you not aware that plants do receive
25 condensed milk to mix with producer milk so the two achieve

1 an ideal fat-to-protein ratio?

2 A I heard of it, yes.

3 Q Okay. A similar question, are you aware that some
4 plants that make cheese receive milk that has been through a
5 reverse osmosis process so that some of the water is taken
6 out before it gets to the plant?

7 A I heard about that, but not -- I am not aware of
8 any of the plants included in this study.

9 Q Okay. Is a question asked in your questionnaire
10 whether plants do receive RO milk?

11 A I ask them to report Grade A milk or Grade B milk
12 received and the butterfat contents and the solid contents
13 and also the skim, if any, and condensed, if any, and cream,
14 if any. And if I look at the numbers and if the fat content
15 is too high or solid content is too high, I might question
16 that.

17 Q Okay.

18 A But he might have made correction and no other
19 plants in here has the kind of abnormality.

20 Q Okay. Again, with respect to your calculation of
21 yield, are you aware that some milk and some fat is lost in
22 the process of getting milk from the holding tank in the
23 farm to the silo in the cheese plant?

24 A You mean the shooting cage between the farm and
25 the plant?

1 Q Yes, yes.

2 A Yes, there is always some shooting cage.

3 Q There is always some loss, okay. And with respect
4 to your calculation of yield, do you know whether the volume
5 of milk measured against the cheese produced for the yield
6 represents the volume received at the silo or the volume
7 that left the farm?

8 A The question asked is milk going into making
9 cheese.

10 Q And --

11 A That's it.

12 Q And --

13 A I mean, for the -- for the purpose of calculating
14 cheese yield, that is the number I use.

15 Q Okay. And in answer to my question, do you have -
16 -

17 MR. COOPER: I am going to object, Your Honor, to
18 this line of questioning. It seems like we are beating a
19 dead horse here. I mean, he told you how he calculated the
20 yield. He told you what milk is included in the survey.
21 And now if Mr. Vetne wants to present 12 other scenarios of
22 how you can calculate it, he can get his own witness. I
23 think we are just going around in circles here.

24 MR. VETNE: Well, this is a whole new line of
25 questioning and it is only my first time at it. But I am

1 trying to find out if the Witness knows whether the data
2 reported is milk in a silo --

3 JUDGE HUNT: Proceed. Proceed.

4 BY MR. VETNE:

5 Q When you ask -- when your questionnaire asks for
6 milk going into cheese, would it be correct to say that you
7 do not know whether what is being reported is milk that goes
8 from the silo to the vat or milk that goes from the farm
9 through the silo to the vat?

10 A Actually, I do know because the -- for the details
11 of Grade A and B milk received at the plant, I asked them to
12 report the producer milk received for the -- for calculating
13 the cheese yield, I ask them milk going into making cheese.

14 Q Okay.

15 A Usually, if there is a discrepancy between the
16 producer milk and the milk going into cheese, the milk going
17 into cheese is lower than the producer milk.

18 Q Yes? So you believe that your yield numbers if
19 the participants are reporting it as you believe is the
20 amount of milk from the farm which the manufacturers account
21 for for payment purposes. Is that correct?

22 A No. The milk that goes into calculating cheese
23 yield is different from the producer milk received.

24 Q Oh, okay. Thank you.

25 With respect to operations making butter, are all

1 of the plants in this report combined butter powder plants?

2 A That is correct.

3 Q Okay. Either the butter cost or the powder cost -
4 - well, let me rephrase that. If included at all, which
5 column of butter and powder includes the cost of making
6 butter milk powder or condensed buttermilk?

7 A I would say it is -- no -- say that again, that
8 last --

9 Q When cream is received and churned, there is a
10 byproduct that is called buttermilk --

11 A Yes.

12 Q -- which commonly is dried --

13 A That is correct.

14 Q -- reduced to powder and reduced to buttermilk
15 powder.

16 A Okay.

17 Q The process of drying that, handling it,
18 separating it, whatever is required, is that included in the
19 butter cost?

20 A In the powder cost.

21 Q It is included in the powder cost. Okay.

22 A As I understand that.

23 Q Pardon?

24 A As I -- it is usually included in the --

25 Q Do you have a specific instruction to the

1 participating plants to allocate that condensing and
2 powdering to their nonfat dry milk costs?

3 A Let me go back to the buttermilk powder again
4 before I answer your next question. When I asked for the
5 data, I asked for the -- I asked for products like maybe the
6 butter powder plants. And they were this nonfat dry milk
7 and butter powder milk and maybe some other products. And
8 then I can check that against the actual pounds of products
9 made, dried at the powder plant and see what is included and
10 what is not included. Okay. And butter powder milk is
11 always included in the powder value.

12 Q In the powder costs. Okay. Are you aware that --
13 sorry. Are you aware of whether buttermilk when it comes
14 out of the butter churn contains lower solids than skim milk
15 that has been separated?

16 A I never pay attention to it. So I cannot answer
17 your question.

18 Q You do not know whether that is the case or not.

19 A That is correct.

20 Q Okay. If it were the case, would it be correct to
21 include that the cost of drying buttermilk powder would be
22 greater -- I mean drying buttermilk would be greater because
23 you have to remove more moisture?

24 A I assume so, yes.

25 Q In your Exhibit 9 which provides an average cheese

1 yield, is the cheese that is included in that yield cheese
2 that is packaged, or cheese that comes out of a vat?

3 A It is 52 -- it is pounds, so -- milk reported --
4 cheese reported. It is supposedly coming out of the vat.

5 Q Are you aware of whether there are losses in
6 product between the stage of manufacturing where it comes
7 out of the vat and where the wrapping or packaging is put
8 around it?

9 A I assume so, yes. But this doesn't include the
10 cut and wrap.

11 Q I am not talking cut and wrap. I am talking
12 whatever container goes around 40-pound blocks or whatever
13 kind of keg goes around the bigger blocks. From the time it
14 is finished in the vat and gets into whatever container it
15 is in, are you aware of whether there are losses in the
16 finished product and are those included in the amount of
17 cheese that you measured for yield or don't you know?

18 A I don't know. I asked for the pound of cheese
19 made. That is all.

20 Q With respect to costs -- make costs per pound for
21 each of these products, have your calculated average or
22 aggregate costs for participating co-ops been different in
23 years prior to 1998 than reported in Exhibit 9?

24 A You mean for specific plants?

25 Q Has the average cost varied over time? Let me ask

1 it that way.

2 A It's fraction has a little bit from year to year,
3 yes.

4 Q Okay. Within the past five years for example, do
5 you have a recollection, even a ballpark recollection on
6 variation of cheese costs from your reported average of
7 12.916 cents? Has it been higher in the past?

8 A In the past, I didn't calculate any weighted
9 average costs, so --

10 Q In the past, when you presented a report to
11 participants that showed the behavior of all participants in
12 one column and compared the individual plant data in
13 another, the all-participant data was not weighted?

14 A That is correct.

15 Q It was a simple average of the participating
16 plants?

17 A That is correct.

18 Q Okay. Is 1998 the first year for which you
19 weighted the average?

20 A That is correct.

21 Q You have -- have you observed in the information
22 provided to you in the questionnaires that the yield of
23 product from plant to plant and from region to region in
24 which the plants are located varies?

25 A I didn't pay particular attention to that. But I

1 assume that there is regional variation in cheese yield.

2 Q Okay. Do you know whether if yields were weighted
3 by volume of milk purchased rather than volume of cheese
4 produced, whether the weighted average would be different
5 than you have reported?

6 A I don't have any idea.

7 Q Okay. Now, with respect to reports -- aggregate
8 reports submitted -- prepared for all the prior -- years
9 prior to 1998, I think your testimony was that it could be
10 produced in a form that does not reveal the individual
11 operations of plants simply by removing the column or the
12 page that has plant information. Am I correct? It is
13 possible.

14 A Possible, yes.

15 Q Okay. Have you -- are you aware of whether there
16 was consideration given to providing prior years non-plant-
17 specific cost information?

18 A No. The request from AMS is for me to testify
19 with regard to 1998 data year. So --

20 Q Okay. When you included 1999 data in your
21 averages, did you advise AMS that that information would be
22 included?

23 A No.

24 Q And with respect to prior years aggregate
25 information which does not reveal confidential information

1 of individual plants, do you recall that about six years ago
2 I submitted a request to your agency under FOIA to share
3 that information with me?

4 A Yes. I remember somebody did request that data.

5 Q Right. And at the first level of review, that
6 request was denied. Do you have any notion of when I might
7 get a response to my appeal? It has only been six years.

8 MR. COOPER: That's --

9 THE WITNESS: I don't know --

10 MR. COOPER: That's -- you don't have to answer
11 that.

12 THE WITNESS: I am not involved in those Freedom
13 of Information requests.

14 MR. VETNE: That was just tongue-in-cheek and a
15 conclusion. Thank you.

16 JUDGE HUNT: At this time --

17 THE WITNESS: Before you leave, how am I going to
18 transmit those -- that range he asked for?

19 MR. VETNE: Your Honor, as far as I am concerned,
20 if Dr. Ling could simply provide a piece of paper that
21 somebody can carry to the hearing that shows the range. I
22 mean, I can't imagine that --

23 JUDGE HUNT: Why don't you discuss that with Mr.
24 Cooper at the break how you are going to arrange that.

25 MS. BRENNER: Are you intending for this to be the

1 end of Dr. Ling's testimony?

2 JUDGE HUNT: I assume that there is more
3 questioning of Mr. Ling and -- or Dr. Ling rather. So we
4 are just going to take that up after lunch. So be back here
5 at 1:00.

6 (Whereupon, at 12:00 p.m., the hearing was
7 recessed to reconvene at 1:04 p.m., this same day.)

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1 up all the cost across all the plants, divide it by all the
2 pounds across the plants.

3 Q All right. And as a result of that system, plants
4 that have more production play a bigger role in determining
5 the weighted average than the simple average, correct?

6 A That is correct.

7 Q And correspondingly, plants with smaller
8 production play a smaller role, correct?

9 A That is correct.

10 Q Now, for cheese, your study says that the weighted
11 average is bigger than the simple average, correct?

12 A That is correct.

13 Q A half a cent bigger, correct?

14 A Yes, whatever the number shows. That is correct.

15 Q So this study if true means that the bigger plants
16 making cheese in this country have a higher cost of cheese
17 manufacturing than the smaller plants.

18 A It is true that some notch scale plants report a
19 higher cost, yes. That is what the numbers show.

20 Q That is very, very counter-intuitive as an
21 economist, isn't it?

22 A Economist don't go by, you know --

23 Q Well, it is counter-intuitive in the sense that
24 the general understanding among agricultural economists is
25 that the larger plants are the more efficient plants with

1 the lower costs, isn't that true?

2 A That is generally true. But a larger plant might
3 require higher quality staff to operate. That might incur
4 higher cost.

5 Q I mean, the conclusions to your report here for
6 cheese are exactly the opposite of what you conclude for
7 butter and powder, correct?

8 A That is correct.

9 Q In fact, you show that the weighted cost for
10 butter is a full three cents lower than the average cost,
11 correct?

12 A That is correct.

13 Q Meaning that the biggest, most efficient butter
14 plants are much cheaper to operate than the smaller butter
15 plants, correct?

16 A Yes. Generally speaking, yes.

17 Q Because they have to be way below the 10.6 --
18 strike that. The big plants have to be way below the 10.6
19 cents to pull the weighted average down to 10.6, right?

20 A That is correct, yes.

21 Q And similarly, you show that for powder, the
22 weighted average is two cents lower than the average,
23 correct?

24 A That is correct.

25 Q Which means that the biggest powder plants are way

1 below 12.7 cents because they have to be to pull that 14-
2 cent average down to 12 cents, correct?

3 A That is correct.

4 Q Do you have some serious doubts as to the accuracy
5 of the cheese numbers?

6 A No. I look at the numbers and I --

7 Q Well, but you --

8 A I could understand why --

9 Q You audit none of these numbers, correct?

10 A I didn't audit numbers.

11 Q Okay. And you have not previously done a weighted
12 average.

13 A That is correct.

14 Q But when you do one here, you find that not
15 withstanding the fact that butter and powder plants, the
16 bigger plants are much more efficient, much cheaper to
17 operate, it is just the opposite for cheese.

18 A That is correct.

19 Q That is what this data tells you.

20 A That is correct.

21 Q Does that come -- did that surprise you when you
22 saw it?

23 A I wouldn't say it was a surprise. I react some
24 way, then I went back to check the numbers on what they --
25 you know, about what they reported.

1 Q Well, I am assuming you did the math correctly. I
2 am asking whether this raised some question in your mind as
3 to the accuracy of the numbers that have been provided.

4 A Not necessarily so, no.

5 Q Did it at all?

6 A As I told you, I went back to check the numbers.
7 And I looked at the plants' overall operations. And I
8 didn't have reason to question the number reported.

9 Q Well, did you look at the -- you -- start that
10 again. You do know, of course, in fact you testified
11 already that the state of California surveys manufacturing
12 costs for its cheese plants, correct?

13 A That is correct.

14 Q And that is actually audited, which yours isn't,
15 correct?

16 A That is correct.

17 Q Did you look to see whether -- what the
18 relationship was between the weighted average and simple
19 average in California?

20 A No.

21 Q Would it surprise you to learn that the simple
22 average in California is 18.5 cents and the weighted average
23 is 16.9 cents?

24 A I looked at the numbers, but I didn't -- it didn't
25 register anything in me. So -- my mind, so --

1 Q Well, assume with me that the numbers I just read
2 are accurate. All right. The simple average is 18.5 cents
3 and the weighted average is 16.9 cents. Okay?

4 A Okay.

5 Q That means the weighted average is 1.6 cents
6 lower. Just a matter of pure math, correct?

7 A Okay.

8 Q And that means that in California, the biggest
9 plants are the most efficient plants. Correct, by
10 definition?

11 A I suppose so.

12 Q Anytime the weighted average is below the simple
13 average, the bigger plants are less expensive. That is
14 inherently the case, isn't it?

15 A I am not sure if it is -- if they are too small
16 plants that not have -- if several small plants have lower
17 costs, then your weighted average might be lower, too,
18 depending on the poundage.

19 Q Well, all I am saying is that if you have compared
20 the weighted average in any survey, it could be of anything,
21 to the simple average, anytime the weighted average is below
22 the simple average, that means that the bigger players have
23 lower costs whether you are measuring cheese or automobiles
24 for that matter.

25 A Not necessarily so. Depending on the costs

1 associated with how many pounds of cheese. Okay. If you
2 have three plants that have very low cost even though they
3 are small, collectively the total can be larger than a
4 single large plant.

5 Q All right. Nonetheless, the reality is that in
6 California, the conclusion is that the larger plants have a
7 lower cost, correct?

8 A Well, you have to look at the individual plant.

9 Q Well, comparing the weighted average to the simple
10 average. That is all I am doing.

11 A Well, that only tells you that the higher -- the --
12 -- there are higher pounds of cheese associated with lower
13 cost. It doesn't tell you which plant is more efficient
14 now.

15 Q Well, if you have ten plants and they have a
16 simple average of -- excuse me, ten plants with a simple
17 average of 18.5 and the weighted average is 16.9 which is
18 lower, then what that means is once you attribute to each of
19 their plants the actual poundage, you have brought down the
20 cost. Correct?

21 A You might, yes.

22 Q Well, you necessarily --

23 A I have to actually run through the numbers.

24 Q Did you -- have you done any analysis to determine
25 how it is possible that the Rural Business Cooperative

1 Survey came up with a relationship between average cost and
2 weighted cost that is the exact opposite of the one in
3 California?

4 A As I told you, I look at the numbers and their
5 summarized scale plans with higher cost.

6 Q Okay.

7 A And I trust their reporting.

8 Q Okay. Beyond the fact that you trust their
9 reporting, did you do anything to investigate that
10 phenomenon?

11 A No, sir.

12 Q Did you do anything to investigate the phenomenon
13 as to why the exact opposite phenomenon was observed in
14 butter and in powder than was being observed in cheese?

15 A No.

16 Q All right. Now, did you do anything to compare
17 the cost being reported in this survey versus the last
18 survey?

19 A I took a look at it. But I didn't -- it didn't
20 register how it compared with the previous survey.

21 Q Okay. Let me -- can I give you -- do you have a
22 pen? Can I give you some numbers, please?

23 A Yes.

24 Q Okay. Now, let's start with the 1998 figures that
25 you have got.

1 A Okay.

2 Q Cheese -- and I am going to do a simple average.
3 Cheese is 12.4, butter is 13.6 and powder is 14.7. That is
4 off of your Exhibit 9, the simple average numbers. And you
5 have already told me previous surveys were simple average
6 numbers, correct?

7 A Yes, that is correct.

8 Q All right. And I am taking these right -- now, I
9 am going to take these from the decision, the final decision
10 implementing our current system. Cheese is 14.21, butter is
11 13.27 and nonfat dry milk is 12.45. And that is from pages
12 16097 and 16098 of the Federal Register of whatever -- April
13 2nd I think it is, 1999.

14 Now -- and I am -- these are the numbers that come
15 from the Rural Cooperative -- excuse me, the Rural Business
16 Cooperative Survey in 1996 as reported in that Federal
17 Register. Now, do you have an explanation as to why it is
18 that cheese costs would have fallen by two cents almost
19 whereas butter went up?

20 A And also powder went down?

21 Q What?

22 A And powder went down?

23 Q Powder went from -- no. Powder went up by 2.5
24 cents between 1996 and 1998 from 12.4 to 14.7. Butter went
25 up from 13.2 in 1996 to 13.6 in 1998. But cheese supposedly

1 dropped from 14.2 to 12.4. I wonder if you have an
2 explanation for that phenomenon.

3 A I don't.

4 Q Do you --

5 A Just what they reported.

6 Q Do you have some reason to think that the amount
7 of electricity costs to run a cheese plant has moved in one
8 direction and the cost of electricity to run a butter and
9 powder plant have gone in the other direction?

10 A I don't have any basis to say one way or the
11 other.

12 Q And eyeballing the cost elements listed on Exhibit
13 9, can you identify any cost item that to your mind would
14 logically have moved in one direction for cheese and the
15 other direction for butter and powder?

16 A I didn't make that comparison myself, so --

17 Q I mean, presumably, laundry, fuels, those things
18 are not going to move one way for cheese and the opposite
19 direction for butter and powder, are they?

20 A I don't know.

21 Q Okay.

22 A It is whatever they report to me.

23 Q Okay. Was there a preliminary version of Exhibit
24 9 before this one that we are looking at?

25 A I sent out a report to co-ops before the final.

1 Q Was there an effort made to get more plants
2 involved after that?

3 A No. The plants, they all promised to send in
4 data. Just data came in late.

5 Q Did the cost come down for cheese?

6 A I don't think so.

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

8 JUDGE HUNT: Mr. Marshall.

9 BY MR. MARSHALL:

10 Q Good afternoon, Dr. Ling. It is interesting
11 cross-examination here in the last few minutes. And I want
12 to try to see if there is a way that the data that you can
13 present to us can help explain why we apparently see the
14 phenomenon of larger plants being more costly than smaller
15 plants. And so I would like to begin by asking you a couple
16 of hypotheticals and then I will ask you if there is some
17 way that we can get at that from your data. Okay?

18 Let me begin by suggesting that based on the
19 cross-examination that I conducted earlier, we talked about
20 the fact that depreciation would vary a great deal with both
21 depreciation schedules and with the age of the plant in
22 terms of whether it was built with 1999 dollars or 1980
23 dollars or older dollars. Do you recall that?

24 A Yes.

25 Q So if hypothetically your smaller plants were also

1 older plants and your larger plants were also newer plants
2 with higher depreciation costs, is it possible that that
3 might explain why your larger plants would seem on the basis
4 of a simple average and weighted average presented, why it
5 would -- would that be a possible explanation of why you
6 would see that phenomenon that Mr. Rosenbaum, described I
7 think accurately as counter-intuitive?

8 A I would have to go back to check the individual
9 plants.

10 Q Is there any data that you have got with you that
11 you could refer to and check to see if there is any
12 correlation apparent?

13 A I don't have --

14 Q Any data that you have here with you that you
15 could --

16 A I don't have individual plant data here.

17 Q Do you have any data with you that would suggest
18 the volume of the highest cost cheese plant in the survey,
19 the volume of the entire survey, the weighting? In other
20 words, I think your exhibit demonstrates the -- shows that
21 the certain volume covered by all of the plants, do you have
22 anything with you that you could refer to that suggests to
23 us what percentage of that volume is represented by the
24 single highest cost plant?

25 A I don't have it with me.

1 Q I am going to suggest to you that that might be
2 useful information. And as I understand it, there may be
3 some other things that you are going to be bringing into the
4 record at a later point. And I would ask if you can -- can
5 you disclose that number without violating any of the
6 confidentiality requirements, the percentage of the total
7 pounds in the survey represented by the largest plant?

8 A Well, I promised the plants -- the co-ops that we
9 don't disclose individual plant data. So --

10 Q But percentage of an unknown number wouldn't
11 necessarily --

12 A Percentage and no number you are asking for.

13 Q Would I be generating in that question the
14 number -- the pounds produced by the highest cost plant?
15 Would I?

16 A Yes.

17 Q Well, let me ask it a different way. Suppose for
18 the sake of in analyzing the confidentiality issues that you
19 were to perform what is called a linear regression of two
20 series of numbers for each plant in a survey, one being
21 depreciation costs and the other being volume produced.
22 Could you do that without violating any confidentiality
23 commitments?

24 A I was not going to get into any individual plant's
25 data.

1 Q Would running a linear correlation coefficient or
2 a graph that shows the linear regression of plant costs for
3 depreciation versus volume disclose any confidential
4 information?

5 A Well, if you are -- you said before that it is --
6 the milk plants will have higher depreciation. So if you
7 reveal the depreciation before, we can tell which plant that
8 is.

9 Q But a linear regression probably doesn't -- if you
10 think about it in terms of a graph, plotting the points,
11 linear -- the linear regression line doesn't hit any of
12 those points, does it, unless by coincidence?

13 A I just want to know why you just concentrate on
14 depreciation because there are so many cost items involved
15 in making the cheese.

16 Q Well, the hypothetical that I am trying to explore
17 -- and I believe it holds up relative to data that I have
18 seen in the past -- is that the high cost plant has the
19 highest depreciation because it is the newest plant and that
20 the low cost plant has the lowest depreciation because it is
21 the oldest plant, maybe even fully depreciated.

22 And there is also a correlation there between
23 plant data. In fact, of some out-of-date data that I have
24 seen, it indicates that a very substantial portion of your
25 entire cheese survey comes from one high cost plant and I

1 hypothesize one modern, large scale plant.

2 And the problem here, just so that we all know
3 where I am heading, is that if we adopt a methodology
4 without some -- without tempering it with wisdom in
5 interpreting your results, we could end up in a position
6 where we said make allowances based on obsolete costs and
7 make it impossible to afford to build a new plant in which
8 case our entire industry's future would be in jeopardy. Do
9 you see?

10 So that is what I am after. I am not telling you
11 to prove my hypothesis. But I am wondering if we could do
12 that without disclosing confidential information.

13 A I have to -- if you want me to do that and
14 disclose it, I have to go back to all the plants -- all the
15 co-ops and ask for their permission to do it.

16 Q What would you ask them to be able to disclose?
17 You are not disclosing their cost. You are just running a
18 correlation coefficient which by the time you correlated
19 over ten plants doesn't disclose any individual plants'
20 data, does it?

21 A Well, by law, we have to ask for their permission
22 to release data.

23 Q What did you ask for earlier? I thought John
24 Vetne asked a question earlier about what you had asked for
25 and they simply said they could release the data.

1 A I released some of it or aggregates.

2 MR. ROSENBAUM: Well, I fear I am prolonging the
3 hearing, Your Honor. And I don't wish to do that. Perhaps
4 before you come back, we can talk about whether that is
5 necessary to go back to the plants. Thank you, Dr. Ling.

6 JUDGE HUNT: Other questions of Dr. Ling? Mr.
7 Berde.

8 BY MR. BERDE:

9 Q Sydney Berde. Dr. Ling, directing your testimony
10 in response to Mr. Rosenbaum's questions about whether you
11 can draw any conclusions from the fact that the weighted
12 average cost came out higher or lower than the simple
13 average, wouldn't it depend upon the aggregate pounds of
14 milk contained in your survey in the smaller plants as
15 compared to the larger plants? Wouldn't you have to know
16 that? Wouldn't that make a difference in what conclusions
17 you can draw?

18 A Would you repeat the question again?

19 Q Yes. Let's assume that the aggregate pounds in
20 the small plants exceeded the pounds in the large plants.
21 Wouldn't that change the suggested counter-intuitive
22 conclusions that one might draw?

23 A That is correct.

24 Q Isn't that correct?

25 A That is correct.

1 Q Thank you.

2 A I think in my testimony, I did spare out several
3 points for caution in reading and reviewing this cost data.

4 MR. BERDE: Thank you.

5 JUDGE HUNT: Ms. Brenner.

6 FURTHER EXAMINATION BY USDA

7 BY MS. BRENNER:

8 Q Dr. Ling, we have one proposal that would replace
9 the current manufacturing allowance for cheese with your
10 survey cost reviewed annually. But if California plants are
11 not adequately represented in your survey, that the
12 published California costs be weighted with the RBCS cost,
13 are there -- there are California plants in your survey. Is
14 that correct?

15 A No cheese plant in my survey.

16 Q No cheese plant. There are butter powder plants.

17 A That's correct.

18 Q Okay. And would you describe them as representing
19 a proportional portion of the total butter and powder
20 production for the country or would it be somewhat less or
21 greater?

22 A You mean the California plants?

23 Q The California plants.

24 A I didn't make the comparison, so I don't know.

25 Q Okay. But there are no cheese plants in there.

1 A No cheese plants.

2 MS. BRENNER: Thank you.

3 THE WITNESS: You are welcome.

4 JUDGE HUNT: Mr. Beshore.

5 BY MR. BESHORE:

6 Q Just a question or two, Dr. Ling. During your
7 cross examination, you were asked a number of question by a
8 number of different persons about particular details of one
9 of the line items in your cost data, Exhibit 9. You were
10 asked about water and sewer costs, packaging costs, you
11 know, depreciation costs, other costs. I don't know whether
12 anybody got into laundry. Is there any dirty laundry in the
13 exhibit here?

14 A I guess they are all dirty, so they need laundry
15 costs.

16 Q I think that is right. I guess my question is I
17 think in response to one of the questions -- one or more
18 than one of the questions. I think you commented that when
19 you saw abnormally low figures relating to electricity,
20 fuels, water, sewer, that often you found that the -- those
21 costs were in another line item in the reports to you. Do
22 you recall that?

23 A Yes, possibly. Yes.

24 Q Okay.

25 A I think the most important number you should look

1 at is total cost.

2 Q You got there before I asked the question. Okay.
3 And that is what you found in performing this analysis with
4 these groups over the number of years that you have done it.

5 A That is correct.

6 MR. BESHORE: Okay. I think that is all I have.
7 Thank you, Dr. Ling.

8 JUDGE HUNT: Anyone else?

9 MR. CHRIST: Your Honor, I am Paul Christ from
10 Land O' Lakes. I would like to hand the Witness four sheets
11 of paper if I may.

12 BY MR. CHRIST:

13 Q Dr. Ling, do you recognize those pages?

14 A Yes, I do.

15 Q Are they the pages from the RCBS cost study that
16 was sent to Land O' Lakes?

17 A That's correct.

18 Q Okay. Earlier today, I asked you if you knew the
19 capacity utilization for the average of the plants in the
20 survey. Are those numbers indicated on those pages?

21 A That is correct.

22 Q Are you able to report those numbers without
23 disclosing confidential information?

24 A I can tell you the other plant capacity utilized
25 in 1998 for butter was 23.6 percent, powder plant was 47.9

1 percent and cheese plant was 88.8 percent.

2 MR. CHRIST: Thank you, Dr. Ling. I believe there
3 were other requests for data from that study. I give you my
4 approval to -- as long as you don't disclose confidential
5 information to use those pages for that. Thank you, Your
6 Honor.

7 JUDGE HUNT: Thank you. Any other questions? You
8 have something to add, Doctor?

9 THE WITNESS: Earlier, Mr. Vetne asked about a
10 range of costs. Okay. For cheese, the simple average for
11 the 12 plants that is reported is 12.442. And the range
12 between the high and low was 8.145 cents per pound of
13 cheese. For butter, the simple average was 13.603 cents per
14 pound of butter and the range was 19.06 cents per pound of
15 butter. And the simple average for powder was 14.723. And
16 the difference in the range was 11.021 cents per pound of
17 powder.

18 MR. BERDE: Your Honor, can we have the Witness
19 repeat the range for butter?

20 JUDGE HUNT: Could you do that, Doctor?

21 THE WITNESS: The range for the high and low was
22 19.046 cents.

23 MR. COOPER: Is that it, Doctor? Does that finish
24 it?

25 THE WITNESS: Yes.

1 JUDGE HUNT: Anything else of Dr. Ling?

2 MR. COOPER: One second, please.

3 JUDGE HUNT: All right, Mr. Beshore -- or, I'm
4 sorry, Mr. Berde.

5 BY MR. BERDE:

6 Q Dr. Ling, statistically, as a matter of
7 statistical practice or good statistical practice, if you
8 have a range of data where the extremes appear somehow to be
9 beyond the realm of possibility, is it statistical practice
10 to discard the extremes?

11 A That depends on the purpose of --

12 Q Well, for the purpose for which we are here today
13 and discussing your results.

14 A Well, the fact of the matter is some butter plants
15 have very low capacity for that particular year. So as a
16 result, it has got a high cost. Whether you want to include
17 that in the calculation or not, that is --

18 Q And that fact --

19 A -- that is not --

20 Q And that fact might explain the reason for what is
21 apparently an extreme variation or extreme amplitude between
22 high and low-cost plants. Is that correct?

23 A That is correct, yes.

24 Q Because some might have been operating at an
25 extremely low percentage of total capacity.

1 1992."

2 We do have somebody from the Economic Research
3 Service, Jim Johnson, here who can answer any questions
4 people might have about these documents. And I don't know
5 if people are familiar with these or have questions or could
6 formulate questions or where we are at. So I will leave it
7 up to people.

8 MR. YALE: Who did the economic study?

9 MR. COOPER: No, that's not them. That is someone
10 else coming up later in the notice of hearing, the
11 preliminary analysis.

12 MR. YALE: I just want to clarify for the record
13 whether or not he is strictly talking about cost of
14 production?

15 MR. COOPER: He is strictly talking about these
16 four documents that we are officially requesting official
17 notice of. And he can speak to any questions anyone has
18 about these documents.

19 JUDGE HUNT: Mr. Cooper has moved that we take
20 official notice of the documents he referred to. And he has
21 a witness who will testify about them if you have any
22 questions concerning those documents. Well, does anybody
23 have any objections to those documents that Mr. Cooper
24 referred to, that we take official notice -- I take official
25 notice of the documents? All right. Then I take official

1 notice of those aforesaid documents. Mr. Cooper?

2 MR. COOPER: Well, if we have no questions on that

3 --

4 JUDGE HUNT: No questions.

5 MR. COOPER: -- we'll move on to the next item.

6 And the next item is the preliminary analysis that is

7 included in the notice of hearing. We are going to have

8 somebody from Dairy Programs, Howard McDowell, who will take

9 the stand and explain exactly what was done there.

10 JUDGE HUNT: Is this a proposed exhibit or to take
11 notice of?

12 MR. COOPER: No, it is in the notice of hearing.

13 JUDGE HUNT: Oh, I see. The notice of hearing.
14 I'm sorry.

15 MR. COOPER: Exhibit 1, the preliminary analysis.
16 It was done based upon a model.

17 JUDGE HUNT: It is in the Register then.

18 MR. COOPER: Mr. McDowell was the one who
19 constructed the model.

20 JUDGE HUNT: Good afternoon.

21 MR. McDOWELL: How are you doing?

22 JUDGE HUNT: Just fine, thank you. Raise your
23 right hand, please.

24 Whereupon,

25 HOWARD McDOWELL, Ph.D.

1 having been first duly sworn, was called as a
2 witness herein, was examined and testified as follows:

3 JUDGE HUNT: Would you state and spell your name
4 and your title, please.

5 THE WITNESS: My name is Howard McDowell. That is
6 spelled M-C-D-O-W-E-L-L. I am a Senior Agricultural
7 Economist in the Office of the Chief Economist of Dairy
8 Programs and Ag. Marketing Service.

9 EXAMINATION BY THE USDA

10 BY MR. COOPER:

11 Q Mr. McDowell, could you tell us a little of your
12 educational background?

13 A I graduated from Virginia Tech and went on to
14 receive a Master's degree there, both in ag. economics, and
15 went to the University of Minnesota and received a Ph.D. in
16 agricultural economics.

17 Q Okay. And could you tell us about your employment
18 experience. I'm sorry. I should have called you doctor. I
19 didn't realize you had the Ph.D.

20 A That is fine. You can call me "Mr." It would be
21 just fine. I -- after finishing graduate school, I worked
22 at Virginia Tech for four years. I had a 50 percent
23 extension appointment there. And about half of my time was
24 spent working on dairy marketing issues.

25 After that, I came to ERS and worked on Class I

1 price surface research in the late '80s and early 1990s.
2 After that, I worked in several other areas in economic
3 research service including trade and also in the resources
4 and environment area.

5 Q Okay. Now, is it correct that you constructed the
6 model that was used in the preliminary analysis that is in
7 Exhibit 1?

8 A That is correct.

9 Q And --

10 A With the help of my assistant, Jason Nearman, a
11 junior economist working with me.

12 Q Was the model and the analysis done in support or
13 opposition to any particular proposal or for informational
14 purposes?

15 A Informational purposes only.

16 Q Why were we putting this out at the notice of
17 hearing?

18 A It is my understanding that the policy is that if
19 an action has potential major impacts, that we do a
20 preliminary impact analysis. And the scenarios chosen for
21 the preliminary analysis were to provide a range of possible
22 impacts for the quantifiable proposals. I might add that in
23 choosing that range, that is simply all we were doing.
24 There were some that were not quantifiable and some
25 proposals that might have fallen in between the ranges. And

1 we could only do so much in the time that we had. So --

2 Q Okay. So there are limitations both in terms of
3 the number of proposals you could look at and in terms of
4 how complete your analysis could be?

5 A That is correct.

6 Q And those were time constraints largely.

7 A That is correct.

8 MR. COOPER: Okay. I have no further questions.
9 I will leave it up to people to cross examine.

10 JUDGE HUNT: Mr. Yale.

11 EXAMINATION BY PARTICIPANTS

12 BY MR. YALE:

13 Q Dr. McDowell, is there anywhere published an
14 explanation of your model?

15 A No, sir. There is not. This is being developed
16 as we go. I came to Dairy Programs in mid October. And we
17 began work on an econometric model that would initially
18 service in the baseline committee work that we do. When
19 this hearing was announced and called, we began adapting
20 that model as best as we could to address this issue here.
21 And so it is not published at all.

22 Q Now, you said you started with a baseline. What
23 is the baseline? Has that been published?

24 A I said that we started with a model that we were
25 using --

1 Q Oh.

2 A -- to participate in the baseline committee
3 process. The baseline has been published.

4 Q It has.

5 A The one as of last -- back in the fall.

6 Q Yes. And your purpose I understand it is that the
7 testimony -- or the testimony -- the model that you are
8 developing was one that would handle the dairy aspect of the
9 baseline model, is that correct?

10 A That is correct.

11 Q All right. Now, in the -- I hate to ask this
12 open-ended question of an economist, but I am going to try
13 it. Could you broadly describe the model and its general
14 inputs and how it works?

15 A I would be happy to. This model, as I said, we
16 initiated this project to participate in a baseline project.
17 It is a national model. And we use the product breakout
18 that is reported by NASS and milk production disposition and
19 income. These products include milk for fluid use, milk
20 available for cheese, butter, whey, condensed can milk, dry
21 whole milk, soft dairy products that we include collectively
22 as Class II.

23 We estimate the supply of milk nationally based on
24 milk per cow and the number of cows as a function of the all
25 milk price, the feed price, the slaughter cattle price. Now

1 I want to go back up to those products again.

2 We estimate demands for those products on a per
3 capita basis and multiply by population to come up with
4 total quantity. We assign milk used in those products by
5 class according to how the Federal Order operates. So we
6 assign the milk in those products Class I if it is fluid,
7 Class II if it is soft products, Class III if it is cheese,
8 Class IV, butter and powder. We allocate milk into Class
9 III and IV on the basis of relative returns for milk used in
10 cheese versus butter and powder.

11 And so the way the model works is that milk used
12 in fluid or Class I, Class II and some of the minor dairy
13 products such as condensed canned milk and dry whole milk
14 are allocated first. And then based on that relative
15 returns equation, we determine how much milk goes into
16 cheese. And then the residual is Class IV. That is on a
17 national basis.

18 In order to adapt this quickly to the federal
19 order, we had to work on a proportional basis. Class -- the
20 question at hand here is Class III and IV pricing and the
21 basic class pricing system operates uniformly across all
22 orders now. So dealing with a national model, we could at
23 least address the manufactured dairy product markets and
24 their interaction through the Federal Order formula to deal
25 with Class III and IV pricing.

1 We do not yet have any impacts on an order basis.
2 And so what we did for the Federal Orders was to include
3 them as one big order. And so we have Federal Order milk in
4 this system as a share of the total. And we have Class I
5 milk that is Federal Order Class I milk as a share of all
6 fluid class milk and so on down the line, Class II and Class
7 III.

8 Class IV is a residual within the Federal Orders.
9 And so it is allocated the same way, Class I, II and III
10 proportional to the national. And then what is left in the
11 Federal Order system, the residual is Class IV. I might add
12 that we intend to disaggregate this model.

13 We have -- we are going to move to 11 orders and
14 also pick up to the extent that we can the major non-Federal
15 Order-regulated milk. California in particular is big. And
16 here are some areas in the east, as well. The model is also
17 on a fat-equivalent basis at this time. And we will be
18 moving to include skim solids, as well.

19 Q Okay. Thank you. Let me just take a few of those
20 and kind of go through this. The numbers -- you indicate
21 this is a national model. And then you said you had the
22 Federal -- the FMMO. Now, is the study that was done as
23 part of the notice of the proposed rule just on the FMMO,
24 the Federal Milk Marketing Order, milk or was it on all milk
25 in the nation?

1 A It includes all milk in the nation. And the
2 reason why we did that, the Class III and IV prices are
3 being driven by national average cheese, nonfat dry milk,
4 butter and whey prices. Milk other than the Federal Order
5 System is involved in these markets, so we needed to include
6 them under any conditions. Even when we go to 11 orders, we
7 will still have to have a national model to be able to
8 address the hard manufacture product markets.

9 Q The -- when you say, for example -- I don't know,
10 I'll just pull a number out. But if you say that it raised
11 the price of milk to producers by seven cents a hundred
12 weight or some number, what price gets raised seven cents or
13 six -- I mean, the number is unimportant. I just want to
14 know if -- what it means. What producers are impacted by
15 that? Let's start with that.

16 A This would be the uniform blend price as reported
17 by the Federal Order System.

18 Q So that would only be seven cents in the Federal
19 Order System that would increase by seven cents under this.

20 A That is correct.

21 Q Okay. Now, in your model, does -- how does it
22 handle payments to producers to participate in the Federal
23 Order, but receive income from sources other than pooled
24 plants or the Producer Settlement Fund? First of all, do
25 you understand my question?

1 A No. I wish you would clarify it a little more.

2 Q I didn't understand it myself. That is why I
3 thought I would ask it again. If -- you recognize, do you
4 not, that not all producers receive income from the Federal
5 Milk Marketing Orders, is that right?

6 A There are milk producers that are selling milk to
7 plants that are not regulated by the Federal Order System.

8 Q And there are producers who sell milk to plants
9 who are regulated in the same month in which they sold to
10 plants that are not regulated. Are you aware of that?

11 A I presume that could be the case.

12 Q All right. Now, my question is when you say that
13 a number goes up, again, I just use the number seven cents.
14 It is a lucky number. If it were to go up for producers or
15 had an impact on producer income, does that have an impact
16 also on the producer income from the non-federal milk
17 marketing resources?

18 A We estimate nationally an all milk price that we
19 are trying to estimate as closely as we can the NASS-
20 reported all milk price which included Federal Orders or
21 milk sold through Federal Orders and includes milk sold
22 through other state-regulated marketing systems. It also
23 includes Grade B manufacturing milk.

24 So nationally, we are working on the all milk
25 price. In the Federal Order System, we have a blend price

1 which is as I described it before. We are trying to
2 estimate it as closely as we can, the 3.5 butterfat uniform
3 blend price averaged over all orders. And so we keep that
4 separate.

5 Q Okay. So this report though, just so I can be a
6 little more clear, let me just identify one of those
7 comments that were made. On page -- well, I had it as page
8 9 I think pulling it down off of the internet. But it talks
9 about the effect of changing the make allowance for butter
10 and butterfat.

11 And under producers, it makes a comment in here
12 that -- it says, "The average all milk price for producers
13 in the Federal Orders declines by only 0.001 cents." And
14 what I wanted to make sure I understand is when you are
15 talking about the all milk price, you are talking about that
16 all milk price for the nation but only as it applies to the
17 producers in the FMMO?

18 A The all milk price for Federal Orders is something
19 else again. That is -- that accounts for the producer milk
20 in Federal Orders that has been manufactured by co-ops,
21 Class III and Class IV milk in particular.

22 So the Federal Order all milk price is trying to
23 account for the fact that cooperatively manufactured milk,
24 producers that are in co-ops receive a milk check that
25 reflects a change in the value of the milk that is

1 manufactured by the co-ops that is in addition to any price,
2 in addition to the blend price itself.

3 That is, if the -- if there are -- if the cheese
4 price goes up and the value of the milk in cheese is higher
5 than the Class III price because of that, then those
6 producers would receive the additional value of that.

7 By the same token, if the cheese price is less,
8 then the -- and would generate a Class III price less than
9 the Class III price -- or value of Class III less than the
10 Class III price, they also take that loss. That would be
11 the all milk price.

12 And so my notes here, let's see, co-ops
13 manufacture about 40 percent of the cheese and about 70
14 percent of the Class IV milk. So we tried to account for
15 that change in value for Class III and Class IV.

16 Q So this number then would reflect if the plant --
17 the cooperative plant makes a "profit" for manufacturing
18 over the Federal Order price, your model will reflect the
19 fact that those co-op members got that additional income.

20 A That is correct. Or loss.

21 Q Or loss as the case may be.

22 A That -- I might add, that would also include the
23 Class I over-order payment is built into that Federal Order
24 all milk price.

25 Q Well, let's talk about these over-order payments a

1 second such as on the Class I. When you -- if there is an
2 increase in the price under your all milk price, that means
3 that -- let me back up. Let's take a situation where there
4 is a dollar over-order premium in a market. All right.

5 And you've got your model all set. And you inject
6 another seven cents that goes into the all milk price
7 because of some changes in the Federal Order Program. Are
8 you with me? Okay. Are you assuming that that dollar
9 remains as the over-order premium or that the dollar would
10 absorb the seven cents in those markets that had the over-
11 order premium?

12 A Are you asking me if the over-order payment would
13 change as a result of something else going on in the market?
14 I am not quite following your question.

15 Q Yes. Well, I am asking in your model, you are
16 assuming there are some over-order payments?

17 A That is correct.

18 Q All right. Do those change in response to the
19 changes from the Federal Order Program?

20 A In this particular model, we held them constant at
21 about 80 cents per hundred-weight.

22 MR. YALE: Okay. Thank you. That was -- I didn't
23 ask the question as clear. I got the answer very clearly.
24 Thank you. I have all the questions answered that I have at
25 this point. Thank you.

1 JUDGE HUNT: Any other questions for Mr. -- oh,
2 I'm sorry. Go ahead, Mr. Christ.

3 BY MR. CHRIST:

4 Q Paul Christ from Land O' Lakes. Dr. McDonald, did
5 I understand that your model treated Class IV milk as a
6 residual?

7 A Correct.

8 Q Okay. That means that the supply of butterfat and
9 skim milk for Class IV would be the amount left over after
10 Class I, Class II and Class III uses were fulfilled.

11 A That's correct.

12 Q So from that, the -- you would not expect a supply
13 response for Class IV milk as a result of Class IV price.

14 A No, I don't think that is correct.

15 Q Would you explain how that is not correct in light
16 of it being a residual?

17 A Well, if -- when I first used the word,
18 "residual", it was in the sense that the system of equations
19 is a simultaneous set of equations that get solved. And the
20 milk in Class I, II and the minor hard manufacturer products
21 are solid outside of the equation where Class III and Class
22 IV is allocated cheese versus butter and powder.

23 Q Okay.

24 A And so probably in the bigger system, residual is
25 not exactly right because it is all together. But it is

1 Class III and IV being solved. And Class III is explicitly
2 solved before leaving Class IV.

3 In the Federal Order System, however, it is a
4 residual because, as I said before, in the time that we have
5 had to work with this, we have got the Class I, II and III
6 in Federal Orders tied proportionally to the national milk
7 that is in Class I, II and III. And so that leaves the
8 Federal Order as a residual.

9 Q Do you have a supply equation for Class IV?

10 A No, I don't.

11 Q Do you have a demand equation for Class IV?

12 A I have a demand equation for butter and powder.

13 MR. CHRIST: In Class IV. I will leave it at
14 that. Thank you very much.

15 JUDGE HUNT: Mr. Rosenbaum, I think you had a
16 question.

17 BY MR. ROSENBAUM:

18 Q Dr. McDowell, I want to ask some questions
19 directed toward how your model treats a change in the make
20 allowance as it affects a co-op cheese plant versus a
21 proprietary cheese plant. So you know what subject I am
22 asking about. Now, for a co-op cheese plant, if you assume
23 that the make allowance is reduced, that increases the
24 minimum milk price, correct?

25 A I want to just state very clearly, we don't

1 separate co-op from non-co-op milk. And with the make
2 allowances that we have used and the pricing formulas, we
3 simply use the formulas as they exist at this point. And,
4 for example, with regard to butter, we were just talking
5 about butter. We had a make allowance of 11.4 cents. And
6 we changed the formula to be 13.3 cents. And that applied
7 to all. So there was no differentiation.

8 Q Okay. And what I am trying to understand is what
9 the implications are in your model for such a change. And I
10 would like to use the cheese one where the cheese make
11 allowance goes from its current 17.02 down to 14.2 cents.
12 That is one of the --

13 A Okay.

14 Q -- things that you model. Correct? I am right
15 about that is one of the specific things that you modeled?

16 A Right.

17 Q All right. Now, and one of the things you are
18 trying to do is figure out to what extent that is going to
19 change usage of various products and receipts and prices,
20 correct?

21 A Correct.

22 Q All right. Now, the -- take a cooperative-owned
23 cheese plant which sees a reduction in the make allowance
24 from 17.02 cents down to 14.2 cents. Does your model assume
25 that the impact of such a change on the cooperative-owned

1 cheese plant is, in fact, zero because any change in the
2 make allowance has an equal and corresponding profitability
3 of that plant?

4 A We didn't address the plant itself. But we tried
5 to account for the fact that in the case of cooperative
6 milk, co-ops still sell on the open market. And so they get
7 the value of cheese in this case. And the value -- the
8 change in the value of cheese is reflected, as I just
9 discussed a few minutes ago, in the Federal Order all milk
10 price where we try to account for the fact that co-ops are
11 manufacturing about 40 percent of the cheese.

12 And so in the case of declines in the amount of
13 milk manufactured in cheese and you would get a price
14 increase in cheese, then that increase is reflected in that
15 all milk price. If there is a decline, then it is getting
16 reflected in there, as well. But we didn't address in any
17 way whether the plant is profitable or not.

18 Q Well, did you address in any way whether a change
19 in make allowance has a disparate impact on a proprietary
20 plant versus a cooperative plant in the sense that the
21 cooperative-owned plant can make its money either through
22 the profitability of the plant or through what its members
23 are paid for its milk where as the proprietary plant only
24 makes money from what it sells its product for?

25 A We -- in the table that was published, we -- the

1 extent to which that was addressed is in the table that we
2 published. The blend price is there. The Federal Order all
3 milk price which accounts for co-op manufactured cheese,
4 butter and powder is there. And the changes in the cheese,
5 butter, nonfat dry milk and whey prices are there. Beyond
6 that we didn't address it.

7 Q Okay. Did you address whether after any of these
8 changes the economics would be such that more of the product
9 would be produced by cooperatives --

10 A No, sir.

11 Q -- than before?

12 A No, sir. This is preliminary analysis. We did
13 not do that.

14 Q Okay. Did you address the question whether as a
15 result of these changes more of the production would shift
16 to non-Federal Order areas?

17 A We did not address that.

18 Q All right. You would agree with me that changes
19 in make allowances can have an impact on whether Federal
20 Order plants have become more or less competitive as opposed
21 to non-Federal Order plants?

22 A I believe it could have an effect.

23 Q I mean, to take the simplest of examples, if you
24 were to increase the price that proprietary handlers in the
25 Federal Order system have to pay for the milk by ten percent

1 but there has been no change in the price that, let's say,
2 California plants have to pay, then obviously the
3 competitive relationship will have changed, correct?

4 A It would appear so.

5 Q And the natural tendency would be for production
6 to shift toward California and away from the Federal Order
7 System in that scenario, correct?

8 A That is a possibility.

9 Q Okay. But that isn't something that your --

10 A We did not address that.

11 Q You didn't try to capture that issue, correct?

12 A We hadn't -- that's correct. We didn't have time
13 to do that.

14 Q Okay. And I am reading the table right to see
15 that change in the make allowance on cheese from 17.02 cents
16 down to 14.2 cents would increase the Class III price by
17 21.1 cents, correct?

18 A That is correct.

19 Q All right. So that a federally regulated plant
20 having to pay the Class III price would see its cost
21 increase by 21.1 cents per hundred-weight if this were
22 adopted, correct?

23 A That is correct.

24 Q And that is after you work your way through the
25 system, through your model, correct?

1 A That is correct.

2 Q And so if that -- well, you know a lot of cheese
3 is made in California, for example, correct?

4 A That is correct.

5 Q And so a federally regulated plant would the day
6 after this proposal were adopted see its Class III prices
7 increased by 21.1 cent per hundred-weight. And presumably,
8 its California competitors would see no price increase
9 whatsoever, correct?

10 A I do not know what California would do.

11 Q Okay. But in the absence of their taking some
12 affirmative steps to change their own class price system,
13 that would be the impact, correct?

14 A I presume that is correct.

15 Q All right. And from the perspective of your
16 model, it is a matter of indifference. And I don't mean
17 that in a pejorative way. But it is a matter of
18 indifference whether the cheese ends up now being produced
19 in California versus the Federal Order System.

20 A That is correct. The only caution I give you is
21 that I mentioned a while ago that in the time that we had to
22 operate here, that the Federal Order share of the total
23 cheese market was held constant.

24 Q Okay. And that is further -- all right. Fine.

25 A This area is very complicated. And we didn't --

1 we just simply didn't have a chance to get any further than
2 we did.

3 Q All right. But certainly you would assume that
4 absent some change in the California regulative price, a
5 21.1 cent increase in the Class III price for the Federal
6 Order System would, in fact, have some impact on the
7 relative share to production.

8 A I think it would have some impact.

9 Q All right. And if one were to assume that the
10 21.1 cent increase impacted proprietary handlers but had no
11 impact on co-op-owned cheese plants, you would expect also
12 to see some shift from proprietaries to co-ops, as well. Is
13 that accurate?

14 A I don't want to address that. I am not sure about
15 that.

16 Q Okay. Well, all I am trying to say is if the
17 price goes up for one fellow by 21.1 cents and the other
18 fellow faces no price increase, it is reasonable to assume
19 the latter is going to take some market share as a result.

20 JUDGE HUNT: Is that a comment or a question?

21 MR. ROSENBAUM: Question mark.

22 JUDGE HUNT: Question, okay.

23 THE WITNESS: That is beyond -- I think I have
24 indicated that that is beyond what we have looked at in this
25 preliminary analysis.

1 BY MR. ROSENBAUM:

2 Q It was your model assumption that total cash
3 receipts for co-op marketings processed by cooperatives
4 would be changed only by changes in the wholesale product
5 prices, is that correct?

6 I am reading from the notice. I am not -- it says
7 here, "A higher minimum Federal Order price could result in
8 cooperatives paying higher monthly prices for milk, but
9 would result in lower returns on investments paid at the end
10 of the year. Total cash receipts for member milk marketings
11 processed by the cooperative would be changed only by
12 changes in wholesale product prices." Is that an assumption
13 that is built into your model?

14 A That is correct. That is that Federal Order all-
15 milk price.

16 Q Okay.

17 A Right. That is where that plays out.

18 Q Okay. Thank you.

19 A With the 40 percent on cheese in particular.

20 Q Thank you.

21 JUDGE HUNT: Any more questions for Mr. McDowell?

22 All right. Thank you very much, sir.

23 MR. COOPER: We have a number of other documents
24 we would like to be officially noticed that we don't have
25 any witnesses for. And after that, we are done. First is

1 an ERS document called "Weights, Measures and Conversion
2 Factors for Agricultural Commodities and Their Products."
3 It is ERS-1992. It is -- there is a -- it is one
4 publication and has a number of tables relevant to dairy in
5 it.

6 The second document is "Livestock, Dairy and
7 Poultry Situation and Outlook." It is released month on the
8 internet. Copies are printed from the internet for the
9 April 27, 2000 issue. It contains data by month for 1998
10 and '99.

11 And the third is -- are three documents put out by
12 the state of California. One is called "Manual of Auditing
13 and Cost Procedures for Dairy Manufacturing Plants Revised
14 February 1990." As I understand it, that is the latest
15 revision.

16 The second one is called "Announcement of
17 Manufacturing Costs for Nonfat Powder, Bulk Butter and
18 Cheddar Cheese; Selected Periods January 1997 through April
19 1999." That document was released on February 8th, 2000 by
20 the state. And the third one is called "Manufacturing Cost
21 Annual 2000." Those are the other documents that we propose
22 official notice be taken of.

23 JUDGE HUNT: Is there a -- Mr. Vetne?

24 MR. VETNE: I don't have an objection, Your Honor.
25 But I do have a request of the government and others

1 including myself that may request official notice. We are
2 going to get a record that has requests for official notice
3 from page 1 to page 800, you know. And sometimes they are
4 read very quickly and, you know, hard to follow.

5 If there is a written document, a printed document
6 which contains the documents for which official notice is
7 requested -- and I see that Mr. Cooper is reading from the
8 document now -- I would very much like it and request those
9 that have documents to be officially noticed to make copies
10 of whatever identifies those documents available. That's
11 all. Thank you.

12 JUDGE HUNT: I asked Mr. Cooper if he had copies
13 of those documents of which official notice is being asked.

14 MR. VETNE: Something identifying the documents,
15 not the whole document.

16 JUDGE HUNT: Oh, I'm sorry. Just to identify the
17 documents. I see. Okay. I stand corrected. Can you
18 prepare a list of those documents that you ask -- which we
19 took official notice, just list them where they are
20 available and make them available for the people here.

21 MR. COOPER: A list of the documents that we took
22 official notice of?

23 JUDGE HUNT: Yes, and where they can be --

24 MR. COOPER: Oh, okay.

25 JUDGE HUNT: -- Federal Register -- wherever they

1 are obtainable.

2 MR. COOPER: Okay. I'll have that for us.

3 JUDGE HUNT: And that would go for anyone else who
4 is asking official notice be taken of some particular
5 document. If you would have the reference to where it can
6 be obtained so somebody wanting to find that document would
7 know where to look for it.

8 MR. COOPER: I have the title of it.

9 JUDGE HUNT: Pardon me?

10 MR. COOPER: I have the title of it and who puts
11 it out. But I don't --

12 JUDGE HUNT: Well, whatever you -- how -- the best
13 you can identify it, the best you can. And so I will just
14 be in touch with you for more clarification. Mr. Beshore.

15 MR. BESHORE: I just had a question of Mr. Cooper.
16 The -- with respect to the documents from the state of
17 California. The government has offered or made available
18 witnesses with respect to the Federal Government documents
19 which have been officially noted in the event there might be
20 any questions about them. And I wondered if there was a
21 witness from the state of California who was going to be
22 made available --

23 MR. COOPER: Now, as I indicated --

24 MR. BESHORE: -- with respect to those -- with
25 respect to those documents for which official notice has

1 been requested.

2 MR. COOPER: Now, as I indicated, nobody from the
3 state of California is available. I might add, they were
4 asked if they had somebody that would be available. And
5 nobody was available. So the option was either to use them
6 without a witness or not to use them.

7 JUDGE HUNT: Well, there is no objections then to
8 the documents Mr. Cooper referred to which he asked to have
9 official notice taken. If there is no objection, then
10 official notice is taken of those documents. And that is
11 it, Mr. Cooper?

12 MR. COOPER: We have nothing further then, Your
13 Honor.

14 JUDGE HUNT: All right. We are going to have to
15 take a break. So we will start with proposals. But before
16 we take the break, I understand that some of the proposals
17 are not grouped together, but they relate to similar
18 subjects. And I understand that proposal 1 and 2 are
19 related -- not related?

20 MS. BRENNER: No. Proposal 1 is sort of on its
21 own.

22 JUDGE HUNT: All right.

23 MS. BRENNER: Proposal 1 kind of stands on its
24 own. And proposal number 2 relates to a lot of other
25 proposals dealing with make allowances.

1 JUDGE HUNT: I see. Okay. Okay. Well, then we
2 will start with proposal 1. And after the break, off the
3 record, we will decide in what order we are going to take
4 the witnesses.

5 MR. YALE: Your Honor, could I be heard?

6 JUDGE HUNT: Yes, yes.

7 MR. YALE: Ben Yale. We are one of the proponents
8 of number 1. First of all, we are also proponents of
9 several other proposals in there. And we want to be able to
10 present testimony of all of them, that they are related. It
11 is much easier just to lay it out in one piece rather than
12 saying we are going to talk about butter make here and
13 cheese yield here and nonfat dry milk prices over there.
14 And we have got a comprehensive thing that goes all the way
15 through it.

16 So, first of all, we would like to be able to put
17 that all together as one piece. And that is how we have got
18 it prepared. And then there are several reasons for this
19 not the least of which is that they are all related. But
20 also, we want to have a situation where it is basically one
21 witness, one trip to the stand rather than having my witness
22 show up four or five times dealing with each of these
23 different components. So that would be our request in the
24 first case.

25 The second thing is that we would prefer to begin

1 first thing tomorrow morning because we have a technical
2 part of our presentation that we are not going to be able to
3 do until first thing tomorrow morning. And so that would --
4 and I understand there are a number of people here today
5 that wanted to testify and get their testimony out so they
6 could leave. And maybe we can allow them to work in the
7 place.

8 JUDGE HUNT: Well, let's take a break right now.
9 We will come back to that, about testifying after the break
10 then.

11 (Whereupon, a brief recess was taken.)

12 MR. ROSENBAUM: Your Honor, as Mr. Coughlin --

13 JUDGE HUNT: Yes, Mr. Rosenbaum.

14 MR. ROSENBAUM: -- is taking the stand -- this is
15 Steve Rosenbaum.

16 JUDGE HUNT: Yes, sir.

17 MR. ROSENBAUM: One of the proposals by the
18 International Dairy Foods Association is proposal 12. The
19 description of that proposal in the notice was accurate, but
20 the order language had an error in it. And I have a letter
21 that we sent in correcting that to USDA. I have extra
22 copies here for anyone who would like to see that. I just
23 wanted to raise that now because I didn't want anyone to
24 testify without knowing about that change. So anyone who
25 wants a copy, I am going to come around the room and hand

1 them out.

2 JUDGE HUNT: Now, are you going to refer to that, Mr.
3 Coughlin?

4 MR. COUGHLIN: No, not specifically. But I will
5 take a copy.

6 JUDGE HUNT: Is the letter self-explanatory?

7 MR. ROSENBAUM: It is, Your Honor.

8 JUDGE HUNT: All right. We are on the record?

9 THE COURT REPORTER: Yes.

10 Whereupon,

11 EDWARD T. COUGHLIN

12 having been first duly sworn, was called as a
13 witness herein, was examined and testified as follows:

14 JUDGE HUNT: Please state and spell your name, Mr.
15 Coughlin, and who you represent. Sure. Go ahead. Take
16 your time.

17 THE WITNESS: I am Edward T. Coughlin, that is
18 C-O-U-G-H-L-I-N, Senior Policy Advisor for the National Milk
19 Producers Federation. My responsibilities with National
20 Milk Producers Federation include all activities pertaining
21 to Federal Milk Marketing Orders.

22 Prior to joining the NMPF staff in July 1998, I
23 spent almost 30 years as a U.S. Department of Agriculture
24 employee, working with the Federal Milk Order Program.
25 During my last six years at USDA, which was June 1982

1 through June 1988, I was the Director of the Dairy Division
2 of the Agricultural Marketing Service.

3 This statement is made on behalf of the dairy
4 cooperative members of NMPF and the dairy producer owners.
5 NMPF is the national farm commodity organizations that
6 represent dairy producers in the dairy cooperative marketing
7 associations they own and operate. The Federation's members
8 produce a substantial majority of the United States milk
9 supply and market milk in all Federal Milk Order areas.

10 The Federal provides the vehicle through which
11 dairy farmers and their cooperatives formulate policy on
12 national issues that affect milk production and marketing.
13 This national hearing was convened to consider the current
14 formulas for establishing the Class III and Class IV milk
15 prices in all Federal Milk Marketing Orders.

16 NMPF is proposing the following three changes in
17 the current Class III and Class IV milk pricing formulas:
18 1) update the current milk manufacturing allowances --
19 manufacturing cost allowances, excuse me, for cheese, butter
20 and nonfat dry milk by replacing the outdated manufacturing
21 cost data from the USDA Rural Business Cooperative Service
22 (RBCS) and state of California dairy product manufacturing
23 cost surveys with the most recent manufacturing cost data
24 from those two surveys.

25 2) Absent current whey manufacturing cost data in

1 the RBCS and California surveys, determine the whey
2 manufacturing cost allowance by using the nonfat dry milk
3 manufacturing cost allowance plus approximately one cent per
4 pound to reflect the additional energy and higher equipment
5 costs incurred in drying whey.

6 And 3) establish the Class IV butterfat price by
7 deducting approximately six cents per pound from the
8 butterfat price.

9 Your Honor, I have prepared four tables that I
10 would like to be marked as exhibits for identification
11 purposes. And these are attached to the copies of the
12 testimony that I have there, at the back of the testimony
13 for those of you have picked up a copy of the testimony
14 which is at the -- I put copies on the back table.

15 The first table is entitled "Dairy Product
16 Manufacturing Cost Surveys." This table shows manufacturing
17 cost information from surveys conducted --

18 JUDGE HUNT: Just a second, Mr. Coughlin. I will
19 mark that as Proposed Exhibit 10.

20 (The document referred to was
21 marked for identification as
22 Proposed Exhibit No. 10.)

23 UNIDENTIFIED MALE SPEAKER: Mark the entire set as
24 this?

25 JUDGE HUNT: Well, no. Just this one -- well, I'm

1 sorry. You are just referring to the one table?

2 THE WITNESS: I will refer to the one -- I will go
3 -- I will ask that they each be marked separately as
4 exhibits. They contain different type of information. This
5 Proposed Exhibit 10, the table shows manufacturing cost
6 information from surveys conducted by RBCS in California.
7 The manufacturing cost allowances that USDA adopted in
8 Federal Milk Orders on January 1, 2000 were developed by
9 averaging the RBCS in California manufacturing cost survey
10 information.

11 Using the same methodology that USDA used to
12 calculate the current manufacturing cost allowances, I
13 calculated what the manufacturing cost allowances for
14 cheese, butter and nonfat dry milk would be based on the
15 data in the most recent RBCS and California surveys.

16 The second table, do you want to --

17 JUDGE HUNT: All right. That would be -- mark
18 that as 11.

19 (The document referred to was
20 marked for identification as
21 Proposed Exhibit No. 11.)

22 THE WITNESS: The second table is entitled "Class
23 III and IV Price Formulas, Comparison Between Current and
24 NMPF Proposal." This table compares the Class III and Class
25 IV prices in March 2000 under current order provisions with

1 what the Class III and Class IV prices would have been using
2 the modifications that NMPF is proposing. Moving to the
3 third one --

4 JUDGE HUNT: This next one he is referring to will
5 be marked as Proposed Exhibit 12.

6 (The document referred to was
7 marked for identification as
8 Proposed Exhibit No. 12.)

9 THE WITNESS: Proposed Exhibit 12, the third table
10 is entitled "Comparison of Federal Order Reformed Class IV
11 and California Class IVA Butterfat Values." This table
12 compares the price per pound of butterfat in each month in
13 1999 using the Federal Order reform provisions that became
14 effective January 1, 2000 and the actual price per pound of
15 Class IVA butterfat in California. And the next one.

16 JUDGE HUNT: The next exhibit he is referring to
17 will be marked as Proposed Exhibit 13.

18 (The document referred to was
19 marked for identification as
20 Proposed Exhibit No. 13.)

21 THE WITNESS: Proposed Exhibit 13, the fourth
22 table contains four pages. It is entitled "Position on
23 Federal Order Class III and Class IV Price Hearing
24 Proposal." This table lists all of the proposals included
25 in the hearing notice, the proponent of each proposal, a

1 brief description of each proposal and the NMPF position on
2 each proposal. As opposed to trying to testify on each
3 proposal, I thought that to put it in in the form of a table
4 and showing exactly the NMPF position was the easiest way to
5 go about it.

6 The NMPF proposals: 1) Use the most recent RBCS
7 and California cost survey data to update the manufacturing
8 cost allowances for butter, cheese and nonfat dry milk.
9 Critical to any product price formula is establishing
10 appropriate manufacturing cost allowances. Manufacturing
11 cost allowances should reflect costs incurred by plants of
12 average efficiency in manufacturing milk into cheese, whey,
13 butter and nonfat dry milk.

14 The current Federal Order manufacturing cost
15 allowances are a weighted average of the California dairy
16 plant manufacturing cost data for September '94 to December
17 '96 compiled by that state and cost data for 1996 from a
18 USDA Rural Business Cooperative Service survey encompassing
19 ten dairy manufacturing plants operated by cooperatives.

20 NMPF urges USDA to continue to use the same
21 methodology employed in determining the current
22 manufacturing allowances and to continue to use the weighted
23 average of the California and the RBCS manufacturing cost
24 surveys. Since both California and RBCS issued new
25 manufacturing cost surveys this year, the current

1 manufacturing cost allowances are based on outdated cost
2 data.

3 The manufacturing cost allowance calculations
4 should be updated to incorporate the most current cost
5 survey data. California and RBCS dairy product
6 manufacturing cost data from the most recent surveys and the
7 survey data used to establish the current manufacturing cost
8 allowances, as I said, were shown in Proposed Exhibit Number
9 10.

10 In calculating the current manufacturing cost
11 allowance, USDA added an amount of 0.0015 per pound
12 marketing costs to both the California and the RBCS survey.
13 NMPF supports continuing to add a 0.0015 cents per pound
14 marketing cost -- excuse me. I said cents. I should add
15 a -- use the dollar sign, \$0.0015 per pound marketing cost
16 to both surveys -- to both the California and RBCS survey
17 results. NMPF member cooperatives will provide testimony on
18 their actual marketing costs.

19 The California marketing cost data includes a
20 return on investment, but the Rural Business Cooperative
21 Service survey does not. In calculating the current
22 manufacturing cost allowance, USDA has added an amount equal
23 to the California return on investment to the RBCS survey
24 results. And NMPF supports continuing to add an amount
25 equal to the California return on investment to the RBCS

1 survey results.

2 The RBCS manufacturing cost data for butter
3 includes costs for print butter. In calculating the
4 manufacturing cost allowances, USDA -- that's -- those that
5 are in the order now -- USDA reduced the packaging cost in
6 the RBCS survey to an amount equal to the bulk butter
7 packaging costs included in the California survey. NMPF
8 supports continuing to reduce the packaging costs in the
9 RBCS survey to an amount equal to the bulk butter packaging
10 costs included in the California survey.

11 The weighted average manufacturing cost allowance
12 is calculated using the same methodology that USDA used to
13 establish the current manufacturing cost allowances with the
14 most recent RBCS in California. Cost survey data used in
15 place of the outdated cost information prior surveys are
16 shown in what I believe we labeled as Exhibit 11.

17 Manufacturing cost allowances per pound that NMPF
18 is proposing compared to the current manufacturing cost
19 allowances are the product cheese. The proposed \$0.1536.
20 The current is \$0.1702. The difference is \$-0.0166.
21 Butter, the proposed is \$0.096. The current is \$0.114. The
22 difference is \$-0.018. On nonfat dry milk, the proposed is
23 \$0.140. The current is \$0.137. The difference is \$0.003.
24 On whey, the proposed is \$0.150. The current is \$0.137.
25 The difference is \$0.013.

1 For product prices, commodity prices used in
2 product price formulas to determine milk prices must reflect
3 national supply-demand conditions in dairy markets. The
4 National Agricultural Statistic Service, NASS, weekly dairy
5 product price reports are the most comprehensive source for
6 commodity price information. Therefore, NMPF supports
7 continuing to use NASS dairy product price data in Federal
8 Milk Order price formulas.

9 However, we are concerned that reporting product
10 prices to NASS is not mandatory nor are the prices reported
11 subject to verification. We recognize that mandatory price
12 reporting is not an issue that can be accomplished through
13 this hearing. NMPF plans to pursue statutory authority for
14 mandatory dairy product price reporting and periodic
15 verification of reported prices with appropriate penalties
16 for anyone who does not comply.

17 To determine component values, NMPF supports
18 continuing to use the following: For the component
19 butterfat, the NASS survey data is AA butter price. For the
20 component nonfat solids, the NASS survey is nonfat dry milk
21 price. For protein, it is the volume weighted average of
22 the block cheese price and the barrel cheese price adjusted
23 to 39 percent moisture plus \$0.03. For other solids, we
24 support using the NASS dry whey price.

25 The butterfat factor in the cheese formula. NMPF

1 submitted a proposal to change the factor for butterfat
2 recovery in the cheese formula from 1.582 to 1.6. USDA
3 included that proposal in the hearing notice. NMPF member
4 cooperatives will present their own testimony on this issue.
5 USDA should determine the appropriate factor based upon the
6 evidence in the hearing record.

7 Proposal number 2, establish the whey
8 manufacturing cost allowance at approximately one cent per
9 pound above the nonfat dry milk manufacturing cost
10 allowance. The RBCS and the California survey did not
11 contain whey manufacturing cost data. NMPF is proposing 15
12 cents per pound as the whey manufacturing cost allowance.

13 Absent cost survey information for whey, NMPF
14 estimates that the whey manufacturing costs exceed nonfat
15 dry milk processing costs by approximately \$0.01 per pound.
16 Adding the one cent per pound to the 14 cent per pound
17 nonfat dry milk manufacturing allowance results in an
18 estimated whey processing cost of 15 cents per pound.

19 We used the nonfat dry milk manufacturing
20 allowance since drying whey and drying nonfat dry milk
21 involves similar processes in equipment. However, drying
22 whey is more costly than drying nonfat dry milk due to
23 higher equipment costs and additional energy needed to
24 remove more moisture. NMPF member cooperatives will provide
25 testimony on the higher whey processing costs to support

1 adding one cent per pound to the nonfat dry milk
2 manufacturing cost allowance.

3 3) Establish a Class IV butterfat price at
4 approximately six cents per pound less than the butterfat
5 price. NMPF proposes to add a new paragraph L following
6 section 1000.50K as follows: "L) The Class IV butterfat
7 price. The Class IV butterfat price per pound shall be the
8 butterfat price minus \$0.06." And we redesignate sections
9 1050 L through Q as M through R.

10 On January 1, 2000, the Class IV butterfat price
11 was increased approximately six cents per pound compared to
12 the Class III butterfat price under the orders in effect
13 prior to that time. Federal Order handlers are not able to
14 recoup the higher butterfat prices through higher market
15 prices for butter or cream due to competitive market
16 conditions created because the California plants pay less
17 for butterfat as shown in proposed Exhibit 12.

18 The butterfat price used to calculate the
19 butterfat value under the California order is the Chicago
20 Mercantile Exchange trading level for AA butter minus a
21 transportation allowance of \$0.045. That would be per
22 pound. Applying the Federal Order Class IV product price
23 formulas that took effect January 1, 2000 to 1999 butter
24 prices shows that the Federal Order value for butterfat
25 would have averaged 4.79 cents per pound above the

1 California butterfat value during -- in 1999.

2 In 1999, 26.9 percent of the butter manufactured
3 in the U.S. was produced in California. Consequently,
4 California plants have a dominant role in establishing
5 butter market prices. Federal Order plants are forced to
6 meet the California butter price in order to market butter.
7 As a result, Federal Order plants are unable to obtain
8 market prices sufficient to enable them to pay the higher
9 Federal Order butterfat value.

10 The butterfat pricing problem is unique to Class
11 IV. Proposals to reduce the butterfat values and other
12 utilization classes should be denied. Proposals to modify
13 the Class I and Class II butterfat values we see as beyond
14 the scope of this hearing.

15 Now, with respect to the proposed product price
16 formulas, NMPF proposed that the prices for butterfat,
17 protein and other solids used in Class III be computed as
18 follows: The butterfat price equals ((NASS AA butter survey
19 price minus 0.096) (divided by 0.82).

20 For the protein price it equals (NASS cheese
21 survey price minus 0.1536) times 1.405 plus (((NASS cheese
22 survey price minus 0.1536) times the butterfat recovery
23 factor) -- which I had said earlier our members will testify
24 as to the appropriate level of that and that is what USDA
25 should be used in deciding -- minus the butterfat price)

1 times 1.28). For the other solids price, it equals ((NASS
2 dry whey survey price minus 0.150) divided by 0.968).

3 NMPF proposes that the prices for butterfat and
4 nonfat solids used in Class IV be computed as follows: The
5 butterfat price equals ((NASS AA butter survey price minus
6 0.096) divided by 0.82) minus 0.06). For the nonfat solids
7 price, it would equal ((NASS nonfat dry milk survey price
8 minus 0.140) divided by 1.02).

9 The impact on the Class III and IV prices, the
10 impact that adopting the NMPF proposals would have on the
11 Class III and IV prices during March 2000 is shown in
12 Exhibit -- and I think I may have indicated a wrong number
13 here. That would be Exhibit 11.

14 In Class III, the price changes would be the
15 protein plus three cents per pound using the current 1.58 to
16 butterfat recovery factor, the butterfat plus two cents per
17 pound, the other solids price minus one cent per pound, the
18 per hundred-weight change for 3.5 percent Class III milk
19 would be a plus nine cents. The Class IV price for the 3.5
20 percent milk would be 17 cents lower.

21 USDA asks for comments on amending our recommended
22 decision. Given the complexity of the issues involved in
23 this hearing, interested parties should have an opportunity
24 to comment on the decision. Since the law requires any
25 changes made as a result of this hearing to be implemented

1 on January 1, 2001, there may not be enough time to issue a
2 recommended decision and still meet the implementation
3 deadline.

4 If that is the case, we urge USDA to implement an
5 interim final rule on January 1, 2001 subject to subsequent
6 change based upon the comments submitted on the interim
7 final rule. This concludes my prepared statement. I will
8 be happy to respond to questions.

9 JUDGE HUNT: Any questions of Mr. Coughlin?

10 MR. YALE: I am not going to let him get by free.

11 JUDGE HUNT: Mr. Yale.

12 EXAMINATION BY PARTICIPANTS

13 BY MR. YALE:

14 Q Good afternoon.

15 A Good afternoon, Mr. Yale.

16 Q I want to turn briefly to one issue that you
17 didn't address in your testimony. But I have a question.
18 On page 7 of your testimony, you state that the nonfat solid
19 price would equal NASS nonfat dry milk survey price minus
20 0.140 (divided by 1.02). Do you see that?

21 A Yes.

22 Q Is it National Milk's position that there is 102
23 pounds of solids, nonfat, and 100 pounds of nonfat dry milk?

24 A No, it is not.

25 Q Is this the exact formula that National Milk

1 proposed during the formulation of the final rule?

2 A I don't remember. But it is the -- the divisor by
3 1.02 is what is in the order now.

4 Q Right. Didn't -- isn't it true that National Milk
5 proposed that that be a lower divisor?

6 A Ben, I just don't remember. I have been working
7 with a lot of numbers lately. And I don't remember.

8 Q Very well. I want to talk a moment about your
9 issue with the butter price for Class IV. Is it my
10 understanding that your rationale -- and I am going to say
11 your, being National Milk's rationale is that there is a
12 misalignment between the Federal Order Program and the
13 California program as regards butter?

14 A Yes.

15 Q And your table on page -- or Exhibit Number 12 is
16 intended to identify that misalignment. Is that right?

17 A That is correct.

18 Q And just bouncing down, you've got a number at the
19 bottom of that table that says "1999 average." And this is
20 a price per pound, is that right?

21 A That is price per pound of butterfat.

22 Q Right. And as I understand --

23 A Not at the bottom. It is in the middle.

24 Q In the middle. And the differences over on --

25 A We explain down below that why the differences

1 exist.

2 Q I understand that. But I am just saying that the
3 actual difference you are showing as an average 4.79 cents
4 per pound for 1999?

5 A That is correct.

6 Q All right. Now, as your testimony reflects, is
7 that the California formula uses the CME price minus 4.5
8 cents. Is that right?

9 A That is correct.

10 Q Why does California use the CME minus 4.5 cents?
11 Do you know?

12 A I think I know.

13 Q Okay.

14 A I mean, it is to reflect a value of -- that would
15 be incurred in transporting butter from California back to
16 Chicago.

17 Q All right.

18 A So the calculation of the determination of the
19 price based in the midwest, Chicago, they back off a number
20 that would be presumably representing the cost of moving
21 butter from California to Chicago.

22 Q So that that butter would be competitive with the
23 butter manufactured in the mid-east and the east, is that
24 correct?

25 A That is the intent of that.

1 Q Right. Now, you indicated in your testimony that
2 approximately I think 29 percent or 27 percent of the butter
3 was produced in California, is that right?

4 A Based upon the dairy products information that
5 USDA published at the end of April, 26.9 percent was the
6 quantity of butter -- U.S. butter that was produced in
7 California in 1999.

8 Q Okay. Where is the market for the butter?

9 A The market for the butter is all over the country.
10 The market is where the people. And, I mean, you are going
11 to ask me back -- is the market back in the east. Yes, a
12 lot of the market is back in the east.

13 Q If I understand your proposal, if you make the
14 adjustment, are you anticipating to have on this line on --
15 for 1999 that the difference would be 10.79 cents?

16 A Well, I am not understanding where your line is.

17 Q Oh, I'm sorry. Exhibit 12, you have the average,
18 1999 average. Do you see that on your table?

19 A The 4.79 cents.

20 Q Yes. Is it your intent under this proposal that
21 that difference would approximate 10.79 cents?

22 A No.

23 Q How much would it approximate?

24 A I mean, our -- the way the calculation and our
25 formula is is we would continue to determine the butterfat

1 value exactly like it is being determined. And after the
2 butterfat value is determined in the Class IV formula, the
3 last parentheses in the formula is a minus six cents.

4 And so our intention would be that if you took --
5 keeping in mind that the monthly data -- to arrive at the
6 monthly data for Federal Order, I used the reform proposal.
7 Reform was not in effect in 1999. It would have reduced the
8 butterfat price per pound from 136.02 to 130.02. That is
9 the intent of the national proposal.

10 Q All right. So that the difference -- you would
11 end up with a --

12 A And I said approximately. Some of my members are
13 going to come up and present additional evidence as to the
14 marketing problems that have existed with respect to this
15 and some of the additional costs that are incurred in
16 processing cream. And the majority of butter in the United
17 States is made from cream into butter.

18 Q Okay. I apologize. I was adding and I should
19 have been subtracting. You were talking that you would end
20 up -- that the average -- under this -- if you were to
21 reformulate this, using National Milk's proposal that
22 instead of the national or order price exceeding by 4.79
23 cents, the Federal Order price would be less than the
24 California price by a fraction of the cent. Is that
25 correct?

1 A Using the six cents, it would have been 1.21.

2 Q All right.

3 A But I -- again, I am saying approximately six.

4 I -- you know, that is a proposal -- it is a range. I think
5 USDA will have to pick on the basis of the data in the
6 record here, is six cents right or is some number more or
7 less than six cents right.

8 Q Then this will -- is it the intent of the National
9 Milk Producer proposal to make butter produced in the
10 Federal Order Program competitive against California plants
11 in California?

12 A Yes.

13 Q And then to have a discount in the rest of the
14 country.

15 A No. I am not saying there is a discount. I am
16 saying that the California -- when California sells its
17 butter -- and our members will get up and testify to this --
18 that when California sells its butter, their selling price
19 for butter is lower and the manufacturers of butter who are
20 members of National Milk have to lower their butter price to
21 compete with that.

22 In other words, it is the transportation allowance
23 -- I mean, we are not dealing solely with the
24 transportation. I am dealing with a marketing situation
25 that exists. And some of our marketers of butter when they

1 get on the stand will be able to answer that question much
2 better than I can. I don't market butter.

3 Q Have you done a historic analysis other than the
4 1999 comparing California to the Federal Order butter
5 prices?

6 A I am not -- I think we are -- we could probably go
7 back three more months. But I don't believe we have NASS
8 data back beyond the last quarter of 1998. I did not do the
9 last quarter of 1998.

10 Q Historically, wasn't a situation where plants
11 would buy cream based on a Grade B butter price and convert
12 it into a AA product and that difference between the AA
13 price represented roughly the cost of that conversion?

14 A I don't know.

15 Q You don't know.

16 A I guess what I could say on that question, I think
17 USDA decided in this proceeding to base the butter values on
18 the AA price. And up until this proceeding, as I think I
19 asked Mr. Rourke earlier today, USDA prior to January 1,
20 2001 had based the butter on the A price which when they
21 made an equivalent price determination, the A price was
22 determined to be nine cents per pound lower than the AA
23 price.

24 Q But at this point, the A price doesn't exist.

25 A There is insufficient volume. That was Mr.

1 Rourke's testimony as I remember it.

2 Q I want to take a tack on another issue.

3 A Attack.

4 Q Not attack. T-A-C-T -- or T-A-C-K, I want to take
5 a tack, not an attack on this issue. You indicate on page 4
6 that some concerns about the NASS. Is that right? Do you
7 see that at the bottom of page 4?

8 A Yes. I mean, as a -- on a long-term basis, we
9 believe that there is a -- the integrity of the milk price
10 determination requires the absolute -- or as great an
11 accuracy as you can of the value of the products that go
12 into it. And given that the -- there are innuendos and
13 rumors surrounding that this plant or that plant doesn't
14 report the NASS -- to NASS, we think it is important to have
15 a universal reporting to NASS.

16 You know, I think Mr. Milton talked a little bit
17 earlier today that Congress did pass some mandatory price
18 reporting legislation last year. We will be going back --
19 we will be going to Congress and seeking the authority to
20 get the mandatory reporting on dairy product values.

21 Q Would you agree that there is also an issue with
22 NASS that plants will begin to index their pricing off the
23 NASS survey?

24 A They -- the circuitry of pricing, which is I think
25 what you are getting at, is, yes, that would be a concern.

1 If somebody says that, you know, one price next week is
2 based upon last week's survey and then you get into a
3 situation where what drives the price? Is there a robust
4 driver of price or is the price because it is driven off of
5 what last week's price was, is that robust?

6 I happen to believe that right now, the NASS is
7 the best system. In the long run, I'm -- my professional
8 opinion is that I think we need to wait and see, and see if
9 this whole system that we have adopted here proves to be
10 accurate. And I think you and I have talked about that.

11 Q The issue with the survey and the audit and the
12 mandatory nature of the reporting would not correct the
13 indexing.

14 A That is correct.

15 Q And as we earlier noted, California is using the
16 CME price for their butter at least, right?

17 A That is correct.

18 Q And if National Milk is seeking to have some
19 alignment with California, wouldn't it make more sense for
20 it to also use the same price series as California?

21 A Not according to our members.

22 Q I want to move over to the butterfat recover
23 factor in the cheese formula. Your -- are you aware of
24 the -- and I am not talking about pricing formula, but the
25 formula that is used to determine the butterfat recovery in

1 cheese? Or are you aware that there is one? I am not going
2 to ask you what it is.

3 A You mean the Vance Light formula?

4 Q Yes.

5 A Yes. I am aware of that. Am I knowledgeable
6 about it? No.

7 Q Right, right. Is that a highly recognized and
8 regarded formula in the pricing of cheese for cheddar?

9 A Yes.

10 Q And is it one in which the results can be
11 determined exactly by mathematics by putting in specific
12 numbers? In other words, you come up with certain
13 assumptions. And once you put those numbers in there, it
14 derives a specific mathematical number?

15 A I will defer to -- I think there is a witness that
16 is going to appear, Dr. Barbano. Ask him questions about
17 Vance Light.

18 Q Okay.

19 A I don't know.

20 Q Well, I am trying to get to National Milk's
21 proposal. You are not --

22 A We are not proposing anything with respect to that
23 number. Our members -- individual members are going to come
24 forward and testify as to what is the right butterfat
25 recovery formula. We adopted -- in our examples, we have

1 adopted or we used what the formula -- or the number that is
2 in the order at the present time.

3 We had made a proposal used to increase it to 1.6.
4 USDA noticed that for hearing. But our members in
5 discussing it decided that they all wanted the opportunity
6 to present their own proposals on this issue.

7 Q Okay. Back on this issue of the cream or the
8 discount on the Class IV, what is the -- isn't it true that
9 much of this that is turned into butter is purchased as
10 cream on the market?

11 A Yes. I believe one of the -- at least one or two
12 of the NMPF witnesses will testify as to the level of butter
13 that is made from cream.

14 Q And hasn't that cream historically been sold as a
15 multiple off of the Grade A price?

16 A My understanding is yes.

17 Q And that the multiple may have by market forces
18 adjusted to the new Grade A price -- AA price?

19 A My understanding is that one of the problems is
20 that it hasn't -- they haven't been able to adjust the
21 multiples. No fair. Two questioners.

22 Q You say there is another witness that is going to
23 testify in terms of the impact of that cream market and the
24 prices.

25 A I believe so. Mr. Christ, are you testifying to

1 that?

2 Q He will have questions about that.

3 A He volunteered, Ben.

4 Q All right. The Federal Order Program, and you are
5 not proposing a change to this, uses the NASS survey. Is
6 that right?

7 A That is correct.

8 Q All right. And the NASS survey includes a survey
9 of butter plants or selling butter in California, does it
10 not in that survey?

11 A That is correct.

12 Q So doesn't the national program already have an
13 adjustment to the California market?

14 A To a certain extent, yes.

15 Q Finally, I have one final question in this. And I
16 will let some other people have a chance. But on the bottom
17 of page 7, you talked about the recommended decision and
18 having an interim final decision. What about proposals 30
19 and 31 which I notice that you oppose? Those are the ones
20 that change Class II and Class I pricing.

21 A We believe they are beyond the scope of the
22 hearing notice.

23 Q Right. I understand that. But if they stay
24 within the scope of the hearing and the Secretary has to
25 deal with the record on those proposals, should they be

1 included in the emergency process of the -- handling the
2 proposals that we have before us on the issues of the III
3 and IV pricing?

4 A We hadn't taken a position on that. But I believe
5 I can speak for National Milk that we would oppose
6 implementing them absent -- on an interim final basis.

7 Q All right. Thank you.

8 A But we would -- again, beyond the scope of the
9 hearing notice, we don't support those at all.

10 MR. YALE: I understand that. I have no further
11 questions at this time.

12 JUDGE HUNT: Mr. Beshore.

13 BY MR. BESHORE:

14 Q Mr. Coughlin, I wonder if you would turn to your
15 Proposed Exhibit 10 for a minute. And your statement, you
16 know, referenced the document and the methodology. But I
17 wonder if you could just take a minute perhaps and walk
18 through the exhibit a bit to indicate how your methodology -
19 - the methodology proposed by National Milk follows the
20 current use of the RBCS and California numbers and how it
21 would be applied with the new numbers.

22 A Okay. At the top of the schedule there are the --
23 if you will, what I am going to call the raw numbers for
24 cheese, butter and nonfat dry milk. The first two number
25 columns show the most recent survey data. The most recent

1 survey data for RBCS for cheese would be 12.92. That is the
2 weighted average make allowance that Mr. Ling testified to
3 earlier.

4 The weighted average for the most recent
5 California is 15.9. The previous over in the -- what is
6 presently -- was used by USDA to arrive at the make
7 allowance which are in the orders today, the Rural Business
8 Cooperative Service was 14.21. California was 17.36.

9 I think there was some discussion earlier relative
10 to, you know, changes. It is interesting to note that both
11 the California and the RBCS surveys moved down. California
12 moved down. The cost moved down a little bit more than the
13 Rural Business Cooperative Service survey did.

14 Q But for cheese on a weighted average, they both
15 moved down more than a penny.

16 A That is correct. The next line would be the
17 similar data for butter. The Rural Business Cooperative
18 Service on butter showed -- the current showed 10.62 cents
19 per pound; California less than that, 8.83 cents per pound.
20 The previous Rural Business Cooperative Service survey was
21 13.27 whereas California was 8.9. Again, they both moved
22 down a little bit.

23 The Rural Business Cooperative Service survey
24 comes in a little bit -- was considerably higher under the
25 previous survey than California. Now it moves somewhat

1 closer to California. And on the nonfat dry milk, the Rural
2 Business Cooperative Service survey is 12.71. California is
3 11.82. The Rural Business previous one was 12.45 and
4 California was 12.68.

5 And, again, that third column shows that they both
6 went up, California by a little more than a quarter of a
7 cent per pound and our -- excuse me, California by 14/100 of
8 a cent and Rural Business Cooperative Service by 26/100 of a
9 cent per pound. The previous Rural Business Cooperative
10 Service did have a whey number in their survey of 15.75.
11 There is no whey number in the current Rural Business
12 Cooperative Service survey.

13 What I did then down below is on each of the
14 individual products, I took the cost per pound. Our
15 testimony -- I testified to that to add a marketing cost
16 which was added to both of the surveys. I had a subtotal
17 then because the California -- the return on investment,
18 that number in the most recent, USDA used the California
19 return on investment and said that they would add that to
20 the Rural Business Cooperative Service survey.

21 So I added the same number of California and so to
22 arrive at, if you will, under the Rural Business Cooperative
23 Service, a 14.10 cents per pound -- 14.1 cents per pound.
24 And the quantity in the Rural Business Service survey was
25 633 million pounds. You know, but that is a multiplication

1 of 14.1 times that. And you come out with -- strike that --
2 89 million dollars.

3 I multiplied the 17.08 under the California by the
4 quantity that was in the California survey. Again, that is
5 obtained out of the -- Mr. Cooper introduced here as the
6 California data earlier. And then I summed the amounts and
7 summed the pounds and divided back. And that comes out to
8 be 15.36 cents per pound. And that compares with the 17.02
9 that is in the current order.

10 Q And the methodology that you have used there is to
11 the best of your knowledge essentially the same methodology
12 that was employed in the order which is presently in effect.

13 A That's correct. As far as I am concerned, it is
14 identical. I mean, I worked with USDA to make sure that I
15 was doing the same things that they previously did.

16 Q Okay.

17 A On the butter, similar things. There was -- there
18 is one difference in the butter. USDA, their decision on
19 the -- shows that they made an adjustment to the Rural
20 Business Cooperative Service survey on the packaging costs.

21 They deducted an amount to bring the Rural
22 Business Cooperative Service packaging cost down to
23 eliminate the consumer-type packages that were in a
24 considerable volume in the Rural Business Cooperative
25 Service survey to bring it back to what was shown --

1 California showed as the bulk packaging cost.

2 So that less the packaging cost there you see as
3 the amount that shows up as packaging costs of 2.77 cents.
4 And the 0.79 was the amount that is in the California
5 survey. If you look at the California survey data, that is
6 in as the bulk packaging costs in California.

7 Again, I come down to the bottom line that, you
8 know, total butter -- the butter, 9.52 cents for Rural
9 Business Cooperative Service, 9.71 for California,
10 multiplied by the respective pounds and it gives you a 9.6
11 cents per pound manufacturing allowance, again, using
12 exactly the same methodology USDA used on the current order.
13 And the current order provision being 11.4 cents per pound.

14 Q Okay. Let me just stop there and ask a question.
15 I think you covered this, but to be sure. The packaging
16 costs -- Dr. Ling testified this morning that there were --
17 there was a certain amount of print butter or consumer-
18 packaged butter manufactured by the plants in the RBCS
19 study. And that was included in their overall costs. Is
20 that correct?

21 A That is correct.

22 Q And he was queried on that in some detail.

23 A Right.

24 Q Okay.

25 A So we backed it out gross and added in -- or

1 backed it out in the gross total amount that he showed and
2 put in an amount that is the same as what California had in
3 their survey. And, again, that is no different methodology
4 than what USDA did in establishing the existing 11.4 cent
5 per pound make allowance.

6 Q And coincidentally or otherwise, the numbers are
7 very similar when you get to the bottom line.

8 A When you get to the bottom line that, you know,
9 the differences in the -- is in less than -- certainly less
10 than a penny.

11 Q Okay.

12 A Very similar.

13 Q And was the same methodology followed then for use
14 of the two sets of data in the nonfat dry milk manufacturing
15 costs?

16 A That's correct. Again, I followed the exact same
17 thing. And I started by working to the 13.7 number, how did
18 USDA get that. And I said, well, if I use the same
19 methodology, what do I arrive at using the new numbers.

20 Q Okay. And those -- the products then of those
21 calculations in Exhibit 10 are the proposed manufacturing
22 allowances with National Milk Producers Federation is
23 supporting in this hearing for those three products.

24 A Yes. Our proposal, you know, in a nutshell is
25 that, you know, take the 17.02 number for cheese and update

1 it based upon the newest cost data. And that would be
2 15.36.

3 Q Okay. And in your view and the view of your
4 members, the cost data which you propose using, that is both
5 the California data and the RBCS data, is that the best data
6 available that you are aware for these kinds of figures?

7 A It is -- for the -- for independently conducted
8 surveys. I say independently, conducted by a government
9 agency. At this point in time, I am not aware of another
10 data. It was -- I mean, I guess, you know, it was a
11 proposal. It wasn't -- National Milk when we went into
12 the -- we commented on the proposed rule-making.

13 We had proposed to use the RBCS data solely.
14 Independent Dairy Foods Association proposed to use the
15 weighted average of the RBCS and California. And USDA
16 adopted the position of the International Dairy Foods
17 Association.

18 Q In the prior rule-making.

19 A In the prior rule-making. In the informal rule-
20 making that was implemented on January 1 of 2000.

21 Q But essentially in this rule-making then, you are
22 supporting the continuation of that --

23 A We are supporting the continuation of the -- what
24 USDA did, just make the numbers -- bring the numbers up to
25 date to what is the current cost surveys show.

1 Q Okay. Could you then turn to Exhibit 11. Does
2 Exhibit 11 then break out in detail the calculation of the
3 Class III and Class IV prices assuming the adoption of the
4 make allowance and other factors which National Milk is
5 supporting?

6 A That it does. It -- for the month of March 2000
7 which when I prepared this table was the latest data that
8 was available, we used the NASS survey prices, applied the -
9 - if you look under Class III, the protein price
10 determination, the current formula is there. The -- and
11 then the next line would be the proposal incorporating the
12 change in the make allowance from 17.02 down to 15.36.

13 All of the other numbers -- well, that is two
14 changes of 15.36. And you apply it to the same price. And,
15 you know, that yields you a three cents per pound difference
16 in the price per pound of protein. And, you know, you carry
17 it over. It is nine cents on a per hundred-weight basis.

18 On the butterfat price, again, exactly the same
19 thing. We propose -- the current make allowance shown on
20 the current line is 11.14 cents per pound. We plugged in
21 the 9.6 cents per pound. Everything else being the same,
22 kept the price the same. That meant with a lower make
23 allowance, the price per pound of butterfat went up by two
24 cents.

25 And on the other solids price, the current make

1 allowance is 13.7. I explained that why -- how we came up
2 with the proposal for 15 cents. It is in -- it is shown on
3 that line there. And using that, increasing the make
4 allowance from 13.7 to 15 cents per pound yields a one cent
5 per pound lower price of the solids and an eight cent per
6 hundred-weight change in the price.

7 And just, you know, the current line, if you
8 remember the price of Class III milk for the month of March
9 was \$9.54. And under the formula that we have proposed, the
10 price of milk would have been -- of Class III would have
11 been \$9.63 or nine cent a hundred-weight difference.

12 And Class IV, again, we did exactly the same
13 thing, plugging in the new numbers. And the one difference
14 in the Class IV is in the butterfat price calculation, we
15 showed a -- in the formula, we have a reduction of six cents
16 per pound. And that reduction of six cents per pound, as a
17 consequence of that, you have got a lower -- you have two
18 offsetting factors in the butterfat price there. And I
19 explained those down at the bottom of the table.

20 The reducing -- first, reducing the Class IV
21 butterfat price by six cents per pound reduces the Class IV
22 price of 3.5 cents by 21 cents per hundred-weight whereas
23 reducing the butter make allowance from 11.4 cents per pound
24 to 9.6 cents per pound would have increased the Class IV
25 price of 3.5 cents by 17 cents. So there are two offsets

1 you see. There is a net minus of 14 cents in the butterfat
2 value.

3 In the Class III price, the actual price for the
4 month of March was \$11.00 a hundred-weight. Under our
5 formula, it would have been \$10.83 or 17 cents less.

6 Q Okay. Let's turn then just for a minute to
7 Exhibit 12. You have -- is it correct that -- This analyzes
8 the differences in the California system of pricing
9 butterfat and the Federal Order System. Assuming that the
10 present Federal Order formulas were in effect in the year
11 1999 which they were not, but making calculations based as
12 if they were --

13 A That was the assumption I had to make. I had no -
14 - they actually were not in effect.

15 Q Okay. And at the bottom, there are a number of
16 technical differences between the formulas which result in
17 differences in price, some up and some down, but primarily
18 resulting in a lower price for California butterfat.

19 A And, again, that principal factor is that 4.5
20 cents deduction off of the CME price.

21 Q Okay. Now, the final exhibit, Exhibit 13, does
22 this set out National Milk's position on every proposal
23 published in the hearing notice --

24 A It does.

25 Q -- if you have taken one? And have you taken a

1 position on almost every proposal?

2 A Almost every. I think there is a couple -- there
3 is a -- the proposal with respect to the appropriate
4 butterfat recovery formula, we haven't -- there is -- if you
5 -- just to explain this a little bit, I grouped the
6 proposals exactly the same way, you know, USDA did. The
7 first page shows butter and butterfat proposals.

8 The second page shows cheese and protein price
9 proposals. So in the cheese and protein price proposals,
10 proposal number 11 by the NFO which was to change the
11 butterfat factor, again, we say the same thing there that
12 let USDA decide what it should be based on the hearing
13 record.

14 With respect to the proposal number 17 by one of
15 our members, Michigan Milk, Michigan Milk has a proposal
16 that they would submit it to simplify the calculations. I
17 believe they have a witness here that will testify to that.
18 And we looked at the numbers. The numbers results in -- or
19 the formula results in exactly the same price. But it may
20 be a simpler way of doing it. So we took no position on
21 that.

22 And so, yes. We -- it in a very brief form puts
23 forth our position of the National Producers Federation I
24 think on each of the proposals that is in the hearing
25 notice.

1 Q Let me ask you just one question about the
2 proposals 2, 3 and 4 which you listed as the National Milk
3 position being opposed. Is it correct that you are opposed
4 to -- National Milk is opposed to reducing butterfat values
5 in any classes or to a greater extent than may be justified
6 as you have indicated with respect to Class IV butterfat?

7 A Well, I mean, we support the change, limited it to
8 -- but limited it to Class IV only. We would very much
9 oppose the changes in butterfat values in other classes and
10 don't believe that the same marketing conditions exist there
11 that warrant the change in Class IV.

12 MR. BESHORE: Okay. Thank yo.

13 JUDGE HUNT: Mr. English.

14 BY MR. ENGLISH:

15 Q Charles English. Mr. Coughlin, following up on
16 those last series of questions from Mr. Beshore and looking
17 for a moment at Exhibit 12, if you took Exhibit 12 and you
18 changed the headings a little bit, I wonder if the numbers
19 in the top half of the page would change. And let me just
20 run through it with you.

21 If you go to the column that is headed, "Federal
22 Order Reform Class IV, Dollars Per Pound of Fat", and if you
23 change that to "Federal Order Reform Class III", would you
24 agree with me that all the numbers in that column would stay
25 the same underneath dollars per pound of fat for those

1 months under Federal Order reform Class III?

2 A Yes, I agree with you.

3 Q Okay. And if you go to California IVB, do you
4 agree that the value of butterfat in that column would also
5 be the same?

6 A I haven't looked at the California IVB.

7 Q Would you accept with me for a moment that the
8 butterfat value in California --

9 A No, I won't accept it because I don't know it.

10 Q Okay. If it turns out to be the case that that is
11 true, then the difference between the two columns would be
12 the same differences you have, correct?

13 A You said it.

14 Q And this is one of the marketing factors that you
15 consider important for establishing the need for taking the
16 six cents on Class IV, correct?

17 A I have explained in my testimony a need for taking
18 the six cents on Class IV is associated with the competition
19 in the butter market.

20 Q Do Class III makers in Federal Orders compete with
21 Class III cheese-makers -- I'm sorry, with Class IVB cheese-
22 makers in California?

23 A Cheese-makers compete nationally.

24 Q Turning for a moment to Exhibit 10 and the
25 adjustment for the return on investment, I note that in

1 every line when you compare the RBCS to California, it is
2 the same unless you look at the butter used in the current
3 order. So right in the middle of the page where you have
4 the addition for turn on investment, you have 0.0068 versus
5 0.0095 from the RBCS compared to California. Do you see
6 that?

7 A Yes.

8 Q Can you explain why that is different --

9 A No.

10 Q -- as opposed to being the same?

11 A No. You have to ask USDA.

12 Q Well, did you ask USDA when you were going through
13 this process to make sure you were doing it the same way
14 they did it?

15 A Yes, I did.

16 Q So did you get an answer as to why those two
17 numbers were different and yet the same -- when you came
18 over to do it for your columns on the left-hand side, you
19 made them the same?

20 A It has to do with the selection. In some cases,
21 they used a simple average. And in other cases, they used a
22 weighted average. And I inquired about that. And I ended
23 up just in my own mind saying I could not get an explanation
24 for what they did. They made a choice.

25 Q But in this instance, you decided not to use the

1 same choice they did.

2 A I used -- I threw out -- used the weighted
3 average. Everything in mine is weighted average. They
4 chose in the butter numbers to use some simple averages in
5 California even though weighted averages were available.
6 And that question would have to be addressed to USDA.

7 Q And why in your mind is simple average more
8 appropriate than weighted?

9 A I used weighted.

10 Q Oh, yes. I'm sorry.

11 A Consistent throughout the whole --

12 Q And you believe for some reason in that particular
13 column, they used simple average.

14 A They did use simple. I was told they did.

15 Q Given the fact that you are making this proposal
16 for this hearing and recognizing what the methodology is, do
17 you object to using this methodology for establishing
18 Federal Order regulated prices?

19 A Which -- what methodology?

20 Q The methodology of using the California weighted
21 and the RBCS weighted costs.

22 A That is our proposal.

23 Q Okay. So but for the fact that you see the need
24 for an update, you are not objecting to what occurred in the
25 final rule.

1 A We haven't challenged anything in the final rule.

2 Q With respect to this material and relating it back
3 to what you said about NASS, you would prefer NASS to be
4 mandatory and audited. Correct?

5 A That is correct.

6 Q Would you also prefer RBCS to be mandatory and
7 audited?

8 A Our proposal that we submitted to USDA that they
9 refused to hear was one where USDA should do like the state
10 of California does and calculate what are the manufacturing
11 costs. I think it is a very important issue.

12 Q So next year when you go to Capitol Hill looking
13 for mandatory audited NASS, will you also be looking for
14 mandatory audited manufacturing costs?

15 A Well, we have no proposal on the table at this
16 point in time for mandatory audited manufacturing costs.
17 Our initiative that we are seeking is mandatory reporting of
18 data for price determination.

19 Q With reference to your discussion about omitting a
20 recommended decision, but implementing through an interim
21 final decision, do you -- would you agree with me that this
22 has been done before, that it would not be new?

23 A That is correct.

24 Q For instance, this was done in 1986 as a result of
25 the '85 Farm Bill?

1 A Let's see. I was there then, yes.

2 Q That is why I asked you the question. Does your
3 organization have concern about the substitutability of dry
4 solids for wet solids in the manufacture of Class II when
5 the difference between Class II and Class IV prices is too
6 great?

7 A Our organization supported tying the Class II
8 price to the Class IV plus a differential of 70 cents. And
9 that is our position.

10 Q Are you aware that adoption of your series of
11 proposals and rejection or opposition to proposals with
12 respect to Class II would increase the difference between
13 the Class II and the Class IV?

14 A We have taken no look at any Class II proposals.
15 We believe they belong beyond the scope of the hearing
16 notice.

17 Q Now, when you say you believe it is beyond the
18 scope of the hearing notice, you certainly don't mean that
19 USDA didn't have a right to put it in this hearing notice,
20 do you?

21 A I believe legislatively, they don't have a right.

22 Q You believe that USDA does not have the right to
23 call a Federal Order hearing with respect to issues?

24 A I am not aware that they have a proposal to call a
25 hearing on Class II. You would have to address that to

1 them. But I haven't heard of any proposal to them.

2 Q But you wouldn't disagree that the -- any
3 proposals with respect to Class II were properly noticed
4 within this hearing notice.

5 A This hearing was convened for the purpose of
6 implementing the legislative directive which was to look --
7 take a -- review the Class III and Class IV price formulas
8 and determine whether or not they were appropriate. And
9 that was -- as I see it, that was the mandate to USDA from
10 the Congress.

11 Q But you agree that since you took a position that
12 Class II should be tied to Class IV, you can hardly move the
13 Class IV without at least thinking about the Class II, can
14 you?

15 A We are not proposing to change the Class II. We
16 are -- any -- the different -- we are not proposing to touch
17 the differential. The differential we believe is off limits
18 at this hearing.

19 Q Are you aware that for the -- if you ran your
20 proposal for the months of January and February 2000, you
21 would increase the difference between Class II and Class IV
22 by 43 cents?

23 A We have not looked at any impact on anything other
24 than III and IV.

25 MR. ENGLISH: Thank you, sir.

1 JUDGE HUNT: Mr. Vetne.

2 THE WITNESS: John, you are thinking.

3 BY MR. VETNE:

4 Q Tell me if my understanding is correct, that NMPF
5 proposes to change the Class IV butterfat price for the
6 reference and arithmetic by which that is calculated because
7 butter-makers can't recover from the market in effect what
8 the current obligation is.

9 A That is part. Yes. That is the gist of my
10 testimony. And because of the competition with California -
11 -

12 Q Yes.

13 A -- there will be a second element of that that
14 will be testified to by some of our members --

15 Q All right.

16 A -- which is not related solely to price. It is
17 related to the -- they will testify to the higher costs
18 incurred in using cream to produce butter.

19 Q Okay. And part of the picture of the problem is
20 that the fat price for milk going into butter is now
21 measured off the AA rather than the A price which has
22 increased raw product costs. But the market has not been
23 able to respond with a corresponding increase in product
24 costs. So that contributes --

25 A That is correct.

1 Q And currently, the fat price for milk going into
2 butter and into cheese are the same. And you want to break
3 those two apart.

4 A Correct.

5 Q Okay. Now, do whey butter and butter made from
6 cream compete in some of the same markets such as for baking
7 and other food processing uses?

8 A Whey butter doesn't make AA butter generally. I
9 mean, it --

10 Q Okay.

11 A I don't know.

12 Q You don't know.

13 A I mean, you need to ask some of the witnesses from
14 who are actually marketing butter. I work for an
15 organization. And we will have some witnesses who will --
16 who actually sell butter.

17 Q All right. Do you know or have a belief as to the
18 value, the market value of whey butter compared to butter
19 made from cream?

20 A Whey butter would be -- would have a lesser value.
21 But I can't speak to the price. I don't know it.

22 Q Okay.

23 A My general source of information with respect to
24 price would be Dairy Market News. And they don't to my
25 knowledge report a whey butter price.

1 Q Okay. Under your proposal nevertheless, the fat
2 that goes to a cheese-maker that ends up in whey butter
3 would be priced at the Class III price just as it is now.

4 A Correct.

5 Q And yet based on your belief, that whey butter
6 suffers to a greater extreme the problem that you describe
7 with respect to competition between the east and California
8 in that the value that can be secured from the market is
9 less than the value in cheese and less than the value even
10 in Grade A butter. Based on that premise for your proposal,
11 would you have any objection to pricing fat that ends up in
12 whey butter at, say, your Class IV fat price minus six cents
13 or something?

14 A That is not our proposal.

15 Q No. That is not -- wasn't my question either.

16 A Well, yes, I have an objection to it because it is
17 not our proposal.

18 Q Your objection -- in other words, you --

19 A I will stick with our proposal.

20 Q You don't have an opinion on whether that should
21 be so for the same reasons.

22 A I am testifying here on behalf of the
23 organization. And I -- our position is what our position
24 is.

25 MR. VETNE: Thank you, or not.

1 (Laughter.)

2 JUDGE HUNT: Mr. Rosenbaum.

3 BY MR. ROSENBAUM:

4 Q Steve Rosenbaum. Mr. Coughlin, you state that,
5 "The National Milk Producer's Federation represents a
6 substantial majority of the United States milk supply in
7 market milk in all Federal Milk Order areas." I am just
8 reading from your testimony.

9 A That's correct.

10 Q Could you -- and I take it that you did not arrive
11 at the positions of the National Milk Producers Federation
12 without substantial consultation with your membership, is
13 that correct?

14 A That is correct.

15 Q All right. And are the views you express you
16 believe the views of --

17 A They are the consensus view. Were they the
18 unanimous view? No, they are not the unanimous view of all
19 members of National Milk. It is the majority view of
20 National Milk.

21 Q All right.

22 A There will be some members who may individually
23 express themselves in a little different position than where
24 National Milk is.

25 Q All right. But nonetheless, with respect to all

1 the proposals as to which you have taken a specific position
2 which is most of them, this is the position of the majority
3 of the members of an organization that you say represents a
4 substantial majority of the farmers, correct?

5 A That is correct.

6 Q Okay. Now, why is it that these people think that
7 it is appropriate to include California make allowance data
8 in determining the make allowances for the Federal Order
9 System?

10 A We are taking the -- taking what is there now and
11 saying let's -- if we -- if it is good enough to put in
12 there now, let's just update it for the new costs.

13 Q Okay. There are --

14 A We don't have any problem with -- we had no
15 problem as an organization. Some of our members submitted a
16 proposal not to include California. And they may testify to
17 that.

18 Q But that is an issue that National Milk Producers
19 specifically considered and reached a considered judgement
20 on.

21 A We -- yes. We took a position that -- with some
22 discussion. But I would -- I believe that when we got all
23 through, that is -- if not unanimous, it was pretty close to
24 unanimous among the group that met.

25 Q Okay. And the desire is to come up with numbers

1 that reflect what is a true make allowance.

2 A That is correct.

3 Q And -- okay. Now, you did say that the
4 methodology that you are proposing is to your understanding
5 the same as the methodology in the current rule. It is just
6 that the make allowance numbers are different, correct?

7 A That is correct.

8 Q I wonder if I could make one small correction.
9 See if you agree with me on this. Which is that the -- in
10 the existing rule, the data from the Rural Business
11 Cooperative Service -- survey, excuse me, is a simple
12 average whereas you are now proposing a weighted average for
13 those numbers.

14 A That is correct. I mean, if Charlie Ling -- I
15 asked Charlie Ling back in November to prepare a weighted
16 average. I said it looks to us like a weighted average is
17 the best way to look at it. So Charlie would tell you that
18 I was the person that asked him to do that. And he did
19 that.

20 Q But my point simply is that is a change from the
21 existing system to your proposal.

22 A Yes, they use -- USDA -- on cheese, they use the
23 California weighted average number. They had no weighted
24 average number for RBCS. So they used a simple average. On
25 butter, USDA will have to describe exactly what -- how they

1 went about making their calculations.

2 And nonfat dry milk, again, they used the weighted
3 average for California and the only number that was
4 available from RBCS which was from the number that the
5 organization I represent submitted, the organization that
6 you represented submitted, the more detailed cost surveys
7 that had the simple average of the number. And that was on
8 the only number that was there.

9 Q All right. Now, you are aware that whether or not
10 marketing costs should be included in the make allowance is
11 a matter of dispute, comparing one proposal to another.

12 A Comparing whose?

13 Q Well, I am just saying, their -- let me rephrase
14 that. There are proposals in the notice that would not
15 include a marketing allowance in the calculation of make
16 allowance.

17 A Yes.

18 Q Okay. But it is your view that they should be
19 included.

20 A That's correct, at the level of the -- the
21 existing level.

22 Q And tell me why it is -- National Milk --

23 A It is a cost that is incurred.

24 Q Okay. And, therefore?

25 A It is appropriate to be reflected.

1 Q Okay. And, I mean, is it your view that the make
2 allowance needs to reflect all of the costs of taking a
3 given amount of milk and turning it into whatever finished
4 product is under consideration?

5 A Well, you've got to define somewhere along the
6 line of what plants you include. All of the costs for the
7 least efficient, most efficient. So it includes -- I think
8 in the beginning of my testimony, I made some reference to
9 the fact that it ought to cover the costs of the --
10 "Manufacturing cost allowances should reflect costs incurred
11 by plants of average efficiency in manufacturing milk into
12 cheese, whey, butter and nonfat dry milk." And I will stick
13 with that.

14 Q But in terms of categories of cost, leaving aside
15 the specific number, you think of it as a category of cost
16 like marketing costs that exist that are necessarily
17 incurred, they should be included in the make allowance.

18 A We believe what is there in the survey is
19 appropriate.

20 Q Okay. Well, and marketing cost is something that
21 you think ought to be added.

22 A And the marketing cost was added in the return on
23 investment. We add it.

24 Q Okay. And for the same philosophy.

25 A Again, yes.

1 Q Now, I am correct that if one were to change the
2 butterfat price for Class IV only, the difference between
3 the Class IV price and the Class II price increases by 17
4 cents. That is your calculation?

5 A That is correct.

6 Q Okay. And in those months in which Class IV sets
7 the price for Class I, that would be the same effect, an
8 increase in 17 cents in the difference.

9 A Well, 17 cents. But it also depends upon the
10 relationship with the -- yes, it does.

11 MR. ROSENBAUM: Okay. All right. Thank you.

12 JUDGE HUNT: Any other questions of Mr. Coughlin.
13 Mr. Yale.

14 MR. YALE: Does somebody else have one?

15 THE WITNESS: Just Connie.

16 JUDGE HUNT: She will be here until we close.

17 THE WITNESS: He may be throwing you out, Ben. I
18 didn't mean that. Please strike that from the record. It
19 is getting late in the day. It is after 4:00.

20 BY MR. YALE:

21 Q Mr. Coughlin, yes, if I address that, I probably
22 will not make it. But the -- we talked earlier today. The
23 NASS survey of butter prices reflects a blended price of all
24 the prices throughout the country reflecting all the
25 different locational attributes to that price. Is that

1 correct?

2 A That is my understanding, yes.

3 Q All right. And included in that NASS price is the
4 California plants reported prices, is that correct?

5 A That is my understanding.

6 Q Right.

7 A I mean, if you want to get into NASS, you should
8 have asked Mr. Milton.

9 Q Well, we asked him some questions. But I -- I am
10 leading up to something I want to ask you. And the question
11 -- the next question is that the rest of the plants in the
12 country respond to those California prices, do they not? If
13 you've got 27 percent of the butter being produced in
14 California, it will have an impact on the prices other
15 plants will sell their butter for, is that right?

16 A That is the premise of my testimony with respect
17 to the need for a six cent per pound reduction in the Class
18 IV butterfat value.

19 Q If you would look at your Exhibit Number 12. And
20 down here at the bottom, you have, "Why is California's
21 price average 48 cents lower?" -- or 4.8 cents. I don't
22 have my glasses on. Do you see that, that line?

23 A Yes, the 4.8 cents is the rounded number of the
24 4.79.

25 Q I understand. That isn't my -- the question comes

1 as point number 1. Isn't this saying that the Grade AA
2 price, the NASS price average is just 6 mls than the CME
3 price?

4 A Point number 1?

5 Q Yes.

6 A The Grade A -- yes.

7 Q So doesn't that indicate that under this, there is
8 an equilibrium between California and the rest of the
9 country that the market has established a relationship?

10 A Well, there are four factors in there.

11 Q I understand.

12 A I mean, and each of them taken separately.

13 Q I am just talking about the impact --

14 A Well, and that is the relationship between the
15 NASS price and the CME price, yes.

16 Q Which reflects the fact that --

17 A Yes.

18 Q -- that all these plants out there that are buying
19 or selling cheese -- or butter in the rest of the country
20 responding in part to this substantial volume of butter in
21 California were coming very close to that CME price at
22 Chicago, right?

23 A Yes.

24 MR. YALE: Thank you.

25 JUDGE HUNT: Mr. English.

1 BY MR. ENGLISH:

2 Q Mr. Coughlin, did you say that your members are
3 hurt both when they purchase producer milk and also when
4 they buy their fluid milk from fluid milk -- buy their cream
5 from fluid milk customers?

6 A I didn't say that.

7 Q Okay.

8 A I mean, I said that one of our members would be
9 testifying that there are higher costs associated with
10 processing butter from cream. That was double costs of
11 pasteurization. There was additional costs of moving milk
12 around. There were additional storage facilities. Those
13 will be -- that will be data that will be presented by an
14 NMPF member.

15 Q But your --

16 A I just -- my testimony is saying that there is
17 a -- the principle thing that I am saying in my testimony is
18 that California takes a Chicago price and reduces it by 4.5
19 cents per pound. That creates a competitive situation in
20 the butter market. And California is the largest single
21 producer in the country of butter, producing almost 27
22 percent of the butter. And consequently, it is the price
23 competition with California in the marketplace that is the
24 cause of the competitiveness.

25 Q And that is your Exhibit 12, right?

1 A What's that? Yes.

2 Q Okay. That really applies to producer milk,
3 correct, because when you are buying your bulk cream, you
4 are buying that at a market price established nationwide,
5 correct?

6 A You are buying it at whatever somebody will sell
7 it to you for. The Federal Order does not regulate the
8 price of cream per se.

9 Q Correct. So in other words, Exhibit --

10 A It only regulates the price of milk.

11 Q So Exhibit 12 then is really limited to a producer
12 milk analysis and does not go to analysis of when you are
13 buying that cream on a bulk market.

14 A This is the price in comparing what the Federal
15 Order price of milk in Class IV would be with the California
16 IVA price per pound of butterfat.

17 Q But the only time your members are responsible for
18 the Federal Order Class IVA price as opposed to the person
19 from whom they buy the milk -- the cream from is when they
20 are buying producer milk, correct?

21 A The Federal Order is not -- yes. The Federal
22 Order is not regulating the price of cream. It is the price
23 of Class IV milk.

24 Q But that was a yes in answer to my question,
25 correct?

1 A That is correct, yes.

2 Q Turning to your Exhibit 11, what -- do you know
3 what percentage of the Class III milk is represented by your
4 members?

5 A No. Mr. Ling testified -- Mr. Ling does a survey
6 of what proportion of the milk supply the cooperatives
7 manufacture. And I believe I heard a couple of people
8 mention the number that about 40 percent of the cheese is
9 produced by cooperatives. The number with respect to butter
10 and nonfat dry milk is considerably higher.

11 Q But I was -- you are getting ahead to my next
12 question which is that the relative percentages of these two
13 products, the cooperatives, your members are producing far
14 greater percentage of the Class IV than the Class III,
15 correct?

16 A That is correct.

17 MR. ENGLISH: Thank you.

18 JUDGE HUNT: All right, Ms. Brenner. I guess we
19 got to you now.

20 EXAMINATION BY THE USDA

21 BY MS. BRENNER

22 Q In proposing to reduce the Class IV butterfat
23 price below the value of butterfat used in butter as
24 determined by the current formula, why would you leave the
25 Class III butterfat price based on the value of butterfat in

1 butter as opposed to cheese?

2 A We still think it represents a fair measure of the
3 value of butterfat. The industry has been relatively
4 accustomed to butter values determining the price of
5 butterfat. We are moving on. I mean, we would still have
6 that except that we are trying to put a factor in to
7 represent the competitive factor with California. The
8 competition with California has been a problem, particularly
9 for our West Coast members for a long time. And it may not
10 be limited to just the butterfat.

11 Q Okay. You mentioned rumors in relation to using
12 the NASS price, that this or that process or -- doesn't
13 report or doesn't -- or reports some months and not others.
14 What about rumors that this process or that process or might
15 by itself be moving the CME prices?

16 A Certainly none of our members would do that.

17 Q I am relieved to hear it. Okay. Again, I mean,
18 yes, I go back to the -- you know, I can go back to the old
19 Green Bay Cheese Exchange. The Green Bay Cheese Exchange
20 was politically broken. Was it broken in fact? Probably
21 not.

22 I mean, the CME is probably a good measure of
23 price. Probably when you come down to it, the -- you know,
24 CME is a price that a lot of people use -- a lot of
25 manufacturers use to establish their price. It still has a

1 high degree of confidence level in setting prices because it
2 is there and it has been used in the -- it is used to being
3 used in the industry.

4 So a lot of contracts are based off of this price.
5 But at this point, we are not supporting using CME. We are
6 supporting continuing to use NASS as the national
7 representative measure. There are factors of -- NASS does
8 measure national price. CME measures more of a price in
9 Chicago.

10 We talked earlier about California moves their
11 butter price down by 4.5 cents per pound to reflect the
12 transportation to get back to the West Coast. So there is a
13 -- yes, form and purpose and location. The location of
14 where the product is and where it is priced. NASS is in the
15 national survey and so we are supporting the national
16 aspects of that survey as opposed to a single price location
17 point of determination in Chicago at CME.

18 Q Thank you. You had a little conversation about
19 the marketing allowance and what reason you included that.
20 Is there any particular justification for the 0.0015 or is
21 that because it is what California uses or --

22 A No. California does not use it.

23 Q California doesn't include one at all.

24 A I mean, at the -- I mean, why are we using it? We
25 started off using it because you people adopted it. I mean,

1 it is -- are we getting into the circuitousness? No. We
2 and the major organization representing, you know, the
3 proprietary processes both recommended that number. USDA
4 adopted it. We still -- we put it in our recommendation.

5 We are -- we have asked our members as they
6 testify to provide evidence for the basis of your decision
7 as to the actual levels of their marketing costs. So some
8 of our members will be coming up hopefully and testifying
9 and giving you some hard data with respect to what their
10 particular marketing costs are.

11 Q And the only other question I had was in looking
12 at your Exhibit Number 10 comparing the RBCS and California
13 numbers and using the quantities for both, it occurred to me
14 that there must be some overlap, at least in the butter and
15 powder areas.

16 Q In the butter and powder, there is the overlap. I
17 assume -- and I think I have seen the numbers on California
18 that represents close to 100 percent of all product that is
19 produced in California. I have no way of backing out the
20 one plant from -- that is in the RBCS survey from
21 California.

22 Q Okay. That is all I have.

23 A And nobody -- I haven't seen the data. And I
24 don't know that anybody else has.

25 MS. BRENNER: That's all I have.

1 JUDGE HUNT: Other questions of Mr. Coughlin? He
2 had the four exhibits, 10, 11, 12, 13. I presume you want
3 those entered into the record?

4 THE WITNESS: I would ask that they be introduced.

5 JUDGE HUNT: Anyone object to those being part of
6 the record? Hearing no objections, Exhibits 10, 11, 12 and
7 13 will be admitted into evidence. All right. And did you
8 have one of your members that is going to follow you in
9 supporting your proposal?

10 (The documents marked for
11 identification as Exhibits
12 Nos. 10, 11, 12 and 13 were
13 received in evidence.)

14 THE WITNESS: There are some of our members that
15 are going to testify. I don't know what --

16 JUDGE HUNT: Anybody available now? They are
17 coming tomorrow?

18 MR. ROSENBAUM: I am ready to go, Your Honor.

19 JUDGE HUNT: Are you? All right. We are still
20 on the record. We are still continuing. Would you raise
21 your right hand, please.

22 Whereupon,

23 ROBERT YONKERS, Ph.D.

24 having been first duly sworn, was called as a
25 witness herein, was examined and testified as follows:

1 JUDGE HUNT: And would you state and spell your
2 name for the record and who you represent, sir.

3 THE WITNESS: My name is Robert Yonkers. It is
4 Robert Y-O-N-K-E-R-S. And I am here representing the
5 International Dairy Foods Association.

6 MR. ROSENBAUM: Dr. Yonkers, have you prepared a
7 written statement for your testimony today?

8 THE WITNESS: Yes, I have.

9 MR. ROSENBAUM: And is that statement true and
10 correct to the best of your knowledge and belief?

11 THE WITNESS: Yes, it is.

12 MR. ROSENBAUM: Your Honor, I would ask that the
13 entire testimony be marked as an exhibit, the reason being
14 that the tables are contained in it that are not an
15 attachment to it. And I think the only way we can get those
16 materials properly before USDA is to have the whole
17 exhibit --the whole testimony come in as an exhibit, which
18 we would ask that that be marked as Exhibit 14.

19 JUDGE HUNT: And they are available for us to
20 follow along?

21 MR. ROSENBAUM: Yes, Your Honor.

22 JUDGE HUNT: All right. Fine. Then we will mark
23 that as Proposed Exhibit 14. That is your testimony and
24 accompanying exhibits. All right, sir. Go ahead.

25 (The document referred to was

1 marked for identification as
2 Proposed Exhibit No. 14.)

3 THE WITNESS: This testimony is submitted on
4 behalf of the International Dairy Foods Association, its
5 constituent groups and their members. IDFA is a trade
6 association representing processors, manufacturers,
7 marketers, distributors and suppliers of dairy foods
8 including milk, cheese, ice cream and frozen desserts.

9 IDFA serves as an umbrella organization for three
10 constituent groups, the Milk Industry Foundation or MIF, the
11 National Cheese Institute or NCI, and the International Ice
12 Cream Association or IICA, which together represent over 80
13 percent of all dairy product processing in the 70-billion-
14 dollar U.S. dairy foods industry.

15 MIF has over 160 member companies that process
16 about 90 percent of the fluid milk and fluid milk products
17 consumed nationwide. NCI has over 75 member companies that
18 manufacture more than 80 percent of the cheese consumed in
19 the U.S. NIICA has over 125 member companies that
20 manufacture and distribute an estimated 85 percent of the
21 ice cream and ice cream-related products consumed in the
22 United States.

23 As buyers and processors of milk, the members of
24 IDFA and its constituent organizations have a critical
25 interest in these hearings. Most of the milk bought and

1 handled by IDFA members is purchased under the Federal Milk
2 Marketing Orders promulgated pursuant to the Agricultural
3 Marketing Agreement Act of 1937, or the AMAA.

4 I am Dr. Robert D. Yonkers, Chief Economist and
5 Director of Policy Analysis at IDFA. I have held that
6 position since June of 1998. I hold a Ph.D. in agricultural
7 economics from Texas A&M University, earned in 1989, a
8 master's degree in dairy science from Texas A&M University,
9 earned in 1981, and a bachelor of science degree in dairy
10 production from Kansas State University earned in 1979. I
11 have been a member of the American Agricultural Economics
12 Association since 1984.

13 Prior to taking my current position at IDFA, I was
14 a tenured faculty member in the Department of Agricultural
15 Economics and Rural Sociology at the Pennsylvania State
16 University where I was employed for nine years. At Penn
17 State, I conducted research on the impacts of changing
18 market conditions, alternative public policies and emerging
19 technologies on the dairy industry.

20 In addition, I had statewide responsibilities to
21 develop and deliver extension materials and programs on
22 topics related to dairy marketing and policy. I have
23 written and spoken extensively on economic issues related to
24 the dairy industry and have prepared and delivered expert
25 witness testimony to state legislatures and to Congress.

1 These hearings were called to consider whether any
2 changes should be made in the Class III and IV milk pricing
3 formulas that were included in the final rule for
4 consolidation and reform of Federal Milk Orders and
5 implemented on January 1, 2000, the final rule.

6 IDFA and its constituent groups submitted several
7 of the proposals that were included in the notice of
8 hearing. And my testimony will address both the reasons why
9 those proposals should be adopted and why other proposals
10 should not for the reasons I am about to explain.

11 1) The make allowance for cheese should be set no
12 lower than 16.87 cents per pound of cheese. 2) The make
13 allowance for dry whey should be set no lower than 15.92
14 cents per pound of dry whey. 3) The Class AA NASS butter
15 price should be reduced by six cents in the product price
16 formula applicable to all classes.

17 4) The NASS survey of cheddar cheese prices should
18 be expanded to include 640-pound blocks. 5) The adjustment
19 to the NASS survey price of cheddar cheese in 500-pound
20 barrels and 640-pound blocks should be reduced from three
21 cents per pound of cheese to one cent per pound of cheese.

22 6) The NASS produce price survey should be mandatory and
23 audited or at least verified.

24 7) None of the other proposals should be adopted.
25 And 8) the Department should issue a recommended decision,

1 followed by a period for written comments prior to issuing a
2 final decision on this proceeding.

3 1) The critical importance of make allowance in a
4 pricing system based upon product price formulas. The final
5 rule utilizes the price of finished products to determine
6 the minimum milk prices that must be paid to farmers through
7 a mechanism commonly referred to as a product price formula.

8
9 Over-simplifying slightly, a product price formula
10 sets the minimum prices that farmers must be paid for their
11 milk, at least by proprietary handlers, as the price
12 handlers receive for their finished products such as cheese
13 or butter, minus the cost the handlers incur in turning farm
14 milk into those finished products commonly referred to as
15 the make allowance.

16 I will provide in section 10 of this testimony an
17 explanation why this approach to minimum milk pricing makes
18 good economic sense and satisfies Agricultural Marketing
19 Agreement Act criteria. But at this point in my testimony,
20 I want to focus on one of the key elements that goes into a
21 product price formula, the make allowance.

22 This make allowance is sometimes referred to as
23 the cost of manufacturing. Although as I will explain, it
24 does and must include more than that. Almost half of the
25 proposals included in the notice of hearing, 15 out of 31,

1 suggests changes in the Federal Order make allowances,
2 proposals number 2, 6, 7, 9, 10, 12, 14, 15, 16, 20, 21, 22,
3 23, 24 and 25.

4 A number of these proposals seek to reduce the
5 current make allowances, some by a significant amount.
6 Obviously, make allowances are a critical component of the
7 product price formulas. And IDFA urges USDA to carefully
8 consider all aspects of all information available on costs
9 of manufacturing and the market implications of any
10 potential changes to make allowances.

11 The key point I want to make in this section of my
12 testimony is that there is a tremendous qualitative
13 difference between setting a make allowance that is too low,
14 one that is less than the true cost of manufacturing, and
15 setting a make allowance that is too high or one that is
16 more than the true cost of manufacturing.

17 And I do not mean by that statement that setting
18 too low is bad for processors and setting too high is good.
19 My point is much more fundamental at that. It is that
20 setting a make allowance that is too low has the immediate,
21 inherent and inescapable effect of imperiling necessary
22 investment and manufacturing facilities while setting a make
23 allowance that is too high can and will be corrected by the
24 marketplace to the satisfaction of processors and handlers.

25 Specifically, a make allowance that is too low

1 will make it uneconomical for proprietary handlers to
2 operate manufacturing facilities. A make allowance that is
3 too low will make it impossible for proprietary handlers to
4 compete with plants not regulated by Federal Orders,
5 especially those in California.

6 A make allowance that is too low will make it
7 impossible for proprietary handlers to compete with
8 cooperative handlers who can escape the impact of a too low
9 make allowance. By contrast, a make allowance that is too
10 high can and will be addressed through the marketplace by
11 way of competitive over-order premiums on milk.

12 Let me now explain why these observations are
13 correct. A) The role of make allowances under new product
14 price formulas. In general, a make allowance is the
15 difference between the wholesale sales value of the
16 manufactured dairy product and the cost to purchase the raw
17 milk necessary for that product's production.

18 This make allowance is used for many economic
19 purposes, for example, to pay for the use of capital
20 necessary to build and maintain the plant, to cover the non-
21 milk costs related to obtaining raw milk, to pay for
22 marketing the processed dairy product, to pay wages to
23 employees of the manufacturing plant, to pay utility
24 companies for the water, electricity and natural gas used to
25 manufacture the dairy product, to buy ingredients other than

1 raw milk, and to cover a wide variety of other expenses such
2 as plant maintenance, equipment and insurance.

3 A hypothetical, but realistic example may help
4 explain the concept of make allowances and product price
5 formulas. Assume the example where the wholesale price of
6 cheese is \$1.27 per pound and the total costs of
7 manufacturing and marketing that cheese is 17 cents per
8 pound of cheese.

9 A manufacturing plant facing these assumed
10 economic factors would be able to pay up to \$1.10 -- that is
11 \$1.27 minus the 17 cent make allowance -- for the raw milk
12 needed to manufacture each pound of cheese. What if this
13 hypothetical plant is regulated under a Federal Order? If
14 the make allowance specified in the regulated minimum price
15 is 17 cents, this example plant can pay all the costs
16 associated with manufacturing and marketing cheese after
17 paying the regulated minimum price to the milk producers
18 supplying the raw milk.

19 If, on the other hand, the make allowance
20 specified in the regulations were 15 cents, the plant would
21 be required to pay a minimum price of \$1.12, or \$1.27 minus
22 15 cents, to milk producers supplying milk. In this
23 scenario, the plant would still receive the wholesale
24 price -- cheese price of \$1.27. But after being required to
25 pay the minimum milk price of \$1.12, would only have 15

1 cents left to cover the total costs of turning that milk
2 into cheese.

3 But with actual total costs of manufacturing and
4 marketing cheese of 17 cents, the plant would be unable to
5 pay for one or more factors of manufacturing and marketing.
6 Obviously, the plant could not continue to operate like this
7 for any extended period of time.

8 It is easy to see through this simple but accurate
9 example the critical need for a make allowance that covers
10 the total costs of turning raw milk into a finished dairy
11 product including marketing that product. Without an
12 adequate level of make allowance, a manufacturing plant
13 could not continue to operate as it would have insufficient
14 funds available to pay the vital costs necessary for
15 operating the plant.

16 The extreme case would be if a manufacturing plant
17 were required to pay the entire sales value of a dairy
18 product to the supplier of the raw milk used for that
19 product. In this extreme case, there would be no funds left
20 to cover any of the costs associated with the manufacturing
21 and marketing of the product. The plant would be forced to
22 cease operation and a viable market for raw milk would no
23 longer exist.

24 But even if the manufacturing plant were permitted
25 to hang on to some of the sales value, it would not be able

1 to cover its costs fully unless it is entitled to hang onto
2 enough money to pay for all of its costs.

3 The final rule included the following observation:
4 "Both handler and producer interests argued that failure to
5 cover processors' costs of converting milk to finished
6 products results in a disincentive to produce finished
7 products. They express concern that the disincentive would
8 discourage investment in the manufacturing sector, leading
9 to reduced manufacturing capacity and reduced outlets for
10 producers' milk." End of observation from the final rule.

11 This observation is absolutely correct and I am
12 aware of no economic theory or analysis which would lead to
13 any other conclusion. Now, an observer might ask if the
14 manufacturing plant is not in our example getting enough
15 money to cover its costs, why doesn't it simply raise its
16 prices for finished products or lower the amount it is
17 paying for milk.

18 In our example, the manufacturer is losing two
19 cents for every pound of cheese that it is selling for
20 \$1.27. Why doesn't it just raise its prices to \$1.29 or
21 lower what it is paying for milk by two cents in order to
22 make up the shortfall?

23 In an unregulated market, that would make perfect
24 sense. The manufacturer would do one of two things. It
25 would either raise the wholesale price of its products or

1 find a less costly source of raw milk. But, of course, we
2 know that under the Federal Order System, they cannot reduce
3 what it is paying farmers below the minimum regulated price.
4 This option is a non-starter. That at least is true for
5 proprietary handlers. I will get to cooperatively-owned
6 manufacturing plants in a minute.

7 What is equally important to recognize is that the
8 handler cannot escape from its conundrum by raising its
9 finished product prices either. We can see why this is so
10 by returning to our example. Recall that the handler is
11 selling cheese for \$1.27. The make allowance is 15 cents.
12 And the minimum price of milk is, therefore, \$1.12. The
13 handler is losing one cent for every pound of cheese it
14 makes because its true cost of manufacturing is 17 cents.
15 But it only has 15 cents left over after it pays for its
16 milk.

17 So why can't the handler simply raise its price to
18 \$1.29? The problem lies in the Federal Order minimum price
19 formula. As previously noted, the minimum price is the
20 price of the finished product minus the make allowance. In
21 our example, before any finished product price increase, the
22 minimum milk price was \$1.27 minus 15 cents equals \$1.12.

23 After the finished product price increase, the
24 minimum milk price is \$1.29 minus 15 cents, equals \$1.14.
25 Thus all of the money derived from the increase in the

1 finished product price has gone directly to the farmer in
2 the form of a higher, legally mandated minimum price. None
3 of the money derived from the finished product price
4 increase has gone to the handler.

5 After paying the now higher minimum milk price,
6 the handler only has 15 cents left over, precisely the same
7 amount as before it raised its finished product prices. The
8 same effect will result no matter how much or, for that
9 matter, how little the handler attempts to raise its
10 finished product prices. You can plug any price increase
11 you want into the equation. The result is always the same
12 because the pricing formula works as a ratchet.

13 All of the finished product price increase gets
14 passed on to the farmer in the form of a higher minimum milk
15 price. None of it is available to the handler to make up
16 for the short fall between the make allowance and the
17 handler's true cost of manufacturing. Any steps it might
18 take would be as futile as a dog chasing its own tail.

19 The example I have been using is focused upon
20 cheese in its make allowance. But the same principles apply
21 equally to all of the make allowances contained in the
22 pricing formulas.

23 The only rational conclusion is simple and
24 straightforward. Too low a make allowance will lead to a
25 reduced manufacturing capacity and reduced outlets for

1 producer milk. USDA must avoid setting a make allowance
2 that is too low. To achieve that result, it must err on the
3 side of a higher rather than lower make allowance. This is
4 especially true given the only remedy available should cost
5 of manufacturing increase, even temporarily, which is to
6 petition USDA to conduct a hearing to consider changing the
7 make allowance.

8 For example, the increase in recent months in oil
9 prices has likely increased the energy costs associated with
10 operating a manufacturing plant. If handlers had requested
11 a hearing to ask that this cost increase be reflected in the
12 make allowance, it would likely have taken more than a year
13 to conduct a hearing, publish a decision and implement any
14 change.

15 The pooling is not a viable option. In a hearing
16 notice, USDA points out that a handler whose operations have
17 been rendered uneconomical by an unduly low make allowance
18 could exercise its legal right to de-pool and, thus, escape
19 from the minimum milk price requirements of the Federal
20 Order System.

21 USDA in the notice solicited comments on this
22 issue. A simple analysis readily demonstrates that the
23 economic opportunity to de-pool is largely illusory and
24 cannot possibly provide a means of overcoming the disastrous
25 impacts that I have demonstrated will flow from a too low

1 make allowance.

2 To understand why, one must examine the benefits
3 that accrue to a handler by being a regulated plant. The
4 example I will use is a cheese plant. But it could just as
5 easily be a plant making another manufactured product. To
6 make our analysis as accurate as possible, I will utilize
7 actual prices for March 2000 as set forth in USDA's Dairy
8 Market News for April 7th and 21st, 2000.

9 Those publications report that the Class III price
10 in March was \$9.54 while the all markets weighted average
11 statistical uniform price, the equivalent of the blend price
12 under the old pricing system, was \$11.59. For example, if
13 this were a single Federal Order market, the Class III
14 handlers entitled to draw \$2.05 per hundred-weight from the
15 producer settlement fund -- that is \$11.59 minus \$9.54
16 dollars -- to pay its farmers on top of the \$9.54 that it
17 must pay itself.

18 Of course, the entire \$2.05 must be paid directly
19 to these handler-shippers and Federal Order auditors will
20 ensure that it does. While it is true that de-pooling would
21 free the plant of any legal requirement to pay the minimum
22 price for Class III milk, the effect of de-pooling would be
23 that that plant would no longer receive a pool draw from the
24 producer settlement fund.

25 Thus, the plant would be in an immediate \$2.05 per

1 hundred-weight competitive disadvantage in competing for a
2 milk supply against all other possible outlets for raw milk.
3 The handler would either have to find some farmers who are
4 willing to accept a price more than \$2.00 below the market
5 price, an impossible scenario, or come up with the money out
6 of its own pocket.

7 But, of course, under this scenario, no cheese
8 manufacturer would have any money left in its pocket. In
9 order to pay a price competitive with other outlets for
10 milk, its raw milk costs in March 2000 would be at least
11 \$11.59 per hundred-weight or roughly \$1.16 per pound of
12 cheese. That cost standing alone exceeds the price a
13 handler can get for its cheese which is reported by AMS in
14 March, averaged at \$1.11 per pound for cheddar cheese.

15 The handler will have received five cents less
16 than the cost of its milk even before paying for the costs
17 of manufacturing per pound of cheese. Moreover, competition
18 from non-pooled cheese plants would prevent it from raising
19 its finished product prices. De-pooling is simply out of
20 the question.

21 While I have based the foregoing analysis on all
22 market figures for class prices and utilization, the same
23 conclusion is reached no matter what individual market is
24 selected for examination. Take the order with the lowest
25 Class I and highest Class III utilization, the Chicago

1 market.

2 For the month of March 2000, the weighted average
3 statistical uniform price was \$10.18, meaning the Class III
4 handlers drew 64 cents from the pool, or \$10.18 minus the
5 Class III price of \$9.54. A handler dropping out of the
6 pool would give up the right to that draw.

7 Perhaps a handler could find suppliers willing to
8 supply milk for a little less than the blend price or from
9 time to time, sell milk at a lower cost during periods of
10 temporary over-supply. But 64 cents or 6.3 percent less
11 over a sustained period, this just is not going to happen.

12 I would also note that the option to de-pool is
13 substantially less attractive than in the past due to two
14 regulatory changes that took effect on January 1, 2000.
15 First, consolidation has caused some marketing areas that
16 used to have low Class I utilization to be part of much
17 larger orders with much higher Class I utilization.

18 This is clearly evident in the former marketing
19 area of southwestern Idaho and eastern Oregon. The Class I
20 use in February was only 11.3 percent in 1998 and a mere
21 five percent in 1999. But this area is now part of the
22 consolidated western marketing area with a Class I use of
23 27.6 percent in February 2000.

24 The higher Class I utilization, of course, leads
25 to a larger spread between the uniform price and the Class

1 III price. Because de-pooling causes a handler to lose its
2 right to draw that spread from the producer settlement fund,
3 de-pooling becomes particularly unattractive.

4 Second, although the Class I price under the
5 former pricing system was the sum of Class I differential
6 and the Class III price, it is now the sum of the Class I
7 differential and the higher of the advanced Class III or
8 Class IV price.

9 The difference between the Class I price and the
10 Class III price will be greater under the new system in
11 those months in which the advanced Class IV skim price is
12 higher than the advanced Class III skim price. This will
13 also cause the spread to increase between the uniform price
14 and the Class III price, again, making de-pooling
15 unattractive.

16 C) Too low a make allowance will cause production
17 to shift to non-federally regulated areas. The foregoing
18 analysis demonstrates that setting too low a make allowance
19 will cause production of manufactured products to be
20 uneconomical resulting in disinvestment in processing
21 facilities as a direct and sole result of this regulatory
22 pricing formula error.

23 But that analysis, of course, only holds true for
24 those plants that are subject to federal minimum price
25 requirements. The largest state in terms of milk

1 production, California, is not covered by a Federal Order,
2 but instead relies on state regulation of milk pricing.

3 The importance of California's milk production and
4 dairy product production cannot be over-stated in analyzing
5 the impact of changes in Federal Order regulations.
6 California consistently is chosen to maintain a state-
7 regulated milk pricing system. Historically, California has
8 regulated minimum prices at levels below Federal Order
9 minimums. And yet as demonstrated by the statistics which
10 follow, milk production and dairy processing have
11 flourished.

12 Past attempts to legislatively mandate California
13 to regulate prices at higher levels were flawed economically
14 and were ultimately rejected. Consequently, since
15 California is not subject to Federal Order minimum milk
16 price regulation nor is there economic justification to
17 force California to regulate milk prices at higher levels,
18 the relationship between California milk and dairy product
19 prices and Federal Order regulation is critical.

20 While both raw milk and dairy product production
21 have increased in both California and the U.S. as a whole,
22 the increases for California are staggering. Between 1980
23 and 1999, total milk production in the U.S. increased by 127
24 percent. But total milk production in California increased
25 by 224 percent.

1 During this period, California's share of U.S.
2 total milk production increased from 10.6 percent in 1980 to
3 18.7 percent in 1999. The trend in dairy product production
4 is even more pronounced. Between 1980 and 1999, the
5 production of all cheese in the U.S. increased by 199
6 percent. But in California, all cheese production increased
7 by 762 percent.

8 This resulted in California's share of all cheese
9 production in the U.S. increasing from 4.6 percent in 1980
10 to 17.4 percent in 1999. California's share of total U.S.
11 nonfat dry milk production increased from 20.9 percent in
12 1980 to 47.2 percent in 1999. And its share of U.S. butter
13 production increased from 16.1 percent to 26.9 percent
14 during the same period.

15 Clearly, USDA cannot ignore the impact of the U.S.
16 -- on the U.S. dairy market of dairy products that are
17 manufactured in plants not regulated by Federal Orders.
18 USDA recognized this in the hearing notice when it noted
19 that, "Prices paid for manufactured milk under Federal
20 Orders cannot get too far out of alignment with the value of
21 milk for manufacturing in the rest of the United States."

22 A comparison of milk prices paid for milk used in
23 manufactured dairy products between Federal Orders and
24 California shows that on average Federal Order prices are
25 already higher than those in California. For the 19 month

1 period beginning with September of 1998 when the NASS survey
2 data now used to calculate federal minimum prices first
3 became available, the current Federal Order product price
4 formula would have yielded an average Class III minimum
5 price of \$12.82 and an average Class IV minimum price of
6 \$12.87 both for milk with 3.5 percent butterfat.

7 The equivalent California minimum regulated prices
8 for milk used to make similar dairy products for the same
9 19-month period were \$12.75 and \$12.77 respectively. Thus,
10 the Federal Order prices already exceeded the California
11 prices by seven cents for Federal Order Class III and by ten
12 cents for Federal Order Class IV.

13 The notice of hearing calculates that the proposal
14 to lower the make allowance on cheese from its current 17.02
15 cents per pound to 14.2 cents would cause the Class III
16 price to increase by 21.2 cents per hundred-weight. Such an
17 increase or anything like it in the already meaningful
18 disparity between Federal Order and California prices is
19 simply not sustainable.

20 For some proprietary handlers with multiple plants
21 across the U.S., the opportunity exists to shift in
22 increasing share of production to plants in areas outside of
23 Federal Order regulation like California. It should be
24 strongly noted, however, that this opportunity does not
25 exist for a single plant firm nor for a firm with all its

1 plants located within a single region where Federal Order
2 regulation dominates.

3 Moreover, the ability of some proprietary handlers
4 to shift production to areas outside of federal regulation
5 is hardly reassuring to anyone who wishes to obtain
6 manufacturing milk production in the Federal Order system.

7 D) Too low a make allowance will cause production
8 to shift to cooperatively owned processing plants. The
9 analysis of the negative impacts of too low a make allowance
10 that I have set forth in sections A and B above is, as I
11 have pointed out, only true for plants that are required by
12 Federal Order regulation to pay at least the minimum price
13 for the milk used in dairy product manufacturing.

14 I have already noted that California plants are
15 not subject to this requirement, nor are plants that are
16 owned and operated by cooperative associations. Cooperative
17 associations regulated by Federal Orders have the legal
18 right to distribute the proceeds of their marketing and
19 operations however the cooperative association deems
20 appropriate.

21 To put it another way, cooperative associations
22 are not required to pay the minimum price for milk. Thus,
23 these types of manufacturing plants are able to adjust for
24 an improperly set or too low make allowance by paying milk
25 producers less than the minimum price specified by the

1 order.

2 Return to our example of a cheese price of \$1.27
3 per pound and a make allowance of 15 cents, a resulting
4 minimum milk price of \$1.12 per pound, and actual costs of
5 manufacturing of 17 cents per pound of cheese. We have
6 already seen that the proprietary cheese manufacturer
7 suffers a loss of two cents per pound of cheese manufactured
8 and that no mechanism exists by which it can recoup this
9 loss.

10 But a cooperative manufacturer in the same
11 position need not pay its farmer members the \$1.12 per pound
12 of cheese for their milk. It can instead lower the price to
13 them to the \$1.10 needed to reduce its losses to zero. The
14 cooperative could instead choose to pay the federal minimum
15 price and finish its operating year with a net loss which
16 will then be a portion to the milk producer members in
17 either an assessment or a reduction in member equity.

18 This merely is as matter of accounting. And the
19 bottom line is the same. The cooperative will have -- kept
20 its plant operating in an economically rational basis and
21 unlike the proprietary handler, will not be forced to
22 disinvest as a sole result of a misguided regulatory pricing
23 formula.

24 In fact, USDA recognizes -- acknowledged this
25 distinction between cooperatives and proprietary handlers in

1 the hearing notice, stating, "It is assumed that these
2 proposals will have a lesser effect on farm prices and
3 receipts of member milk processed and marketed by
4 cooperatives than on prices and receipts of milk
5 manufactured by proprietary processors."

6 "A baseline assumption is that a cooperative
7 passes through to its members the best price and best return
8 on investment that it can. A higher minimum Federal Order
9 price could result in cooperatives paying higher monthly
10 milk prices, but would result in lower returns on
11 investments paid at the end of the year."

12 As an economist, I fully endorse this USDA
13 analysis and its conclusion that, "Total cash receipts for
14 member milk marketings processed by the cooperative would be
15 changed only by changes in wholesale product prices."

16 Well, the short-term result of specifying the make
17 allowance too low is likely to be less available plant
18 capacity. The longer run result is that an increasing share
19 of the U.S. production of manufactured dairy products will
20 shift either to plants owned and operated by cooperative
21 associations or to areas where Federal Order regulation is
22 either non-existent or not as much of a factor in
23 determining the competitive value of raw milk.

24 In either case, milk producers' share of the
25 wholesale sales value of manufactured dairy products is not

1 likely to change as the very reason for such a structural
2 shift in dairy product manufacturing is to avoid the too
3 high minimum milk price resulting from specifying a too low
4 make allowance.

5 It is likely that in Federal Order areas, the
6 market would continue to clear only through plants owned and
7 operated by cooperative associations. In effect, these
8 processing cooperatives would be balancing the market with
9 the entire expense of doing so placed on their member milk
10 producers.

11 Member milk producers of bargaining cooperative
12 associations without processing plants would not directly
13 bear this cost. I am not alone in reaching these
14 conclusions regarding the deleterious impact of too low a
15 make allowance. A recent article by Dr. Mark Stephenson of
16 Cornell University emphasized that, "The real danger in
17 regulating minimum prices is to regulate a price that is too
18 high."

19 Dr. Stephenson goes on to say, "If processors must
20 pay more than a market clearing price, they will not want to
21 buy as much milk as is available. Farmers may then be left
22 with unsold milk or their cooperatives will be forced to
23 find outlets for distressed sales of milk. This would
24 constitute one form of disorderly marketing, something
25 Federal Orders are supposed to prevent."

1 I am in agreement with Dr. Stephenson's
2 sentiments. USDA must take all steps necessary to ensure
3 that make allowances are not less than the actual costs of
4 manufacturing.

5 E) The impact of specifying a too-high make
6 allowance in Federal Orders is corrected by the market. In
7 contrast to the severe and negative impacts of specifying
8 too low a make allowance in Federal Orders, a too high make
9 allowance, that is one that is in excess of the true costs
10 of manufacturing, would have much less influence on the
11 structure of dairy markets.

12 This is largely a function of the role of minimum
13 milk price regulation in Federal Orders where plants can and
14 often do pay more than the minimum price for raw milk used
15 to make manufactured dairy products. For plants owned and
16 operated by cooperative associations, a too high make
17 allowance makes no difference in the ultimate price
18 delivered to milk producer members for raw milk.

19 As an example, if the cheese make allowance were
20 hypothetically set too high, say, 20 cents versus a 17-cent
21 actual total cost of manufacturing, the cooperative
22 association would return the extra three cents per pound of
23 cheese manufactured to its member milk producers either in
24 the form of an over-order premium or at the end of the year
25 when operating returns are distributed.

1 For those plants not operated by a cooperative
2 association, competitive market conditions would influence
3 the level of over-order premiums paid above the Federal
4 Order minimum price. Cooperative associations, as already
5 discussed, would pass all of the wholesale sales value of
6 dairy products in excess of that needed to cover the total
7 costs of manufacturing to their milk producer members.

8 Since cooperative associations are significant
9 players in the manufacturing of dairy products, 76 percent
10 of the dry milk products, 61 percent of the butter, 48
11 percent of the dry whey products and 40 percent of the
12 cheese produced in the U.S. in 1997 according to Dr. Ling,
13 they are a considerable force to be reckoned with in the
14 marketplace.

15 In order to maintain -- remain -- excuse me, in
16 order to remain competitive in the marketplace for raw milk,
17 a proprietary plant would have to pay an amount at least
18 equal to the cooperative association in the above example as
19 an over-order premium. In short, market forces will result
20 in over-order premiums that will adjust the amount being
21 paid to farmers to reflect the fact that the make allowance
22 was set higher than the actual cost of production.

23 This is in keeping with the approach to minimum
24 price regulation described by the University Study
25 Committee, or USC, that helped shape the final rule and

1 which I endorse as an economist who served on this study
2 committee.

3 "While the AMAA was enacted a half century ago,
4 regulatory experience indicates that minimum pricing allows
5 latitude for market forces to operate, while providing
6 stability, orderliness and a reflection of national supply
7 and demand conditions. In other words, the USC concludes
8 that the framers of the AMAA acted with considerable wisdom
9 and insight which should be taken seriously in designing a
10 substitute for the MNW price series."

11 Indeed, when one takes a step back, one sees that
12 allowing market forces to play a significant role in
13 determining the minimum price of milk used for manufactured
14 products is deeply ingrained in the Federal Order System.
15 For decades, the Class III price was exactly equal to the
16 market price as established by the price paid for
17 unregulated Grade B milk in Minnesota and Wisconsin.

18 In other words, market forces did not merely play
19 a significant, but a determinative role in setting
20 manufacturing milk prices. It should give no one pause to
21 continue with that general philosophy under the new product
22 price formulas and to allow market forces to correct for any
23 make allowances that are set too high. This would be true
24 even if too low make allowances did not carry such severe
25 adverse consequences.

1 One commonly made argument against setting a too-
2 high make allowance is that while competitive market forces
3 will result in an over-order premium being paid to the
4 producers supplying that plant, the added value of the raw
5 milk input will not be pooled in the Federal Order and,
6 therefore, will not be part of the total price paid to milk
7 producers supplying other plants.

8 This argument has no economic basis in fact.
9 Consider the following example where a cheese plant
10 regulated by a Federal Order had the cost of manufacturing
11 of 17 cents per pound of cheese. But the Federal Order make
12 allowance is 20 cents per pound. And the wholesale price of
13 cheese is \$1.27.

14 If this is a plant owned and operated by a
15 cooperative association, milk producer members will receive
16 not nearly the minimum price for milk of \$1.07 or \$1.27
17 minus the 20 cent make allowance, but will also receive the
18 three cent difference between the Federal Order make
19 allowance and the plant's actual cost as an over-order
20 premium. As described above, other non-cooperative cheese
21 plants would also have to pay this three-cent over-order
22 premium for competitive market reasons.

23 Furthermore, other non-cheese plants would also
24 need to increase their over-order premium in order to
25 compete for a raw milk supply in this market. In a Federal

1 Order, all producers receive the same minimum price
2 regardless of which products their milk is made into.

3 In the above example, cheese plants in the Federal
4 Order would be paying their milk producers the same minimum
5 price as every other plant in the Federal Order plus the
6 three-cent per pound of cheese over-order premium. In order
7 to be competent for a milk supply, all other plants in the
8 marketing area would have to pay an equivalent three cents
9 per pound of cheese above the minimum price.

10 2) What factors should be included in determining
11 make allowances? As I have explored at length in section 1
12 under product price formulas, the minimum milk price equals
13 the finished product price minus the make allowance. And,
14 therefore, the make allowance equals the finished product
15 price minus a minimum milk price.

16 In other words, product price formulas are
17 designed to require the manufacturer to pay to the dairy
18 farmer in the form of a regulated minimum price everything
19 the processor receives for its finished product in excess of
20 the make allowance. The processor by definition never gets
21 to hold on to a penny more than the make allowance.

22 Given this purposeful design, it seems perfectly
23 obvious from the standpoint of an economist, and for that
24 matter a plant operator, that all costs that a processor
25 incurs in taking raw milk and turning it into a finished

1 product must, and I will repeat must be included in the make
2 allowance. To do anything else would guarantee that a
3 processor will never be able to cover its costs and must
4 disinvest from its manufacturing facilities and activities.

5 The reasons why the processor cannot adjust for a
6 make allowance that fails to include all such costs by
7 raising its finished product prices were fully explained in
8 section 1(A) of this testimony. IDFA, therefore, strongly
9 supports using actual industry datas for costs of
10 manufacturing as the basis for order make allowances.

11 This must include all costs beginning with those
12 raw milk procurement costs not directly reflected in the
13 price paid for the raw milk all the way through the costs of
14 marketing bulk commodities in the wholesale dairy market.
15 In other words, all costs commensurate with producing,
16 marketing and delivering the products for which the prices
17 are gathered by the NASS dairy products prices survey must
18 be included.

19 Failure to include any cost incurred during this
20 process of taking raw milk and delivering a finished
21 wholesale product would result in too low a make allowance
22 whose consequences I have already outlined.

23 Among the costs that must be included in the make
24 allowance are the following: a) Procurement costs. Raw
25 milk does not magically appear at a manufacturing plant's

1 receiving area. In addition to the price paid for the raw
2 milk, most manufacturing plants have costs associated with
3 ensuring that a sufficient volume of milk is delivered in a
4 timely fashion to the plant. For example, field staff, milk
5 assembly coordination and shipper relations.

6 Such costs must be included in the difference
7 between the wholesale sales value and the price paid for raw
8 milk if a plant is to continue to operate over time.
9 Several proposals for this hearing have suggested using
10 summary data from the annual survey conducted for
11 cooperative associations by USDA's Rural Business
12 Cooperative Service.

13 I will discuss later some other problems with this
14 data source. But the problem I will note here is that the
15 instructions for completing that survey specifically asks
16 that all milk procurement costs be excluded from the costs
17 accounted for in the survey. One reason may be that for
18 cooperatives, some milk procurement costs such as those for
19 field staff are difficult to apportion among the multiple
20 functions they perform like member relations versus milk
21 procurement.

22 IDFA specifically opposes those proposals that
23 suggest using data that does not include this cost of
24 obtaining raw milk including proposal numbers 6, 7, 9, 10,
25 17, 15, 16, 21, 22, 23, 24 and 25.

1 b) Marketing costs. Another key cost which is
2 excluded from the Rural Business Cooperative Service survey
3 is the cost associated with marketing the finished bulk
4 commodity. Once again, the wholesale sales value does not
5 magically appear as soon as a dairy product is produced.
6 Manufacturing plants have costs associated with marketing
7 and selling their finished products which must be covered
8 over time if the plant is to remain in operation.

9 Some proposals that suggest that the RBCS survey
10 be used in determining make allowance specifically seek to
11 include an allowance for marketing costs in the make
12 allowances including proposal numbers 6, 14, 21 and 23.
13 However, proposal numbers 2, 7, 22 and 24 do not include a
14 marketing allowance. And IDFA opposes those proposals on
15 this basis.

16 c) Cost of capital. The RBCS survey specifically
17 excludes an allowance for the cost of capital invested in a
18 manufacturing plant. But capital costs must be incurred in
19 order to finance the construction and other non-operating
20 aspects of the plant. In order to ensure the long-term
21 economic viability of such plants, an amount sufficient to
22 cover the cost of capital invested whether that capital is a
23 result of borrowed capital or investor capital must be
24 included in any determination of the cost of manufacturing
25 used as the basis for make allowances.

1 IDFA opposes those proposals in the hearing notice
2 that do not include an allowance to cover the cost of
3 capital for manufacturing plants including proposal numbers
4 6, 7, 9, 10, 14, 15, 16, 21, 22, 23, 24 and 25.

5 d) Administrative costs. Instructions for
6 completing the RBCS survey specifically exclude
7 administrative costs which are noted on the survey to
8 include plant office costs, the plant manager wages and
9 corporate overhead. These are all necessary costs
10 associated with operating a manufacturing facility and IDFA
11 opposes those proposals that do not include an allowance to
12 cover administrative costs for manufacturing plants
13 including proposal numbers 6, 7, 9, 10, 14, 15, 16, 21, 22,
14 23, 24 and 25.

15 Aside from these key aspects of the total costs of
16 manufacturing dairy products, there appears to be little
17 disagreement in the industry about the inclusion of most
18 plant operating costs. These include all labor costs
19 associated with the conversion of raw milk to finished bulk
20 dairy products, e.g. direct plant labor costs and
21 supervisory labor costs all including fringe benefits, all
22 non-labor processing costs, for example, electricity,
23 natural gas, sewer and water, repairs and maintenance, and
24 all costs of ingredients other than the price paid for raw
25 milk ingredients and packaging.

1 Failure to include any of the costs described
2 above would result in too low a make allowance and the
3 disorderly marketing conditions that would follow. IDFA
4 supports the proposals that seek to include all costs
5 associated with taking raw milk and processing and marketing
6 of finished dairy product in the wholesale market including
7 proposal numbers 12 and 20.

8 3) The data sources that should be used to
9 determine make allowances and the make allowances that
10 should be incorporated into the formulas. I have now
11 discussed the costs that must be included in the make
12 allowances. The next step is to determine what those costs
13 are.

14 One important criterion is that the cost data
15 represent plants owned and operated by both cooperative
16 associations and non-cooperative plants. To begin with,
17 both types of plants can be subject to Federal Order
18 regulation. And both compete with each other regardless of
19 whether they are regulated by the Federal Order System.

20 In addition, the NASS dairy products prices
21 surveys that provide the product price data used in the
22 product price formulas include both types of plant ownership
23 in its survey. In order to ensure an apples-to-apples
24 matching of prices and costs, the data used in the Federal
25 Order product price formula should make every effort to

1 include data from the same sources.

2 Furthermore, manufacturing plants subject to
3 regulation based on the make allowances used in Federal
4 Orders compete with plants that are not subject to such
5 regulation. In some cases, these may be plants that are not
6 regulated by either federal or state milk price regulation
7 and, therefore, have no regulated minimum milk price
8 requirements.

9 In other cases, these plants will be subject to
10 state milk price regulation which may use different make
11 allowances. In either case, failure to include these plants
12 and data used to determine Federal Order make allowances
13 could result in a non-representative make allowance,
14 potentially providing incentives for investments in existing
15 and new plants and equipment outside of Federal Order
16 regulation.

17 In the final rule, USDA stated that, "The make
18 allowances contained in the proposed rule were developed
19 primarily from make allowance studies conducted and
20 published by Cornell University and an analysis of
21 manufacturing plant size in relationship to the data
22 contained in the Cornell studies. Audited cost of
23 production data published by the California Department of
24 Food and Agriculture was also used in determining a
25 reasonable level of make allowances."

1 IDFA notes that the Cornell studies relied on in
2 the proposed rule were all published between 1987 and 1992,
3 and all relied on data more than ten years old at the time
4 the proposed rule was published in January 1998.

5 USDA then noted, "Nearly all the comments received
6 relating to make allowances asserted that the proposed rule
7 make allowances were understated." In the final rule, USDA
8 substantially changed nearly all the make allowances to
9 reflect these comments. In place of the out-of-date Cornell
10 studies, USDA relied on two primarily sources of data on
11 make allowances that were identified by industry in written
12 comments on the proposed rule.

13 The first was make allowances collected and
14 published by the California Department of Food and
15 Agriculture, or CDFA, which is part of CDFA's ongoing milk
16 pricing system. This data is based on audited surveys of
17 plants which make mostly cheddar cheese and includes costs
18 associated with all bulk cheddar cheese package sizes,
19 although packaging labor and packaging expenses reflect
20 costs from only the 40-pound block cheese plants in the
21 survey.

22 In its final decision, USDA reported that the CDFA
23 data supported a make allowance of 18.55 cents per pound of
24 cheese. This was based on CDFA's audited survey of nine
25 cheddar cheese plants with a total processing volume of

1 375.6 million pounds for the two-year period from January
2 1995 through December 1996.

3 The second source of data was provided by the
4 Rural Business Cooperative Service of USDA. As part of its
5 ongoing technical assistance program to cooperatives, RBCS
6 annually surveys cooperative dairy manufacturing plants
7 about costs of processing. This is not a make allowance
8 study, but rather an effort to provide cooperative dairy
9 plants with benchmark data for costs of manufacturing.

10 This survey is not limited to 40-pound block
11 cheddar cheese, but includes all sizes and packaging types
12 including 640-pound blocks and 500-pound barrels, and even
13 includes data from plants which produce both cheddar and
14 other types of cheese.

15 However, this survey explicitly excludes the costs
16 associated with procuring raw milk, marketing the finished
17 dairy product and allowance for the cost of capital invested
18 in the plant, and even excludes the administrative costs
19 associated with managing the plant, the plant office costs,
20 plant manager salary and fringe benefits and corporate
21 overhead.

22 In its final decision, USDA reported that the RBCS
23 data supported a make allowance of 15.4 cents per pound of
24 cheese. This was based on data provided by four
25 cooperatives on six cheddar cheese plants with a total

1 processing volume of 352.6 million pounds for calendar year
2 1996.

3 Industry comments submitted to USDA during the
4 reform process contained suggestions raising from using --
5 ranging from using the RBCS study alone to using the CDFA
6 study alone to set the make allowance for cheese in the
7 Class III product price formula. IDFA and others suggested
8 using an average of the two sources of data weighted by the
9 volume of cheese processed.

10 In the final rule, the suggestion was the one
11 adopted by USDA resulting in a make allowance for cheese of
12 17.02 cents per pound. Since that time, CDFA has completed
13 additional surveys of make allowances. The most recent data
14 was published in February 2000.

15 CDFA reported data for nine cheese plants,
16 representing 466 million pounds of cheese production with a
17 weighted by volume of cheese produced average, actual, total
18 cost of manufacturing of 16.93 cents per pound of cheese.
19 IDFA believes this data provides a very useful input for
20 determining Federal Order make allowances.

21 The volume covered by the survey is substantial.
22 The survey does not specifically exclude noncooperative
23 plants. The CDFA audits all the plants in the survey. And
24 the only cost not included in this report are those
25 associated with marketing the finished product.

1 However, IDFA strongly believes that data
2 representative of other geographic areas of the country in
3 addition to California also should be used as input in
4 determining make allowances. In the final rule, the only
5 data available for geographic regions outside of California
6 was the study I have already mentioned that is conducted as
7 part of a technical assistance program by the Rural Business
8 Cooperative Service.

9 Accordingly, USDA had little choice but to include
10 its data. But this data has several serious drawbacks.
11 First, the purpose of the study is to provide operating cost
12 benchmarks for in-plant costs of manufacturing, not for the
13 purpose of determining make allowances.

14 Second, as I have noted above, a number of
15 important cost elements are excluded from this survey.
16 Third, the RBCS data for 1996 represented only six cheddar
17 cheese plants from only four cooperative associations and
18 included data on the cost of manufacturing dry whey from
19 only three plants.

20 As I have noted, this RBCS was the only non-
21 California data available when the final rule was
22 promulgated. And USDA had little choice but to use it.
23 That is no longer the case. For the purpose of this
24 hearing, one of IDFA's constituent organizations, the
25 National Cheese Institute, undertook a much broader survey

1 of cheese plants to obtain the costs of manufacturing
2 cheddar cheese and dry whey.

3 A survey form was developed by NCI that followed
4 that used by the RBCS, but does not exclude costs associated
5 with procuring raw milk and explicitly includes the costs of
6 marketing finished dairy products and administrative
7 overhead, both excluded by the RBCS survey.

8 NCI by design did not ask for cost of capital data
9 because it was preferable to rely on the audited plant data
10 from CDFA for the cost of capital. Since the CDFA uses a
11 consistent method of determining the total capital
12 investment in each surveyed plant and then uses this current
13 -- and then uses the current prime interest rate to
14 establish the total value on the return of capital invested.

15 This NCI survey form, a copy is attached to my
16 testimony, was sent to all dairy product manufacturing
17 plants that manufacture cheddar cheese according to USDA's
18 plant inspection list except for those plants located in
19 California and, thus, already represented by data in the
20 CDFA audited survey.

21 In addition, because CDFA does not collect any
22 data on the costs of manufacturing dry whey, the NCI whey
23 survey included cheese plants in California that
24 manufactured dry whey, as well as plants in other states
25 that produced products other than cheddar cheese but do

1 produce dry whey. These plants were only asked to provide
2 data on dry whey.

3 All plants were asked to provide data for the most
4 recent 12-month period available with a preference for data
5 which had been confirmed by at least internal firm audit.
6 Actual plant data was not reported to IDFA in order to
7 assure the confidentiality of individual plant data.
8 Instead, all data was submitted to a third party survey and
9 accounting firm, Association Survey Resources or ASR LLC of
10 Bethesda, Maryland.

11 At IDFA's direction, ASR checked each data item
12 reported against the range of data reported in the 1996 RBCS
13 survey. Any data item which was on a per-pound-of-cheese
14 basis more than ten percent outside of the range of data
15 reported in the 1996 RBCS report resulted in a call from ASR
16 to the plant contact indicated on the NCI survey form to
17 confirm the data as reported.

18 Fifteen plants from ten different firms returned
19 useable data on the cost of manufacturing cheddar cheese.
20 Seven plants from six firms responded with data on the cost
21 of manufacturing dry whey. The 15 cheddar cheese plants
22 reported a total volume of cheese manufactured of 1.029
23 billion pounds of cheese annually, represented 36.5 percent
24 of the total U.S. cheddar cheese production of 2.817 billion
25 pounds reported by USDA NASS in 1999.

1 The weighted by volume of cheese produced average
2 of total cost of manufacturing for all 15 plants was 16.79
3 cents per pound of cheese. The NCI survey also found that
4 the cost of marketing, which is not included in either the
5 RBCS or CDFA surveys, was 11 -- excuse me, was 0.11 cents
6 per pound of cheese.

7 For the following calculation, IDFA added this
8 0.11 cents marketing cost to the CDFA weighted average
9 cheese cost of manufacturing of 16.93 cents for a total cost
10 of manufacturing including marketing of 17.04 cents for the
11 CDFA data. Combining the NCI and CDFA surveys results in
12 data from 24 cheese plants with a total combined cheese
13 production of 1.495 billion pounds or 53.1 percent of total
14 US cheese production in 1999.

15 The weighted average cost of manufacturing
16 including marketing cost and an allowance for cost of
17 capital using both these sources of data is 16.87 cents per
18 pound of cheese. IDFA proposes that USDA adopt as a make
19 allowance for cheese a value no lower than 16.87 cents per
20 pound of cheese for use in the protein product price
21 formula.

22 In fact, USDA would support no change in the
23 cheese make allowance in the protein product price formula
24 from its current level of 17.02 cents per pound of cheese.
25 And I have included a table that shows the cost in the CDFA

1 survey and similarly grouped costs from the NCI survey and
2 our combined weighted average of the two.

3 MR. ROSENBAUM: Dr. Yonkers, I think you said USDA
4 in that last sentence. You meant IDFA would support no
5 change?

6 THE WITNESS: Yes.

7 MR. ROSENBAUM: I hope USDA, also.

8 THE WITNESS: I'm sorry.

9 MR. ROSENBAUM: But your testimony is to IDFA.

10 THE WITNESS: Yes, I can't read what I wrote.
11 Thank you, Steve. In the final rule, the USDA did not rely
12 directly on a survey of the costs of manufacturing dry whey
13 in determining the make allowance for the other solids
14 product price formula. USDA instead used as a surrogate for
15 actual whey cost of manufacturing data the make allowance
16 used for nonfat dry milk which was 13.7 cents.

17 IDFA believes this approach results in too low a
18 make allowance for dry whey. First, raw liquid whey is
19 approximately 94 percent water compared to liquid skim milk
20 which is approximately 91 percent water.

21 The cost of removing the water from liquid whey is
22 therefore greater than that for skim milk because there is
23 more to remove. In addition, I understand that the
24 manufacturing process for dry whey requires a
25 crystallization process which is a more costly drying

1 process than that used for nonfat dry milk which is not
2 crystallized.

3 In the NCI survey, the seven plants reporting cost
4 of manufacturing for dry whey produced 307.2 million pounds
5 of dry whey in 1999. This represents 28.4 percent of the
6 1.083 billion pounds of dry whey for human use produced in
7 the U.S. in 1999 as reported by USDA's NASS.

8 The weighted by volume of dry whey produced
9 average of the cost of manufacturing dry whey was 15.92
10 cents per pound of dry whey. IDFA proposes that USDA adopt
11 as the make allowance for dry whey a value no lower than
12 15.92 cents per pound of dry whey for use in the other
13 solids product price formula. And, once again, we have
14 included a similar table. Since there was no California
15 data, there is no weighted average of the two. It is just
16 the NCI survey data.

17 The combination of the CDFA and NCI survey data
18 provides a more than sufficient, indeed, a very solid
19 foundation for determining make allowances. These data
20 sources overcome the numerous deficiencies I have identified
21 in the RBCS survey data. IDFA therefore supports the use of
22 the CDFA and NCI data and opposes those proposals that would
23 base the make allowances on the RBCS survey, proposal number
24 6, 7, 14, 15, 16, 21, 22, 23 and 24.

25 4) The current yield factor should not be changed.

1 As with make allowances, an inappropriate yield factor in
2 the product price formulas can have serious and negative
3 repercussions on plants and dairy industry structure. In
4 the case of make allowances, the negative impacts result
5 from a make allowance that is too low as compared to actual
6 costs of production.

7 In the case of yield factors, the negative impacts
8 result from overstating the amount of dairy products that
9 can be produced from a given unit of milk components. Such
10 an error would overstate the wholesale sales value
11 attributed to the yield of each component. This would cause
12 the handler to over-pay for the component and just like a
13 too-low make allowance, cause its operations to be
14 uneconomical.

15 The yield factors addressed by the proposals in
16 the notice of hearing are those used to compute the minimum
17 prices of protein and nonfat solids. For the reasons I will
18 now explain, none of these proposals should be adopted.

19 A) The cheese yield factor. Four proposals favor
20 changing the yield factor associated with the butterfat
21 adjustment in the protein product price formula used in
22 calculating the minimum price for Class III milk, proposal
23 numbers 10, 11, 14 and 15. All of these proposals concern
24 the retention of butterfat in cheddar cheese manufacturing.

25 Currently, the Federal Order product price formula

1 for protein includes a multiplier of 1.582 which is based on
2 the fact that on average 90 percent of the butterfat is
3 retained in cheese during manufacturing. The other ten
4 percent on average ends up in the whey cream fraction and is
5 usually recovered as whey cream which I am told is generally
6 sold at a discount to sweet cream.

7 Proposal numbers 11, 14 and 15 all suggest using a
8 butterfat retention of 91 percent, while proposal number 10
9 suggests a butterfat retention of 92 percent. IDFA opposes
10 all four of these proposals and there are two reasons why.

11 1) Class III milk is not limited to cheddar cheese produced
12 at a single butterfat recovery rate.

13 The first reason why the yield should not be
14 changed results to the fact that the Class III price is the
15 minimum price that must be paid for all hard cheeses, not
16 just cheddar cheese. Indeed, only 35 percent of the cheese
17 manufactured in the United States during 1999 was cheddar
18 cheese. In addition, there is not data available which
19 indicates the average butterfat recovery rate of the cheddar
20 cheese transactions reported in the NASS dairy products
21 prices report.

22 Using the wrong yield factor even with the correct
23 price series could overstate the total value of cheese from
24 a given unit of milk. As I have already noted, any formula
25 that overstates the amount of dairy products that can be

1 produced from a unit of milk components overstates the
2 wholesale sales value attributed to the yield of each
3 component. Thus, a yield factor that is based upon cheddar
4 cheese but applies to lower yield cheeses as well will over-
5 price the milk going into those cheeses.

6 This phenomenon was recognized by USDA in the
7 final rule and, in fact, formed the basis of its decision to
8 reject proposals to set the yield factor in the formula at
9 0.91 rather than 0.90. "Since Class III includes other
10 types of cheese such as mozzarella that has a lower fat
11 retention than cheddar cheese, increasing the value
12 attributed to that retention is not appropriate. Increasing
13 the protein price for all milk used in Class III based on
14 only a portion of the products included in Class III would
15 put other Class III products at a competitive disadvantage."

16 "Calculation of a minimum price will enable
17 handlers to adjust prices paid to producers above the
18 minimum Federal Order prices. Therefore, the 1.582 factor
19 will be used in the protein price formula contained in this
20 decision."

21 As I have said, others will -- excuse me, close
22 quote. As I have said, others will testify as to the yield
23 experienced with those other cheeses. But as an economist,
24 I can state that the conclusions drawn in the final rule are
25 as sound today as they were then.

1 2) The yield factor cannot be set at a level that
2 ignores shrinkage. There is another reason why the cheese
3 yield factor should not be increased. The scientific work
4 suggests that a cheddar cheese plant can achieve a
5 recovery -- excuse me, the scientific work that suggests
6 that a cheddar cheese plant can achieve a recovery of
7 butterfat in cheddar cheese higher than 90 percent bases
8 that inclusion on a theoretical amount of cheese that can be
9 produced in a closed system starting from a given quantity
10 of milk in the vat at the plant.

11 But handlers must pay for milk based upon the
12 quantities measured at the farm, not in the vat. And there
13 are significant losses of milk or shrinkage that occur
14 between the time the milk is measured at the farm and the
15 point at which the finished product is produced.

16 I am informed that shrinkage is on the order of
17 two percent for the average cheese manufacturer. Under the
18 Federal Order System, the manufacturer must pay for that
19 milk including the protein contained in that milk even
20 though by definition none of it makes its way into a
21 finished product and the manufacturer accordingly gains no
22 economic benefit from it.

23 This shrinkage is not accounted for in the make
24 allowance or anywhere else in the product pricing formulas.
25 The only place where shrinkage can be accounted for is in

1 the yield factor. Setting a yield factor below that which
2 is theoretically achievable in a closed system starting with
3 the milk in the vat is precisely how that should be
4 accomplished. That is what the current product price
5 formula does. Raising the yield factor in the direction of
6 the theoretical yield is a step in the wrong direction.

7 B) Nonfat solids. Currently, the Federal Order
8 product price formula for nonfat solids used to calculate
9 the Class IV price includes a divisor of 1.02. Two
10 proposals suggest changes to that divisor, proposals number
11 27 and 28. One proposes changing the divider to 0.99 and
12 the other to 0.975.

13 Both proposals are based on the purported need to
14 account in the divider for the average percent moisture in
15 nonfat dry milk, a soon to be two percent moisture in
16 proposal number 27 and 2.5 percent moisture in proposal
17 number 28. These proposals might make sense if the only
18 thing produced when raw milk is processed into Class IV
19 products were butter and nonfat dry milk.

20 But, in fact, raw milk processed into Class IV
21 dairy products, butter and nonfat dry milk, will also yield
22 some nonfat solids in the form of dry buttermilk, a lower
23 valued product. Indeed, the key reason USDA noted in the
24 final rule for selecting the 1.02 yield factor for nonfat
25 dry milk was the need to account for this dry buttermilk.

1 And I quote, "Since buttermilk powder is also
2 used" -- "is also a product of manufacturing butter and
3 nonfat dry milk, its value needs to be addressed. Because
4 the proposed rule did not account for the yield of
5 buttermilk, the 0.96 factor was appropriate."

6 "However, failing to account for buttermilk powder
7 resulted in overstating the nonfat solids price since the
8 pounds of nonfat solids were understated. Use of the 1.02
9 factor allows the nonfat solids contained in nonfat dry milk
10 and buttermilk powder to be accounted for and the value of
11 all nonfat solids to be accurately reflected in the nonfat
12 solids price." And I close quote.

13 I agree with that analysis. USDA made the correct
14 adjustments in setting a yield factor of 1.02 in order to
15 account for the fact that nonfat solids and dry buttermilk
16 are a product of Class IV processing and have a lower value
17 than those used in nonfat dry milk.

18 The latter is evident in the fact that over the
19 19-month period beginning September 1998, the central
20 states' dry buttermilk average price was 0.9 -- excuse me,
21 0.798 dollars per pound while the central states mostly
22 priced for nonfat dry milk averaged \$1.043 per pound, a
23 difference of 24.5 cents per pound.

24 The adoption of a yield factor in the final rule
25 of 1.02 accounts for this lower value of dry buttermilk

1 without unduly complicating the nonfat solids product price
2 formula. The only other manner in which this could be
3 accomplished would be to add a dry buttermilk component to
4 the Federal Order product price formulas.

5 But this would require that dry buttermilk be
6 added to the NASS dairy products prices survey and that a
7 make allowance and yield factor be established for this
8 product. This would be quite a burdensome undertaking for
9 very little benefit. It is a far better solution to account
10 for dry buttermilk through the adoption of the 1.02 yield
11 factor as the final rule is done.

12 Therefore, IDFA opposes proposals -- proposal
13 numbers 27 and 28 which would abandon this approach without
14 providing any alternative means of addressing the dry
15 buttermilk issue.

16 5) Finished product prices should continue to be
17 determined through the NASS surveys. The product price
18 formulas used to determine minimum milk prices under the
19 final rule are based on the wholesale selling prices of
20 butter, cheddar cheese, nonfat dry milk and dry whey. As a
21 primary building block of Federal Order minimum milk prices,
22 these wholesale prices determine what handlers pay and
23 producers receive for all regulated milk under the Federal
24 Order Program.

25 Therefore, it is imperative that the wholesale

1 selling prices used to determine minimum Federal Order
2 producer prices represent the wholesale value of the
3 underlying product in the marketplace as accurately and
4 completely as possible. Accurately representing the average
5 wholesale price of these products in the marketplace can
6 only be accomplished by including the largest possible
7 sampling of wholesale prices.

8 For that reason, the product prices used to
9 determine Federal Order minimum prices must represent actual
10 market sales transactions. In addition, the product price
11 data should represent transactions from all areas of the
12 country and not be limited geographically to one sales
13 region or another.

14 Finally, such price data should include the
15 largest volume of manufactured dairy products as possible.
16 Currently, only the dairy product prices survey conducted
17 weekly by the National Ag. Statistics Service of USDA meets
18 these criteria. IDFA supports its continued use and opposes
19 all proposals to substitute a different information source.

20 IDFA, therefore, opposes proposals 1, 10, 19, 26
21 and 27. The most frequently cited alternative to the NASS
22 dairy products prices survey is the Chicago Mercantile
23 Exchange, or CME spot markets. However, USDA in the final
24 rule discussed the many reasons why the CME is not a
25 suitable data source for any of the four products at issue.

1 First, noting that the CME weekly cash butter
2 contract had been used in setting the butterfat
3 differential, the final rule states, "This price series has
4 been criticized due to the thinness of trading."

5 With respect to cheese, USDA stated in the final
6 rule, "Criticism of the cheese exchange trading including
7 inaccurate representation of cheese prices and accusations
8 of market manipulation reached the point that the national
9 cheese exchange discontinued trading and cash trading of
10 cheese moved to the CME. The CME also has received some
11 criticism for thinness of trading."

12 While there exists a cash contract for nonfat dry
13 milk at the CME, USDA noted in the final rule that, "There
14 is very limited exchange trading of nonfat dry milk."
15 Finally, there is no cash exchange market for dry whey.

16 All of the available evidence supports the
17 correctness, both then and now, of USDA's decision in the
18 final rule not to utilize CME data. Since September 1998,
19 the volume of cheddar cheese included in the NASS dairy
20 products prices survey has represented 26.4 percent of all
21 cheddar cheese production in the U.S. During the same 18-
22 month period through February 2000, the CME volume of
23 cheddar cheese traded represented only 1.7 percent of U.S.
24 cheddar cheese production.

25 To switch from the NASS data to the CME data would

1 be to switch from a very broad to an extremely thin
2 representation of actual cheese transactions. The same is
3 true for butter. For the same 18-month period, the NASS
4 survey volumes represented 14.4 percent of all U.S. butter
5 production while CME trading consisted of only 2.6 percent.

6 This thinness carries through consequences.
7 First, it raises the very real prospect that the reported
8 prices are not, in fact, representative of finished product
9 transaction prices. But the prices used to set minimum milk
10 prices must be accurate if the entire pricing system is to
11 function properly.

12 Second, these markets are sufficiently thin so as
13 to encourage purchasing for the purpose of causing minimum
14 milk prices to rise if they form the basis of minimum milk
15 prices. In addition to their thinness, the CME market is
16 not national in scope. In the final rule, USDA noted that,
17 "The scope of the surveys that have been undertaken by NASS
18 and their geographic representation appears to be
19 comprehensive."

20 But because the CME spot prices represent
21 transactions in Chicago only, the CME spot prices do not
22 satisfactorily capture the national scope of manufactured
23 dairy product markets.

24 A final criticism of using CME spot prices in
25 determining Federal Order minimum prices concerns the impact

1 on futures markets. The Commodity Futures Trading
2 Commission, or CFTC, has strict rules to protect against
3 manipulation of underlying cash markets for the purpose of
4 reaping large gains on futures positions.

5 For example, in the thinly traded CME spot cheese
6 market, it would be possible for a cheese manufacturer to
7 take a large short futures position by selling several milk
8 futures contracts and then sell a smaller quantity of cheese
9 on the CME spot market well under the opening cash price.

10 If there is not an adequate trading for the spot
11 cheese market to rebound in the same trading session and the
12 cheese manufacturer is able to move the spot market
13 dramatically lower by selling a small quantity of cheese on
14 the spot market, the milk futures markets will respond by
15 dropping accordingly.

16 The cheese manufacturer then buys back the futures
17 contracts at the reduced futures price and makes a ten-
18 dollar profit in the futures markets for each dollar lost in
19 the spot market. To protect against this type of
20 manipulation, the CFTC determines futures position limits
21 based on the volume represented by the underlying cash
22 market.

23 In the case of the milk futures market, the
24 underlying reference price -- prices are the NASS survey
25 prices, cheese, butter and dry whey used to determine the

1 Class III milk price. Because the NASS survey captures 15
2 to 25 percent of the markets for these products, it would be
3 very difficult for one manufacturer to manipulate the survey
4 prices. Therefore, the CFTC allows rather liberal position
5 limits on milk futures contracts.

6 This encourages trading activity which increases
7 liquidity in the market and allows adequate opportunities
8 for hedgers to secure price protection. However, adopting
9 the much thinner traded CME spot market as the basis for
10 determining Class III prices would dramatically increase the
11 opportunity to manipulate the cash market for futures market
12 gains.

13 Consequently, the CFTC likely would have to
14 dramatically reduce futures market position limits for
15 contracts based on either Class milk prices or dairy product
16 prices. This would provide a disincentive to traders to
17 participate in the futures markets and thereby reduce
18 producers' and processors' ability to gain price protection
19 by hedging their sales or purchases on the futures markets.

20 6) The NASS survey should be improved. For the
21 reasons I have just explained, the Federal Order's reliance
22 upon the NASS surveys should be retained. But the survey
23 should be improved in two ways. a) The NASS survey should
24 include 640-pound block cheddar cheese. As set forth in
25 proposal number 12, the NASS cheese survey should be

1 expanded to include 640-pound blocks.

2 While no publicly available data on total
3 production of 640-block cheddar cheese exists, industry
4 estimates suggest that 640-blocks could represent as much as
5 20 to 25 percent of total cheddar cheese production.
6 Intentionally excluding such a large percentage of cheddar
7 production dramatically limits the NASS survey's ability to
8 represent the true wholesale value of cheddar cheese.

9 Under no circumstance should any proposal be
10 accepted that would reduce the percentage of cheese covered
11 by the NASS survey and included in the product price
12 formulas. IDFA strongly opposes proposal number 1 which in
13 addition to proposing to use the CME instead of the NASS
14 survey, also proposes to use only cheddar cheese data for
15 40-pound block packages.

16 Over the period September 1998 through February
17 2000, the combined 40-pound block and 500-pound barrel
18 volume on the NASS survey represented 26.3 percent of total
19 cheddar cheese production with 500-pound barrels
20 representing 61 percent of the NASS survey volume.
21 Eliminating 500-pound barrel cheese and calculating Federal
22 Order minimum prices would have reduced the sample from 26.3
23 percent of total cheddar production to only 9.5 percent.

24 b) Greater steps should be taken to verify the
25 NASS survey data. While IDFA strongly supports the

1 continued use of the NASS surveys, they can be improved.
2 Unlike all other agricultural commodity data collected by
3 USDA, this is the only data used directly to determine
4 minimum prices that must be paid to producers by processors.

5 The current NASS survey is neither mandatory nor
6 subject to audit or verification in any way. IDFA urges
7 USDA to make changes to the NASS dairy products prices
8 survey in order to minimize potential errors that could
9 result in mis-specification of minimum prices.

10 One option would be to make the NASS survey
11 mandatory. I have included an addendum to my testimony, a
12 discussion of the authority that IDFA believes USDA
13 currently has to do so. At the very least, the NASS survey
14 should be modified in order to allow USDA to periodically
15 ascertain whether or not wholesale sales transaction data is
16 being reported correctly.

17 One way to do so which is fully supported by IDFA
18 is to verify periodically that the data reported by
19 manufacturing plants is confirmed by those customers
20 purchasing the products. We recognize that actual cheese
21 manufacturer audits of bulk cheese sales would be an
22 additional regulatory burden both on the part of USDA and
23 the cheese manufacturers.

24 Therefore, IDFA proposes the following procedure
25 for bulk cheese price verification. First, modify the

1 existing transaction survey form to include reporting by
2 each cheese manufacturer of their largest three or four
3 buying firms each week.

4 USDA could then select a small sample of survey
5 respondents each week and contact the indicated bulk cheese
6 buyers regarding the confirmation of such a purchase and the
7 average price paid to the cheese manufacturer. This
8 verification process minimizes the reporting burden on any
9 party to the bulk cheese transaction. IDFA considers this
10 verification process necessary for all dairy product prices
11 used to calculate minimum prices for milk under Federal Milk
12 Marketing Orders.

13 7) The adjustment to the NASS survey price of
14 cheddar cheese in 500-pound barrels and 640-pound blocks
15 should be reduced from the three cents per pound of cheese
16 to one cent per pound of cheese. Under current Federal
17 Order pricing, the NASS dairy products prices survey price
18 for cheddar cheese sold in 500-pound barrels has a price
19 adjustment.

20 During the informal rule-making process leading to
21 the final rule, it appears that this was entirely based on
22 the historical difference between the wholesale price of
23 cheddar cheese sold in 40-pound blocks and the moisture
24 adjusted to 39 percent moisture wholesale price for cheddar
25 cheese sold in 500-pound barrels.

1 This three cents per pound of cheese has often
2 been cited as representing the difference in the costs of
3 manufacturing and especially packaging cheddar cheese in
4 these two package sizes. However, this three cents really
5 consists of two components.

6 The first relates to the actual differences in
7 cost of manufacturing between 40-pound blocks and 500-pound
8 barrels. The second relates to the fact that in the market,
9 the price received for cheddar cheese in 500-pound barrels
10 is adjusted to 39 percent moisture while the actual percent
11 moisture for cheddar cheese in 40-pound blocks is about 38
12 percent so I am told.

13 Therefore, this part of the three cents is only
14 due to the difference in the moisture content of the cheese
15 in the two sizes. Since yield formulas for cheddar cheese
16 are based on the percent moisture in the cheese, milk with
17 the same level of components will result in a different
18 yield of cheese at different moisture levels in the cheese.

19 For example, cheddar cheese in 500-pound barrels
20 is frequently reported to average about 35 percent moisture
21 in the NASS dairy products prices survey while I am told
22 that cheddar cheese in 40-pound blocks is usually found to
23 have about 38 percent moisture. An equivalent volume of
24 farm milk with the same component levels will therefore
25 result in fewer pounds of cheddar cheese made into 500-pound

1 barrels than if the same milk was made into 40-pound block
2 cheese.

3 This is seen in the following table where despite
4 receiving a higher moisture adjusted price per pound of
5 cheese in the marketplace, the fact that there are fewer
6 pounds to sell from the same volume of farm milk with
7 identical component tests is critical.

8 As you can see, the result of a three-cent
9 difference in the price of cheese in 40-pound blocks versus
10 a 39-percent moisture adjusted price of cheese in 500-pound
11 barrels is only 9.1 cents per hundred-weight of milk, or
12 only 0.92 cents rounded per pound of 40-pound block yield.

13 The bottom line is that per pound of 40-pound
14 block yield, a manufacturer of cheddar cheese in 500-pound
15 barrels has only a 0.92 cents advantage over a manufacturer
16 of 40-pound blocks, not three cents per pound. Therefore,
17 the other part of the three cents, 2.08 worth, which is
18 three cents minus 0.92, is due to the moisture only.

19 8) The butter price should be reduced by six cents and for
20 all classes.

21 MR. BESHORE: Your Honor?

22 JUDGE HUNT: Yes, Mr. Beshore.

23 MR. BESHORE: At this point I would like to object
24 to Dr. Yonkers testifying to the proposals -- purporting
25 testifying to the proposals which would reduce or change

1 prices other than Class III or Class IV prices. The hearing
2 notice states that the hearing was called in response to the
3 mandate from Congress in the Consolidated Appropriations Act
4 of 2000 which requires the Secretary of Agriculture to
5 conduct a formal rule-making proceeding to reconsider the
6 Class III and Class IV milk pricing formulas in the final
7 rule.

8 That same legislation as we know and as the Courts
9 have ruled in litigation leading up to that legislation --
10 that legislation mandated implementation of the other
11 provisions of the final rule, but allowed these Class III
12 and Class IV formulas only to be reconsidered. And that is
13 what has been done at this mandated rule-making hearing.

14 Any attempts to make changes in Class I and Class
15 II prices which is what is being done in the testimony about
16 to be presented is an attempt to bootstrap into this
17 proceeding changes in prices which should not and cannot be
18 considered.

19 JUDGE HUNT: You have looked at this testimony.
20 You have covered the -- you anticipate this is what he is
21 going to say?

22 MR. BESHORE: I have read it. It has been
23 distributed. It is available. I know what it is going to
24 say. And I know what the impact of it is. And we object to
25 it.

1 JUDGE HUNT: Mr. Cooper, have you reviewed this
2 testimony he objects to as being outside the scope of the
3 hearing?

4 MR. COOPER: The scope of the hearing specifically
5 has proposals in it that address the effect on Class I and
6 II prices.

7 JUDGE HUNT: As it affects those classes.

8 MR. COOPER: Yes.

9 JUDGE HUNT: So you don't feel it is outside the
10 scope of the hearing then.

11 MR. COOPER: I don't feel that it is outside the
12 scope.

13 JUDGE HUNT: All right. Then I will overrule your
14 objection, Mr. Beshore. You can continue, Mr. Yonkers.

15 THE WITNESS: Thank you, Marvin, for the break.
16 USDA historically has used the wholesale Grade A butter
17 price in any formulas to determine the minimum price of
18 butterfat used under Federal Order regulation. This was
19 true when the Chicago Mercantile Exchange's Grade A butter
20 market was operating when this wholesale price was used in
21 the calculation of the butterfat differential.

22 When the CME eliminated the trading of Grade A
23 butter, USDA substituted the CME Grade AA butter price minus
24 nine cents which represented the historical difference
25 between these two grades of butter. Currently, the NASS

1 survey price for butter used in the final rule Class III and
2 IV product price formulas for butterfat is based on a survey
3 of only Grade AA butter prices.

4 The final rule uses this NASS Grade AA butter
5 price without any adjustments to represent the difference
6 between Grade AA and Grade A butter. The resulting higher
7 value for butterfat under the final rule appears to be
8 unintended as the final rule never discusses the matter.

9 IDFA proposes, proposal number 4, that USDA adjust
10 the butter price used in the product price formulas by six
11 cents to correct the fact that the NASS dairy products
12 prices survey is only of Grade AA butter. This would base
13 the value of butter used to determine the minimum price of
14 butterfat on an equivalent to the Grade A butter price.

15 This change to the butterfat value should apply to
16 all classes of milk including Class II. In the final rule,
17 USDA noted that, "Butterfat used in Class II products
18 competes on a current month basis with butterfat used in
19 cheese and butter. And its price should be determined on
20 the basis of the same month's values." This is sound
21 economics.

22 A failure to adjust the butterfat price equally
23 for all classes raises the real prospect of an increase in
24 the substitution of lower priced Class IV products for
25 higher class milk. Even under the current final rule

1 provisions, if butter prices rise substantially over a short
2 period of time, a strong economic incentive exists to
3 advance purchased butterfat in the form of Class IV products
4 such as butter or anhydrous milk fat.

5 This occurs if butter prices rise more than the
6 cost of converting butter fat to butter. In the final rule
7 make allowance, just this cost is 11.4 cents per pound for
8 anhydrous milk fat and then back to a form for use in
9 further manufacturing. Of course, the cost of storing
10 butter or anhydrous milk fat for those few months must also
11 be taken into account.

12 Adopting the six-cent reduction in butter fat
13 prices in Class IV only, suggested in proposal number 8,
14 would provide significant added incentive to advance
15 purchase Class IV butterfat products and store them.
16 Furthermore, the incentive to substitute would be just as
17 strong for Class III manufacturers as for Class II handlers
18 if the six-cent reduction only applied to Class IV.

19 Cheese manufacturers can use butter in making
20 cheese. And they would have the same incentive as a Class
21 II handler to advance purchase butterfat as a Class IV
22 product rather than buying butterfat in producer milk.

23 In short, adopting a proposal that changes the
24 relative prices of butterfat in Class II and IV effectively
25 increases the Class II differential in butterfat from 0.7

1 cents to 6.7 cents, would clearly increase the frequency of
2 substitution of Class IV butterfat products for producer
3 milk, the type of disorderly marketing that the Federal
4 Order System was designed to eliminate.

5 In addition, proposal number 3 would subtract six
6 cents from the NASS butterfat price used in the butter
7 product price formula in three classes of milk, IV, III and
8 II. IDFA supports proposal 3 only in conjunction with the
9 proposal number 4 which would extend this price adjustment
10 to Class I, also.

11 Currently, the Class I differential between the
12 price of butterfat in both Class III and IV versus Class I
13 is equal to the location-specific Class I differential
14 divided by 100 per pound of butterfat. And an average Class
15 I differential of \$2.60 per hundred-weight of milk as
16 reported by USDA in the regulatory impact analysis of the
17 final rule.

18 This results in a Class I differential of 2.6
19 cents per pound of butterfat. Adopting either proposal
20 numbers 3 or 8 would increase this differential to 8.6 cents
21 per pound of butterfat, an increase in the Class I
22 differential for butterfat of over 230 percent.

23 IDFA would first note that the current Class I
24 differentials were mandated by Congress. Second, proposal
25 number 3 would add an additional level of complexity in the

1 dairy market as handlers selling Class II fluid cream
2 products likely would have to institute a much sharper
3 relative price difference between Class I fluid milk
4 products of differing butterfat contents than for Class II
5 fluid milk products of differing butterfat contents.

6 9) Any increase in the Class IV skim milk price
7 should be reflected in an equal and opposite decrease in the
8 70-cent differential. Several proposals would have the
9 effect of increasing the Class IV skim milk price, proposals
10 number 27 and 28. I have already explained why these
11 proposals should not be adopted.

12 MR. ROSENBAUM: Just to clarify, the word, "not",
13 should be inserted in that sentence, Dr. Yonkers. Is that
14 right?

15 THE WITNESS: I have already -- yes, yes. I agree
16 with you. I have already explained why these proposals
17 should not be adopted. But if any are adopted, then USDA
18 needs to also reduce the Class II differential by an equal
19 and opposite amount. I will now explain why this is so.

20 In the final rule, USDA noted that, "Generally,
21 the source of inputs alternative to producer milk for the
22 manufacture of Class II products is dry milk products and
23 butterfat that would otherwise be used in butter."

24 "Basing this price of milk used to make Class II
25 products on these alternative ingredients should help

1 considerably to remedy a situation in which it is perceived
2 that a separate product class for dry milk, Class IIIA, has
3 resulted in a competitive advantage over producer milk used
4 to produce Class II products."

5 "The 70-cent differential between Class IV and
6 Class II skim milk prices is an estimate of the cost of
7 drying condensed milk and re-wetting the solids to be used
8 in Class II products."

9 This analysis is basically sound leaving aside for
10 today whether the 70 cents is the right number. But it is
11 more accurate to state that the price relationship on which
12 the focus is not that between Class IV and Class II skim
13 milk prices, but rather that between the wholesale price of
14 nonfat dry milk and the Class II skim price.

15 It is the relationship between these two prices
16 that determines whether a processor has an economic
17 advantage to switch from using Class II skim milk to Class
18 IV nonfat dry milk. When a processor does so, farmers are
19 the losers because they lose the right to obtain the higher
20 price that Class II milk obtains.

21 As I have noted, some of the proposals would raise
22 the Class IV skim price. But for the reasons I have already
23 outlined in Section 1A of this testimony, any changes
24 resulting from this hearing in the Class IV skim milk price
25 will have no direct effect on the wholesale price of nonfat

1 dry milk.

2 However, any increase in the Class IV skim price
3 would increase the Class II skim price by the same amount
4 given that the Class II skim price is the Class IV skim
5 price plus 70 cents.

6 In the final rule, USDA determined that the
7 correct relationship between the wholesale value of nonfat
8 dry milk and the Class II skim milk price should be 70 cents
9 per equivalent unit. If that relationship is to be
10 maintained, then any increase in the Class IV skim milk
11 price and the resultant increase in the Class II skim milk
12 price must be offset by an equal and opposite decrease in
13 the 70-cent Class II differential.

14 Without such an adjustment, the difference in
15 value between wholesale sales value of nonfat dry milk and
16 of the Class II skim milk price would increase, resulting in
17 an increase in the incidence of using alternative Class IV
18 ingredients as a substitute for skim milk in Class II
19 products.

20 JUDGE HUNT: I am going to interrupt at this
21 point, Mr. Yonkers. I understand we have the room until
22 6:00. And I don't think it is likely you are going to be
23 finished by that time. So we will interrupt you and we will
24 take you first thing in the morning at 8:00 at this point.

25 Before we recess for the evening, is there any

1 housekeeping matters, anything to take care of? Yes, Mr. --

2 MR. YALE: I just have a question. What is going
3 to be the schedule for tomorrow? Are we going to try to do
4 8:00 to 5:00? I mean, that is fine. I just need to know
5 the -- although we --

6 JUDGE HUNT: Yes, 8:00 to 5:00. We've just got --
7 we got into this more than I was probably estimating. But
8 it will be 8:00 to 5:00, yes, 8:00 to 5:00.

9 MR. YALE: Okay. And the other question is
10 because of the internet, is that the reason we are going to
11 be reading the testimony? Is that --

12 MS. BRENNER: No.

13 JUDGE HUNT: No. It is to read in -- this is the
14 procedure, is to give the testimony.

15 MR. YALE: Okay. That's fine.

16 MS. BRENNER: We do have some people that are
17 planning to come tomorrow --

18 MR. YALE: At what time?

19 MS. BRENNER: Sometime during the day.

20 MR. YALE: I mean, I am willing to work. I just
21 need to know --

22 JUDGE HUNT: All right. Let's see, is this -- we
23 can go off the record on this. Yes.

24 //

25 //

1 (Whereupon, at 5:54 p.m., the hearing in the
2 above-entitled matter was adjourned until Tuesday, May 9,
3 2000 at 8:00 a.m.)

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1 CERTIFICATE OF REPORTER, TRANSCRIBER AND PROOFREADER

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 8, 2000

9 Date of Hearing

10 We, the undersigned, do hereby certify that the
11 foregoing pages, numbers 1 through 320 , inclusive,
12 constitute the true, accurate and complete transcript
13 prepared from the tapes and notes prepared and reported by
14 Sharon Bellamy, who was in attendance at the above
15 identified hearing, in accordance with the applicable
16 provisions of the current USDA contract, and have verified
17 the accuracy of the transcript (1) by preparing the
18 typewritten transcript from the reporting or recording
19 accomplished at the hearing and (2) by comparing the final
20 proofed typewritten transcript against the recording tapes
21 and/or notes accomplished at the hearing.

22 May 10, 2000 Bonnie Niemann

23 Date

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