

1                   THE UNITED STATES DEPARTMENT OF AGRICULTURE  
2   In the Matter of:                   )  
3   MILK IN THE NORTHEAST,            )  
4   AND OTHER MARKETING AREAS,        )  
5                   Petitioner,        )  
6                   )   Docket No.:   A0-14-A69 et al,  
7   v.                                 )                   DA-003  
8   UNITED STATES DEPARTMENT         )  
9   OF AGRICULTURE,                    )  
10                   Respondent.        )  
11                                       Virginia Room A  
12                                       Embassy Suite Hotel  
13                                       1900 Diagonal Road  
14                                       Alexandria, VA  
15                                       Thursday,  
16                                       May 11, 2000  
17                   The hearing in the above-entitled matter was  
18   convened, pursuant to notice, at 8:03 a.m.  
19                   BEFORE: HONORABLE JAMES W. HUNT  
20                                       Administrative Law Judge  
21                   APPEARANCES:  
22                   On Behalf of the USDA:  
23                   GREGORY COOPER, Esquire  
24                   Office of General Counsel  
25                   United States Department of Agriculture  
26                   CONSTANCE M. BRENNER, Dairy Market Specialist  
27                   CAROL S. WARLICK  
28                   Dairy Programs  
29                   Agricultural Marketing Service  
30                   HENRY H. SCHAEFER, Chief Agricultural Economist  
31                   Federal Milk Market Administration  
32                   Minneapolis, Minnesota

1 APPEARANCES: (cont'd.)  
2 Participants:  
3 MARVIN BESHORE  
4 PAUL CHRIST  
5 CYRUS S. COCHRAN  
6 ED COUGHLIN  
7 NANCY DANIELSON  
8 JAMES R. DAVIS  
9 JAMES EICHSTADT  
10 CHARLES ENGLISH  
11 STEVEN D. ETKA  
12 PAM FESTGE  
13 TIM GALLOWAY  
14 CHARLES GARRISON  
15 NEIL S. GULDEN  
16 PETER L. HARDIN  
17 ELVIN HOLLON  
18 WILL HUGHES  
19 JERRY KOZAK  
20 TOM LANDIS  
21 KENNETH MAHALKO  
22 RICHARD NEWPHER  
23 SEAN W. NOLAN  
24 HENRY L. PARR  
25 THOMAS PITTMAN  
26 CARL RASCH  
27 STEVEN ROSENBAUM  
28 LELAND SWENSON  
29 AUDREY THRONE  
30 LINWOOD TIP  
31 CONNIE TIP  
32 WILLIAM VARGULICK

1 APPEARANCES: (cont'd.)  
2 Participants:  
3 AARON WIDRICK  
4 JOHN WILSON  
5 WALT WOSJE  
6 BEN YALE  
7 BOB YONKERS  
8 DEBORAH VANDYKE  
9 SYDNEY BERDE  
10 DOUG MARSHALL  
11 JOHN VETNE  
12 MIKE MCCLUSKEY  
13 KEN OLSON  
14 FRANK PACHECO  
15 ARDEN TEWKSBURY  
16 RANDY JASPER  
17 BONITA DAVIS  
18 HANK ROSENBAUM  
19 DR. DAVID BARBANO  
20 J. BRADLEY OLSEN  
21 MIKE BROWN  
22 JOAQUIN CONTENTE  
23 ERNEST YATES  
24 MARTIN SCHANBACK  
25 KRISTINE REED  
26 GEOFFREY VANDEN HEUVEL  
27 DENNIS SHAD  
28 MARK STEPHENSON  
29 CLAY GALARNO  
30 WILLIAM TINKLEPAUGH

|    |                     |                 |       |          |         |      |
|----|---------------------|-----------------|-------|----------|---------|------|
| 1  |                     | C O N T E N T S |       |          |         |      |
| 2  |                     |                 |       |          |         | VOIR |
| 3  | WITNESSES:          | DIRECT          | CROSS | REDIRECT | RECROSS | DIRE |
| 4  | Michael Reinke      | 1033            | 1049  | 1086     | 1087    |      |
| 5  | Francis Pacheco     | 1100            | 1128  |          |         |      |
| 6  | William Schiek      | 1151            | 1164  | 1176     | 1177    |      |
| 7  | Neil Gulden         | 1181            | 1183  |          |         |      |
| 8  | Dennis Schad        | 1194            | 1233  | 1235     |         |      |
| 9  | Paul Christ         | 1241            | 1243  |          |         |      |
| 10 | Robert Lenahan      | 1251            | 1256  | 1268     | 1269    |      |
| 11 |                     |                 |       | 1271     | 1271    |      |
| 12 | Thomas Eastham      | 1275            | 1279  |          |         |      |
| 13 | Jeffry Williams     | 1294            | 1304  |          |         |      |
| 14 | Greg Dryer          | 1320            | 1325  |          |         |      |
| 15 | Mary Keough Ledman  | 1327            | 1346  |          |         |      |
| 16 | Dan Blaise          | 1372            | 1377  | 1382     | 1382    |      |
| 17 |                     |                 |       | 1384     | 1384    |      |
| 18 | C. K. Venkatachalam | 1387            | 1400  |          |         |      |
| 19 |                     |                 |       |          |         |      |

| E X H I B I T S |           |            |          |                        |
|-----------------|-----------|------------|----------|------------------------|
|                 | EXHIBITS: | IDENTIFIED | RECEIVED | DESCRIPTION            |
| 1               |           |            |          |                        |
| 2               |           |            |          |                        |
| 3               | 30        | 1034       | 1046     | Charts by Kraft Food   |
| 4               | 30(a)     | 1250       | 1250     | Clean Copy of Exhibit  |
| 5               |           |            |          | 30                     |
| 6               | 31        | 1127       | 1150     | Francis Pacheco        |
| 7               |           |            |          | Testimony & Charts     |
| 8               | 32        | 1134       | 1150     | 1999 Monthly Averages  |
| 9               |           |            |          | from CME               |
| 10              | 33        | 1197       | 1208     | Attachments from Schad |
| 11              |           |            |          | Testimony              |
| 12              | 34        | 1215       | 1233     | Letter from John       |
| 13              |           |            |          | Vorchec                |
| 14              | 35        | 1251       | 1275     | Dairy Plant Product    |
| 15              |           |            |          | Loss Analysis          |
| 16              |           |            |          | Utilizing Effluent BOD |
| 17              | 36        | 1329       | 1346     | Mary Ledman CV         |
| 18              | 37        | 1331       | 1346     | Comparison Monthly     |
| 19              |           |            |          | Average NASS Grade AA  |
| 20              |           |            |          | Butter Prices & CME    |
| 21              |           |            |          | Grade AA Butter Prices |
| 22              | 38        | 1331       | 1346     | Letter from Paul       |
| 23              |           |            |          | Christ                 |
| 24              | 39        | 1331       | 1346     | Statement by Constance |
| 25              |           |            |          | Tipton                 |
| 26              | 40        | 1332       | 1346     | Impact Analysis of     |
| 27              |           |            |          | Proposals 3 and 8, at  |
| 28              |           |            |          | Test                   |
| 29              | 41        | 1386       | 1416     | C.K. Venkatachalam's   |
| 30              |           |            |          | Statement with Charts  |

## 1 P R O C E E D I N G S

2 (8:03 a.m.)

3 JUDGE HUNT: On the record.

4 Whereupon,

5 MICHAEL REINKE

6 having been first duly sworn, was called as a witness herein  
7 and was examined and testified as follows:8 JUDGE HUNT: Would you state and spell your name,  
9 Mr. Reinke?10 THE WITNESS: My name is Michael Reinke,  
11 R-E-I-N-K-E.12 MR. VETNE: Your Honor, once again I'm John Vetne  
13 appearing for Kraft Foods, Inc. Mr. Reinke is a witness for  
14 Kraft.

## 15 DIRECT EXAMINATION

16 BY MR. VETNE:

17 Q Mr. Reinke, before you proceed with your written  
18 testimony can you please give a thumbnail sketch of your  
19 experience and employment in this industry?20 A For approximately the last 19 years I've worked  
21 for Kraft Foods in various milk procurement capacities. I'm  
22 currently Category Manager for Milk which is I guess a fancy  
23 way of saying I'm responsible for buying the milk for Kraft,  
24 and included in that is any regulatory issues that pertain  
25 to milk for Kraft.

1           Like I say, I've done that for 19 years, and prior  
2   to that I worked for the Market Administrator, Order 30, for  
3   10 years in Chicago, primarily in field audit.

4           MR. VETNE: Your Honor, Mr. Reinke has a prepared  
5   statement to which are attached three attachments.

6           I don't propose to mark his testimony as an  
7   exhibit, but I have placed on your table four copies of the,  
8   bound together of the three pages of attachments which I  
9   would like to have marked for identification as the next  
10  consecutive exhibit.

11          JUDGE HUNT: We'll mark that as proposed Exhibit  
12  No. 30.

13                                           (The document referred to was  
14                                           marked for identification as  
15                                           Exhibit No. 30.)

16          BY MR. VETNE:

17          Q   Mr. Reinke, would you proceed with your prepared  
18  statement, please?

19          A   Kraft Foods is a member of the National Cheese  
20  Institute and IDFA. This testimony is presented in support  
21  of the IDFA hearing proposal and in opposition to all  
22  proposals not consistent therewith.

23           I do not wish to duplicate IDFA's testimony, but  
24  rather highlight some issues of policy which we deem  
25  critical to a final decision and illustrate from our own

1 experience facts which we believe must be considered to  
2 achieve a result consistent with longstanding administrative  
3 policy and rational economic analysis.

4 Kraft procures cheese on a regular basis from its  
5 own plants and other plants located in California, Arizona,  
6 Idaho, Minnesota, South Dakota, North Dakota, Wisconsin,  
7 Illinois, Iowa, and Vermont. Kraft operates its own  
8 manufacturing and processing facilities in nine states.  
9 These include six dairy plants in New York with principal  
10 products as follows: Walton, cottage cheese and sour cream;  
11 North Lawrence, cottage cheese and yogurt; South Edmonston,  
12 yogurt; Campell, Italian cheese; Canton, cheddar cheese; and  
13 Lowville, cream cheese.

14 Our Farmdale, Ohio plant produces cottage cheese  
15 and sour cream. Our Allentown, Pennsylvania plant makes  
16 processed cheese, as does our plant in Champaign, Illinois  
17 and New Ulm, Minnesota.

18 Our plant in Melrose, Minnesota makes Italian and  
19 cheddar cheese. The Springfield, Missouri plant makes cream  
20 cheese and processed cheese. Bentonville, Arkansas produces  
21 cheddar for process. The Rupert, Idaho plant makes cream  
22 cheese and low fat cheddar.

23 In California our plant at Visalia makes cottage  
24 cheese, sour cream, non-fat dry milk, and butter. And the  
25 Tulare plant makes Italian cheese.

1           Kraft has closed many manufacturing plants over  
2   the last 20 years and rely increasingly on dairy products we  
3   purchase from others.

4           Similar to national production trends, we have  
5   continued to increase our purchases and production from the  
6   Western states. Six year ago we built in Tulare and have  
7   recently expanded its capacity. This replaced cheese we  
8   previously produced in the Midwest.

9           We began sourcing cheese from Idaho eight years  
10   ago. We significantly increased purchases from California  
11   and Arizona in 1995 and 1999 respectively.

12           We purchase cream from numerous states throughout  
13   the U.S. In total we purchase slightly less than 10 percent  
14   of the U.S. milk supply in the form of milk, cheese, non-fat  
15   or cream.

16           Administrative policy considerations. USDA's  
17   policy for pricing raw milk used in manufactured Class 3 and  
18   Class 4 products has evolved over the course of more than 60  
19   years and the experience of trial and occasional error.

20           Since the 1960s it has been USDA's policy to price  
21   manufactured milk based on the competitive value of that  
22   milk. This value was measured by unregulated prices  
23   included in the MW survey and the BFP through 1999.

24           Because of dwindling volume of unregulated milk  
25   transactions, USDA decided with consensus support of the

1 industry to calculate an imputed competitive value for  
2 manufactured milk by reference to unregulated prices paid  
3 for manufactured products.

4           For the recent 15 month period in which both NASS  
5 survey, cheese, whey, and butter prices and unregulated MW  
6 and BFP data was available, October 1998 through December  
7 1999, the reform decision class reproduct formula price  
8 actually exceeded or would have exceeded the competitive  
9 milk price by 20 cents per 100 weight at average components  
10 as calculated by the Chicago Market Administrator and  
11 reproduced in the first attached table.

12           To make the conversion from product price to farm  
13 price without a change in policy underlying the MW and the  
14 BFP formulas, it is necessary to ascertain and subtract a  
15 manufacturing margin reflecting manufacturers' costs from  
16 the point of raw farm purchases to finished product sale. A  
17 failure to account for any portion of these costs or to  
18 account for them fully would conflict with federal policy  
19 that administered prices should resemble the market rather  
20 than interfere with the market, as the Secretary reiterated  
21 in his final reform decision published last April.

22           In further applicational policy, USDA has not  
23 tried to capture a fixed value at the regulated price, but  
24 rather a minimum value allowing market premiums to make  
25 competitive adjustments from region to region, plant to

1 plant, and product to produce far more efficiently than  
2 price regulation can accomplish.

3 When administered pricing interferes with the  
4 market, the market responds with results that are sometimes  
5 not intended by the agency and are frequently inconsistent  
6 with economic efficiency of public interest.

7 For example in the late 1980s the administered  
8 milk price for powdered use prevented recovery of  
9 manufacturer costs and product sales. Producers and  
10 manufacturers therefore attempted to avoid use of milk in  
11 powder. The margin or profitability problem was fixed by a  
12 new class or 3A Class price which triggered a sharp increase  
13 in the flow of farm milk to non-fat dry milk plants. But  
14 much of the powder was then used as a low cost raw product  
15 alternative for producer milk and cheese in Class 2  
16 products.

17 Administrated prices inevitably do interfere with  
18 the market. The objective, as consistently explained by  
19 USDA in the past, is to keep interference to a minimum.

20 In this proceeding several proposals will  
21 significantly change the raw milk and finished product  
22 competitive relationships between cheddar cheese and other  
23 cheese, between Class 3 and Class 4 milk, between  
24 manufactured product uses and Class 1 or 2, and between fat  
25 uses in every class.

1           Several proposals unabashedly seek to use this  
2   hearing to reverse the past agency policy and to fix an  
3   administered price of milk above competitive values applied  
4   in the past. These proposals we feel go beyond the mandate  
5   of Congress last fall which was to hold a formal,  
6   evidentiary hearing to justify the manufacturing formula  
7   because it differed from early proposals and the expedited  
8   notice and comment rulemaking process. Congress did not  
9   tell USDA to do an about-face in its long term milk pricing  
10  policies.

11           Product price formula considerations. As noted  
12  above, actual plant margins between raw milk purchases and  
13  finished product sales have always been implicitly included  
14  in the MW/BFP formula. They should be captured in a formula  
15  now when product prices are used to derive an implicit milk  
16  value

17           For example, administrative costs, procurement  
18  costs and marketing costs are both real and necessary to  
19  convert raw farm milk to a milk product and a finished  
20  product sale. It is, after all, the sale price which is  
21  measured by the NASS survey.

22           The Kraft cheddar cheese plants in Canton and the  
23  whey processing plants in Tulare participated in the NCI  
24  cost survey. Both plants experienced costs greater than the  
25  weighted average in that survey for a number of reasons.

1           As to other formula details I offer the following  
2   in further support of the IDFA proposal.

3           Pricing Class 3 fat. Fat pricing issues include  
4   fat recovery in cheese and the value of fat not recovered  
5   but which comes out in the whey. Our Canton cheddar plant  
6   recovers in cheese about 88 percent of the fat that goes  
7   into the vat. This is partly because we add cream to  
8   standardize the milk to achieve the desired fat content in  
9   cheese.

10           Our Italian cheese mozzarella plant in Campell  
11   recovers less of the fat which goes into the vat than the  
12   average cheddar plant, which the Secretary found in the  
13   April 1999 decision, and Dr. Barbano has confirmed in prior  
14   testimony as typical of mozzarella plants.

15           Since all cheese plants are subject to the Class 3  
16   price, lower fat recovery of part skim and other non-cheddar  
17   cheeses must also be taken into account in the pricing  
18   formula. Like all plants, we also experience loss of fat  
19   between the farm gate and our cheese vat or from farm gate  
20   through someone else's separator to our vat in the form of  
21   cream. All this milk must be accounted for at the Class 3  
22   price, not just the milk that ends up in the vat.

23           Therefore, any yield or fat recovery expressly or  
24   implicitly included in the formula must account fully for  
25   shrinkage between farm and the vat so that the yield or fat

1 recovery is not artificially or arbitrarily inflated.

2           Additionally, the 10 percent or more of fat that  
3 is not recovered but is sold instead in whey cream or whey  
4 butter does not command a market price equal to fat and  
5 cheese or fat and butter.

6           Kraft typically is able to recover a market value  
7 for fat and whey cream which is about 40 cents per pound  
8 less than the market value of fat and fresh cream. This is  
9 because it is sold at below the market price for fat and  
10 grade A butter, uses a lower multiplier, and Kraft pays  
11 transportation to the buying handler.

12           Since the Class 3 fat price applies regardless of  
13 whey fat market price, the price losses and marketing costs  
14 as well as plant make costs must be captured as part of the  
15 cost to make cheese in any Class 3 product price formula.

16           Whey processing costs. There is consensus in  
17 testimony at this hearing that it costs more to dry whey  
18 than to dry non-fat dry milk. There are not only lower  
19 solids in whey, more water to remove, but also an additional  
20 manufacturing step.

21           In California, our whey plant make costs at Tulare  
22 are about 2.6 cents per pound greater than our non-fat dry  
23 milk costs at Visalia. Although the Tulare plant is large  
24 and efficient, it also represents a recent capital  
25 investment, thus depreciation costs add to the mix.

1           However, if an indirect result of regulated price  
2   is to force manufacturers to improve efficiencies,  
3   investments costs not now included in cost audits and  
4   surveys must be anticipated.

5           USDA must also consider that many cheese plants do  
6   not process whey but rather dispose of it for transportation  
7   and sale to another facility. Some plants may still dump  
8   whey for spreading as fertilizer or waste product. These  
9   are real costs to real plants and must not be ignored in  
10   fixing a minimum price which is flexible enough to reflect  
11   rather than interfere with the market.

12           Products and transactions used to derive Class 3  
13   prices. Kraft supports the NC IDFA proposal to employ the  
14   NASS survey and include both block and barrel prices  
15   surveyed. Even this would represent prices for only one-  
16   third of all cheese produced.

17           Reliance on the CME prices alone would measure  
18   from a much thinner market and exclude the substantial and  
19   growing volume of cheese produced in the Western states,  
20   particularly California, as reflected in the third  
21   attachment. Barrel as well as block cheddar transactions  
22   should be included in the survey, but an apples to apples  
23   adjustment per barrel and block price differences should not  
24   be more than one cent to account for packaging and testing  
25   differences as described in the attached table.

1           Further, if participation in the survey is not  
2   mandatory and not audited, the USDA should independently  
3   survey buyers to verify prices and reconcile any reporting  
4   differences.

5           Kraft supports the inclusion of 640 pound blocks  
6   in the NASS survey. Based on our assessment, 640 pound  
7   blocks represents 12 percent of total annual U.S. cheese  
8   production of approximately 7.5 billion pounds, and 27  
9   percent of total cheddar production. Increasing the number  
10   of transactions and volume of cheese included in the NASS  
11   survey will improve the reliability of its use as a measure  
12   of average cheddar cheese value for milk pricing purposes,  
13   enhance industry confidence in the system, and mitigate some  
14   concerns about the lack of mandatory reporting of  
15   transactions.

16           Finally, Kraft supports the IDFA proposal for an  
17   adjustment on regulated butterfat prices in all use  
18   classifications.

19           Prior to the final rule, milk fat used to produce  
20   butter was priced at Class 3 and the same fat price applied  
21   to Class 2 products plus a specified differential.

22           The final rule continued that practice although  
23   the applicable Class 2 differential was increased.  
24   Adjusting butterfat prices in Class 4 only will  
25   inappropriately create further distortion between the

1 competitive relationship between fat in Class 2 and fat in  
2 Class 4.

3 Thank you for this opportunity to present our  
4 views.

5 Q That concludes your prepared testimony, Mr.  
6 Reinke?

7 A Yes, it does.

8 MR. VETNE: Your Honor, there was reference in the  
9 testimony to three attachments which have previously been  
10 separately marked and I neglected to note the exhibit  
11 number.

12 JUDGE HUNT: Thirty.

13 BY MR. VETNE:

14 Q Mr. Reinke, could you briefly look at the  
15 attachments and describe what is contained therein and the  
16 source, please?

17 A The first one is a comparison of average Midwest  
18 components. This is some information that I and others had  
19 requested from the Market Administrator in Chicago. When  
20 the final rule first came out there was a lot of confusion  
21 on what that price actually would return to dairy farmers.  
22 People kept referring to a 3-5 milk price and very little  
23 milk is actually at 3-5.

24 So they did a calculation based on average  
25 components for the 15 month period when we had the NASS

1 survey results for all the components used in the pricing  
2 formulas, and they did a simple weighted average that said  
3 that price would have averaged 20 cents higher.

4 Q These numbers and this first page of attachment  
5 then came directly from the Chicago Market Administrator's  
6 Office?

7 A That's correct.

8 Q The second page of your attachments, the heading  
9 of which, "These are the main milk-producing states."  
10 Describe it and it's source, please.

11 A This is just the USDA reported data on production  
12 of milk in the major milk-producing states for a period of  
13 1990 through 1999 showing the growth in those states.

14 Q This is production of milk as opposed to cheese

15 A I'm sorry, it's cheese, yeah.

16 Q Thank you. And the third page?

17 A We do a calculation because we buy a lot of  
18 cheese, both in 640 block and barrels, primarily 640 and  
19 barrels, and we do a calculation of what the cost difference  
20 is between a 40 pound block plant and a barrel plant, and  
21 traditionally barrels trade about three cents below blocks.  
22 This calculation indicates that that's due primarily for two  
23 reasons. One is a cost difference of about a penny a pound,  
24 and the other a difference of about two cents a pound due to  
25 the moisture adjustment that a barrel producer receives on

1 his cheese that a block producer does not receive.

2 Q This third page of the Exhibit No. 30 was prepared  
3 by Kraft?

4 A Yes.

5 Q It is the type of information that is analyzed by  
6 Kraft on a regular basis for business reasons, is that  
7 correct?

8 A Yes. Like I previously said. Obviously we have  
9 to be able to attract cheese, and we compete a lot of times  
10 with plants that make both 40 pound blocks and barrels, and  
11 this is our analysis of the differences that would keep a  
12 block or barrel plant whole, on equal terms.

13 MR. VETNE: Your Honor, with that explanation and  
14 the reference in the prepared testimony I would move the  
15 receipt of Exhibit 30.

16 JUDGE HUNT: Any objections to proposed Exhibit  
17 30?

18 (No audible response)

19 JUDGE HUNT: Hearing no objections, Exhibit 30  
20 will be received into evidence.

21 (The document referred to,  
22 having been previously marked  
23 for identification as Exhibit  
24 No. 30, was received in  
25 evidence.)

1 BY MR. VETNE:

2 Q Mr. Reinke, there has been testimony by several  
3 prior witnesses, soft testimony, expressing a common  
4 practice in cheese plants or perhaps just in cheddar cheese  
5 plants of recycling whey cream into a subsequent vat of  
6 cheese.

7 With respect to your cheddar cheese plants, is  
8 that something that Kraft does?

9 A No, I think I indicated in my testimony that we do  
10 add cream, and that is sweet cream, and we do sell cream  
11 which is whey cream, and I guess one thing I haven't heard a  
12 lot of in this hearing is where the consumer is in all of  
13 this. But we do a lot of testing of consumer desires, and  
14 what we have determined, two things. One is we want a  
15 consistent product going to consumers and secondly, they  
16 appear to prefer an aged cheddar that has a little higher  
17 fat value in it. So therefore we add sweet cream, and we  
18 think that gives us a better quality and flavor profile than  
19 trying to add whey cream.

20 Q Your decision not to add whey cream is a decision  
21 based on the quality of the finished product, is that  
22 correct?

23 A Yes.

24 Q And when you dispose of whey cream, you experience  
25 real costs and real losses, is that correct?

1           A     Correct. The market for whey cream is very  
2     limited and we're having to haul this or pay the  
3     transportation back to Ohio, I think is the location.

4           MR. VETNE: Your Honor, before we offer Mr. Reinke  
5     for Cross-Examination, I have one additional request for  
6     official notice.

7           Yesterday we noticed a joint publication of the  
8     State of California and USDA's National Agricultural  
9     Statistics Service. I would like to request official notice  
10    of a comparable publication jointly produced by the State of  
11    Wisconsin and NASS, and it's called "Wisconsin Dairy Facts".  
12    It is published annually. It contains a little bit more  
13    detail -- actually quite a bit more detail -- on state-  
14    specific information on cheese production plans than other  
15    NASS publications. And I'd like to request notice of those  
16    publications for the available years since and including  
17    1995.

18           JUDGE HUNT: Does anyone object to taking official  
19    notice of those documents referred to by Mr. Vetne?

20           (No audible response)

21           JUDGE HUNT: All right, no objections, then I'll  
22    take official notice of this document.

23           MR. VETNE: Thank you.

24           The witness is available for Cross.

25           JUDGE HUNT: Mr. Rosenbaum?

1 CROSS-EXAMINATION

2 BY MR. ROSENBAUM:

3 Q Good morning, Mr. Reinke. I wanted to focus my  
4 question on the last page of Exhibit 30.

5 Right now there is a three cent adjustment in the  
6 barrel price under the order, is that correct?

7 A There traditionally has been a three cent trading  
8 difference. When USDA, the final rule, added three cents to  
9 the barrel price and I think that was under maybe the  
10 misunderstanding that they thought the make costs  
11 differences in blocks and barrels were three cents. And  
12 probably 20 years ago or so it might have been. The barrel  
13 plants were the first plants that did modernize and scaled  
14 up. But since then blocks and barrels have similar scale,  
15 and much of that cost difference has gone away to the point  
16 that it's now about a penny.

17 Q And you're aware that one of the proposals of the  
18 International Dairy Foods Association is that that three  
19 cent adjustment be reduced to one cent. Correct?

20 A Correct.

21 Q And this calculation, the last page of Exhibit 30,  
22 goes to that question, correct?

23 A Correct.

24 Q And what you're trying to identify here is what is  
25 the actual difference in the cost of manufacturing 40 pound

1 blocks versus barrels, correct?

2 A Correct. Well, we said two cents of that was the  
3 moisture adjustment. The other one penny was the make cost  
4 difference.

5 Q Is it your view that the moisture difference is  
6 already accounted for elsewhere in the formula already?

7 A Yes.

8 Q By that I mean elsewhere in the formula that's  
9 already in the rule, correct?

10 A Correct.

11 Q So that by adjusting for three cents rather than  
12 one cent off the price, the current rule is double counting,  
13 correct?

14 A It's over-inflating the barrel price by two cents.

15 Q Could you just take us through what you've done  
16 here?

17 A There's four examples. One is the traditional  
18 block/barrel spread of three cents which assumed a block  
19 market of \$1.03 and a barrel market of \$1.27. Using the  
20 VanSlyke formula up above with those parameters in it it  
21 calculates what a net different return would be to a block  
22 producer versus a barrel producer which comes out to .009  
23 cents per pound.

24 Then it said if the block cost is a penny a pound  
25 above, right below that, it equates out to what the

1 equivalent revenue to each manufacturer would be, which  
2 would be a thousandths of a cent, I guess.

3 The third one tells you what kind of moisture  
4 you'd have to have in a block market to equate to an equal  
5 cost to a barrel producer.

6 The last one just takes that moisture value and  
7 calculates -- it's a two cent adjustment on moisture for a  
8 barrel producer.

9 Q So if I understand correctly, once you adjust for  
10 the difference in moisture, the price difference between  
11 blocks and barrels falls to .0092 dollars.

12 A Correct.

13 Q In other words, .92 cents. Correct?

14 A Yes, just under a penny.

15 Q So that's what represents the actual difference in  
16 the cost of manufacturing barrels versus blocks, correct?

17 A Yes.

18 Q That's why that adjustment to the NASS price in  
19 the formula is supposedly adjusting for the difference in  
20 the cost of manufacturing, ought to be one cent rather than  
21 three cents.

22 A Yes.

23 MR. ROSENBAUM: Thank you.

24 JUDGE HUNT: Mr. Coughlin?

25 MR. COUGHLIN: Good morning, Ed Coughlin.

1           Good morning, Mike.

2           THE WITNESS: Good morning.

3           BY MR. COUGHLIN:

4           Q    You identified earlier in your testimony here  
5    which of your plants make cheddar cheese. Which of the ones  
6    make blocks and which make barrels?

7           A    The Canton plant makes 640 blocks. The Ruppert  
8    plant that makes the low fat cheddar makes a 640 block. The  
9    plant in Melrose, Minnesota that primarily makes Italian  
10   cheese only makes cheddar when our Italian inventories are  
11   too high, makes barrels. And the Tulare, California plant  
12   primarily makes Italian cheese in barrels.

13                We make no 40 pound block, if that's your  
14   question.

15           Q    You make no 40 pound block. But you are  
16   testifying relative to some cost differences here?

17           A    The one plant that we had that was a cheddar plant  
18   that fit the criteria for the survey was Canton, New York,  
19   that made nothing but cheddar, and it makes it in 640s.

20           Q    Is it generally most efficient to make in larger  
21   sizes?

22           A    It used to probably be that way. Now you look at  
23   40 pound blocks collated into 640, there's not a big  
24   difference anymore.

25           Q    You made a decision then at Kraft that you

1 submitted manufacturing cost data for one plant but not all  
2 of your plants?

3 A Correct.

4 Q Why did you leave out the plants that you did not  
5 submit data for?

6 A Primarily because they weren't primarily a barrel  
7 cheese plant. They were making different styles of cheese  
8 and we were serving cheddar cheese. So my Minnesota plant  
9 and my Idaho plant makes cream cheese and I had a real  
10 dilemma on trying to apportion costs which is something we  
11 don't do to what was cheddar and what was cream cheese or  
12 what was Italian cheese and what was cheddar.

13 Q How about Bentonville, Arkansas now? You  
14 identified that as producing cheddar.

15 A Bentonville makes a proprietary style of cheddar  
16 cheese that doesn't fit any of the survey prices.

17 Q So you feel you submitted the data for all of the  
18 plants that would have been relevant to the determination of  
19 cost that's trying to be made?

20 A That's correct.

21 Q I noticed in your testimony on page four, it's  
22 right above that area where you're talking the product price  
23 formula considerations. You talk about what was the mandate  
24 of Congress was to hold a formal, evidentiary hearing to  
25 justify. Is that a term that was taken out of the statute?

1 Justify?

2 A Probably not. I think that's my language.

3 Q If I refreshed your memory, if the Congress used  
4 the term reconsider?

5 A Okay.

6 Q Over on page six of your testimony, under number  
7 two the bottom of the first paragraph, you make the  
8 statement, "However, if an indirect result of a regulated  
9 price is to force manufacturers to improve efficiency,  
10 investment costs" and then you say "not now included in cost  
11 audits and surveys must be anticipated."

12 Doesn't the present make allowance that's in the  
13 audit include return on investment?

14 A It's a return on investment, but not an investment  
15 cost.

16 Q Can you describe for me --

17 A Well I guess, there's been a lot of discussion on  
18 what is the appropriate yields, and I think there's a whole  
19 range of actual yields out there. I guess what we're  
20 saying, if plants are going to have to modernize to meet  
21 some new achievable average yield, there's an investment  
22 there that's not there now.

23 Q Isn't that captured as part of depreciation?

24 A Not currently, no. The investment's not there  
25 now.

1           Q     But in the surveys that are being made, there is a  
2     depreciation factor that's included --

3           A     I guess what I'm saying is there's a whole new  
4     level of investment. The depreciation levels will look much  
5     different in future surveys than they do now.

6           Q     Offsetting that there may be greater plant  
7     efficiencies, too.

8           A     What I'm saying, they may have to do that to meet  
9     the proposed yields.

10           MR. COUGHLIN: No further questions, thank you.

11           JUDGE HUNT: Mr. Yale, you've been patient. Do  
12     you have a question?

13           MR. YALE: No. Thank you, Your Honor.

14           JUDGE HUNT: Mr. Christ?

15           MR. CHRIST: Thank you, Your Honor.

16           I'm Paul Christ from Land O'Lakes.

17           BY MR. CHRIST:

18           Q     Mr. Reinke, I have a couple of questions on  
19     shrinkage and substitution.

20                     In your cheese operations you have normal  
21     shrinkage, is that correct?

22           A     Most of the times, yes.

23           Q     I'm not asking you to quantify the amount of  
24     shrinkage, but the types of shrinkage that occur.

25                     Can you tell me some of the types of shrinkage

1     that occur between the form and the solids that you're able  
2     to sell?

3             A     Are you talking a cheese plant?

4             Q     Yes.

5             A     There's obviously when you pick it up from the  
6     farm I think this has been documented before, that usually  
7     the industry tries to target somewhere around a quarter to a  
8     third of a percent between the farm and your intake.

9                     Then you've got the intake to the vats.

10                    I think the combination of all of that might be  
11     around one.

12                    Then you've also got the loss on the whey, and all  
13     of the cheese doesn't necessarily end up in the box also, so  
14     that probably is another half a percent when you add it all  
15     up.

16             Q     Do you know what a desludging evaporator is?

17             A     Yes.

18             Q     Do you have those types of evaporators in your  
19     facilities?

20             A     Yes. I think that may be what's called a  
21     separator clarifier, maybe what's called a separator in the  
22     steps of the exhibit yesterday.

23             Q     Is there shrinkage associated with that sort of  
24     equipment?

25             A     Yes.

1 Q And is it due to a periodic flushing of an  
2 accumulation of solids out of the evaporator?

3 A Yes.

4 Q In your cheddar operations do you produce a  
5 product called salt whey?

6 A Yes, we do.

7 Q Does that have any value that can be recovered?

8 A No, it ends up becoming a disposal cost.

9 Q Does that salt whey have a higher content of fat  
10 than would separated whey?

11 A Yes, it would.

12 Q Are you able to recover the value of that fat in  
13 the salt whey?

14 A No.

15 Q When you separate whey, is the separated whey 100  
16 percent free of fat or is there some residual fat in the  
17 separated whey?

18 A There is some residual fat in it.

19 Q Are you paid for that residual fat in separated  
20 whey?

21 A No.

22 Q So that's a financial loss as well.

23 I want to explore a couple of other sources of  
24 financial shrink, not necessarily physical shrink. What  
25 we've talked about so far is physical shrink. By that my

1 definition would be reduced value not reflected in the yield  
2 formulas, in the product formulas, in the order.

3 You mentioned in your testimony you sell whey  
4 cream and you're able to recover less value than if it were  
5 sweet cream.

6 A Correct.

7 Q And on the input side, the butterfat cost reflects  
8 the value of AA butter, right?

9 A Correct. We pay for the whole value of fat going  
10 to the cheese product.

11 Q Are you familiar with the terms juniors and  
12 undergrades in cheddar cheese operations?

13 A Somewhat.

14 Q Can you describe what that means?

15 A It's cheese that doesn't necessarily grade out to  
16 what you hope all the cheese would grade, so you have some  
17 rejects in the course of making cheese because there is some  
18 art form to it.

19 Q Are you able to recover the same value for juniors  
20 and undergrades as you can from cheese that does meet grade?

21 A No, it's usually significantly discounted.

22 Q So you have a loss of revenues to the degree you  
23 have some juniors and undergrades. So there's a financial  
24 shrink not reflected in the product formula.

25 The last question relates to substitution. We

1 heard earlier testimony that if we change the pricing  
2 structures we may encourage substitution from Class 4  
3 products to other classes.

4 In cheese manufacturing do you know of any use of  
5 butter as an ingredient to make American cheese?

6 A American cheese? No.

7 JUDGE HUNT: Mr. Marshall?

8 MR. MARSHALL: Thank you, Your Honor.

9 BY MR. MARSHALL:

10 Q Mr. Reinke, I'm going to explore some issues  
11 surrounding the concept of marketing costs or marketing and  
12 selling costs. I noted that you did not address that  
13 directly in your testimony, but your counsel encourages me  
14 to think that perhaps you can be helpful. If not, we'll  
15 take it as far as we can go and then stop.

16 (Laughter)

17 Q With respect to the bulk commodities that are  
18 surveyed by NCI of the type surveyed by, excuse me, NASS,  
19 and they're made by Kraft, are those mostly used internally  
20 by Kraft or do you actually market some of those outside of  
21 the Kraft system in bulk form?

22 A We do sell some bulk powder and butter. Most of  
23 our cheese is used internally.

24 Q Do you think you can identify marketing costs,  
25 selling costs, or other post-vat type costs that might

1 properly be categorized as marketing and selling for  
2 purposes of the formulas that we currently have?

3 A I'm sure there's a lot of Kraft, like I said, we  
4 use all of our cheese internally so our marketing costs are  
5 dramatically different.

6 Q That's why I asked the question.

7 A I assume there could be brokerage commissions,  
8 there could be sales people employed to do that for a  
9 business that other people don't, but that's about as far as  
10 I can go down that road.

11 Q Let me turn it around and ask you to think of  
12 yourself as the buyer and a company like mine as the seller.

13 Do you periodically do visitations to our plants  
14 and have visitations from us sellers that require, that  
15 would not be included within the plant cost, that would be  
16 part of the relationship building and the ironing out of  
17 problems in --

18 A That's very ongoing. We have procurement  
19 managers, as we call them, that visit our contract plants  
20 monthly. We probably have quarterly meetings with those  
21 suppliers. Sometimes we visit them, sometimes they visit  
22 us. Those are all kinds of added costs that would show up  
23 that aren't in plant make costs.

24 Q Paul Christ just asked some questions about  
25 financial shrink and off-grade product for which some value

1 is recovered. Does it ever happen in your experience that a  
2 supplier might send you a load that has to be rejected?

3 A We've had suppliers that have probably had to bury  
4 some cheese.

5 (Laughter)

6 Q I'm sorry, I couldn't hear you. Did you say bury?

7 A Bury some cheese.

8 (Laughter)

9 Q In that case it would be, because of that  
10 possibility I suppose many of those supplier buy insurance,  
11 would they not?

12 A Yes.

13 Q Would you think that insurance costs would be a  
14 legitimate aspect of the total marketing and selling  
15 operation?

16 A I think it would be, yes.

17 Q Liability insurance as well as potential insurance  
18 against loss.

19 A Yes.

20 Q If I were to sell you a block of cheese and there  
21 was to be some inherent fault that caused somebody to become  
22 ill and they were to sue Kraft, would you be expecting us to  
23 hold you harmless in that transaction?

24 A That's a standard clause in all of our contracts.

25 Q So liability insurance as well as potential

1 insurance for loss.

2           So would you be able to identify any other costs  
3 that are incurred with some frequency or infrequency that  
4 are regular and expectable costs that you would see as a  
5 buyer, that would be incurred by a seller such as our  
6 company?

7           A     There's probably, I would assume, occasionally  
8 some additional testing costs that you'd have on the product  
9 for various reasons. Either a buyer requires it or you're  
10 doing it to reverify compositions or quality or whatever.

11           MR. MARSHALL: Great. Thank you very, very much.

12           JUDGE HUNT: Anyone else?

13           Mr. Galarneau?

14           MR. GALARNEAU: Clay Galarneau with Michigan Milk.

15           Good morning, Mr. Reinke.

16           THE WITNESS: Good morning.

17           BY MR. GALARNEAU:

18           Q     Looking at your Exhibit 30 on the analysis you've  
19 made between the block and barrel cheese price, and you've  
20 identified what appears to be about a two cent difference.

21           A     We said normally if you look at the traditional  
22 spread of three cents on a block barrel and you make the  
23 moisture adjustment back, we said that two cents is in the  
24 moisture alone, and barrels will trade two cents lower than  
25 blocks just because the recover a moisture premium.

1           The other one cent that calculates in here is due  
2   to a cost difference.

3           Q    It looks like that analysis is done entirely on  
4   the raw material cost of the milk?

5           A    It's the VanSlyke cheese formula.

6           Q    Wouldn't there also be differences attributed to  
7   packaging and labor?

8           A    Not significantly. That's in the one cent.

9           Q    You think that totally covers it?

10          A    Yes.

11               MR. GALARNEAU: That's all.

12               Thanks.

13               JUDGE HUNT: Mr. Beshore?

14               BY MR. BESHORE:

15          Q    Good morning, Mike.

16          A    Good morning, Marvin.

17          Q    Does Kraft participate in the NASS cheese price  
18   survey?

19          A    As a seller, no, because the rules, cheese sold to  
20   ourselves doesn't count.

21          Q    And all the cheese you make is sold to yourself,  
22   or is processed internally by Kraft.

23          A    The cheese that we make, yes.

24          Q    Would you, if the NASS survey were expanded to  
25   include reporting and reviewing information by cheese

1 buyers, would Kraft participate in that survey?

2 A If you're saying on the cheese we buy, yes.

3 Cheese that we produce and transfer, I don't know how we

4 would actually come up with a -- Because of the way --

5 Q I meant the cheese you buy.

6 A The cheese we buy, yes. In fact I think we said

7 in our testimony that that would be one solution.

8 Q To what?

9 A If there are questions about NASS, another option  
10 would be to occasionally survey buyers. And I need to stand  
11 corrected, we do participate on some of the whey data on the  
12 NASS survey.

13 Q But as far as cheese is concerned you don't  
14 participate as a seller because you don't sell externally.

15 A Correct.

16 Q Do you work on a daily basis with your cheese  
17 plants with respect to their manufacturing costs, internal  
18 plant manufacturing costs?

19 A On a daily basis, no.

20 Q Your responsibilities with Kraft are for getting  
21 the raw product into those plants?

22 A Correct.

23 Q The milk ingredients.

24 A Correct.

25 Q So you weren't involved in compiling or reviewing

1 the information that was submitted for the NCI survey then,  
2 I assume.

3 A I was somewhat of a conduit. The request came and  
4 I gave it to our finance people with the parameters, and  
5 then after it was analyzed if there were any outliers, I  
6 took those questions and fielded them back to the plants .  
7 In most cases we had the plants talk directly with the  
8 accounting firms.

9 Q Did you review the information before it was  
10 submitted?

11 A I knew what the data was before it was submitted.  
12 I didn't compile the data.

13 Q But did you review it before it was submitted?

14 A Yes.

15 Q And you understood what its impact was and its  
16 importance was, what the purpose of it being gathered was?

17 A Yes.

18 Q Do you know whether Kraft's internal --

19 A Corporate overhead?

20 Q No. Scratch that.

21 (Laughter)

22 Q Let's talk about barrels and blocks a minute.

23 Exhibit 30, the third page of Exhibit 30. You've  
24 testified in response to Mr. Rosenbaum's questions and on  
25 Direct that this is intended to demonstrate why the three

1 cent factor presently in the NASS survey or in the formula  
2 for using the NASS barrel and block prices should be reduced  
3 to one cent.

4 Kraft doesn't make block cheese, I think you've  
5 testified, right? Forty pound blocks.

6 A We do not make 40 pound blocks.

7 Q And you don't sell any 640 pound blocks you make  
8 to any external buyers.

9 A We do on rare occasions, only when our inventories  
10 are burdensome. We have sold some on occasion.

11 Q But you would have no, Kraft has no cost  
12 information to document the difference in cost between  
13 producing 40 pound block cheese and barrel cheese.

14 A No, other than I said that we buy cheese from  
15 manufacturers that produce both block and barrel and we have  
16 to compete with the blocks to buy that cheese.

17 Q You know what you pay for blocks, you know what  
18 you pay for barrels, but you don't have any information with  
19 respect to what it costs to make blocks versus barrels.

20 A I do not have specific 40 pound block data for any  
21 of our plants, no.

22 Q And therefore, you do not, Kraft does not have its  
23 own information with respect to any cost difference between  
24 producing 40 pound blocks and barrels, isn't that correct?

25 A Direct costs, no. I'm saying what it takes for us

1 to attract barrel cheese from a plant that produces both,  
2 this is our analysis and this is what we use.

3 Q You haven't provided any information, maybe you  
4 would like to, with respect to what Kraft pays for and has  
5 paid over any period of time, for 40 pound blocks --

6 A We don't buy 40 pound blocks.

7 Q Oh, you don't buy 40 pound blocks at all. So you  
8 wouldn't have any of your own purchase information with  
9 respect to what any buying price differences are between 40  
10 pound blocks and barrels.

11 A No, what I said Marvin, is we buy from plants that  
12 produce both barrels and 640s and 40 pound blocks. They  
13 have dual operations. We have to be able to compete with  
14 that plant when they make 40 pound blocks. This is the data  
15 that we use to justify the revenue neutrality of where they  
16 would need to be to be indifferent.

17 Q This is the kind of thing that -- Do you do the  
18 buying from those plants? Are you personally involved in  
19 that?

20 A I used to be. I'm not directly anymore. This is  
21 data that I got from one of our procurement managers that's  
22 primarily responsible for buying cheddar cheese.

23 Q So you don't buy those blocks or barrels from  
24 those plants now. You personally.

25 A Me personally, no.

1 Q And you personally don't prepare and didn't  
2 prepare the analysis on the third page of Exhibit 30,  
3 correct?

4 A Our cheddar cheese procurement manager did.

5 Q Right. And that's not you.

6 A Not today it's not, no. Today maybe I wish it  
7 was. I wouldn't have to be here.

8 (Laughter)

9 Q Did you compare, by the way, your, the analysis  
10 that your cheese procurement manager did with the analysis  
11 that Dr. Yonkers provided in his testimony on barrels versus  
12 blocks?

13 A Did I compare? He was aware of the data. This  
14 was data that --

15 Q Who was aware?

16 A Bob Yonkers. This is data that I shared with him.

17 Q Prior to his testimony?

18 A Yes.

19 Q But have you compared, you presented your exhibit,  
20 he presented his. Have you compared them?

21 A I don't know what you mean by --

22 Q The formulas or the -- They both come out to the  
23 same, interestingly, they both come out to the same bottom  
24 line.

25 A I think the math is, if you plug in the VanSlyke

1 formula, it's going to calculate that.

2 Q It depends on what fat recovery you put in for  
3 instance, right?

4 A I use this at different yield factors and it still  
5 comes back at pretty close to the same results, within mils  
6 of a cent.

7 Q Are you sure about that?

8 A Yeah. I did it at 92, I did it at 91, anyway.

9 Q How about the crude protein ratio?

10 A I don't have that with me. I can't recall for sure  
11 if I changed both or not.

12 Q You used a different one that Dr. Yonkers did, did  
13 you not? If they show they're different --

14 A Yeah, and I think they still probably come very  
15 close to the same relationship.

16 Q The Canton plant. It makes 640s. What products  
17 are they used for internally by Kraft?

18 A It goes into our aged cheddar.

19 Q So that's cheese that is intended and held and  
20 used for aging. Correct?

21 A Yes.

22 Q Which is different than the cheese that's  
23 specified in the NASS survey which is not held or used for  
24 aging at the time of its sale, right?

25 A The NASS survey I think is cheese from four to 30

1 days of age. And so it's not, you're correct.

2 Q The Canton plant, is that a new facility or an  
3 older facility?

4 A I think I mentioned for a number of reasons why it  
5 is higher cost. There's parts of it that have been updated.  
6 Vats are 20-some years old. The brick and mortar is  
7 probably 40-50 years old. It's not a large cheddar plant on  
8 the scale of cheddar, and it's in New York State, which is  
9 not the cheapest place to do business.

10 Q When you purchase -- You talked about your fat  
11 recovery there and it's only 88 percent. Part of that is  
12 because of the aged cheese, the product you're using, you  
13 choose not to use any whey cream in the cheesemaking  
14 process. Is that correct?

15 A From a quality assessment on our part, yes.

16 Q You purchase cream and use it in the cheese making  
17 at Canton, I take it?

18 A Yes.

19 Q Bulk cream. I may have misunderstood your  
20 testimony, but I thought that you were implying that in  
21 purchasing that bulk cream, you're somehow responsible for  
22 the farm-to-plant loss if there is any on those  
23 transactions. You're not, are you? I mean you're buying  
24 that on tanker weights and tests and bringing it into that  
25 plant, correct?

1           A     Correct. I think what I'm alluding to here is if  
2     the value on Class 3 cream changes because of a formula,  
3     then whoever has to account for that cream is going to want  
4     an increased multiplier or price to adjust for how that  
5     formula changes, which I will then end up paying more for.

6           Q     Are you supporting, by the way, the reduction in  
7     the Class 3 cream price in this hearing?

8           A     I think my statement, I supported it in all  
9     classes, yeah.

10          Q     And so you think you ought to have a cut in the  
11     price of Class 3 cream you're bringing into Canton to  
12     process into those aged Cracker Barrel and other cheese?

13          A     No. I'm thinking I ought to have the same  
14     relationship I've always had on Class 3 cream with butter.

15          Q     Which would be a reduction in the price that you  
16     presently pay for Class 3 cream, correct?

17          A     A reduction in price currently, but not to where  
18     it was prior to final rule.

19          Q     Do you buy -- From what sources do you buy cream  
20     at Canton? Fluid milk plants?

21          A     It could be. It could be a mozzarella plant. We  
22     buy cream from --

23          Q     Do you move it from your own mozzarella plant at  
24     Campell --

25          A     We do that also.

1 Q -- up to Canton?

2 A I'm not sure that logistics wise it makes sense to  
3 move that cream to Canton.

4 Q Is it moved from other Kraft plants in New York  
5 from --

6 A It probably from Canton would come out of our  
7 North Lawrence cottage cheese plant.

8 Q So you make low fat cottage cheese, you move the  
9 cream down to Canton.

10 A Yes.

11 Q Do you purchase any of your cream at Canton  
12 externally?

13 A I think logistically the best place to source that  
14 cream is from North Lawrence.

15 Q So when you bring cream from North Lawrence, a  
16 Class 2 plant, down to Canton, you're actually reducing your  
17 ingredient costs on that cream, are you not? Within the  
18 Kraft system.

19 A The cream is going to be allocated to whatever  
20 class it's sold to. If it went into sour cream it would be  
21 2, if it went into 3, it's 3.

22 Q But the cost of that cream at Class 3 is less than  
23 it would be if it was used in Class 2 up at North Lawrence.

24 A But it's going into a totally different product,  
25 also. It's going into a Class 3 product.

1 MR. BESHORE: That's all I have. Thanks, Mike.

2 JUDGE HUNT: Mr. Berde?

3 MR. BERDE: Sydney Berde.

4 BY MR. BERDE:

5 Q Mike, do you buy barrel cheese that is destined  
6 for use solely in processed cheese?

7 A Yes.

8 Q Is that cheese differentiated from your ordinary  
9 purchase of barrel cheddar?

10 A Well we buy all kinds of different styles specific  
11 for -- We may buy some with a different flavor profile, some  
12 with a different fat profile, depending on what type of  
13 formulation it's going into.

14 Q But my question is directed really as to whether  
15 the cheese that you buy that you know is destined solely and  
16 only for use in processed cheese, Velveeta, let's say,  
17 that's a different, you buy that cheese on a different  
18 basis, do you not, from the cheese that is destined for aged  
19 cheese, for example?

20 A We buy it on a barrel price plus or minus some  
21 adjustment.

22 Q Is the minus adjustment off of the ordinary barrel  
23 cheese that is destined for use for aging?

24 A No.

25 Q Is there a discount for cheese, barrel cheese,

1 that is purchased that you intend to use solely for  
2 processing? This is a different cheese.

3 A I don't know of a discount for it, no. We do --  
4 The only place we probably would use some barrels is in a  
5 shredding program. We don't really cut barrels, per se,  
6 into anything else. We could shred some barrels.

7 Q Isn't the cheese that you purchase that is  
8 destined for use solely as process cheese of a different  
9 formulation than the ordinary cheddar that you're going to  
10 age?

11 A From aged cheddar yes. There's probably some  
12 different nuances in how it's made. Not overly significant,  
13 though. I think it goes back to this penny I'm talking  
14 about.

15 Q Is there a discount from the NASS reported cheddar  
16 prices?

17 A Not for barrel for processing, no.

18 Q Not for barrels that are going directly for  
19 processed cheese?

20 A No.

21 Q Do you know whether the cheese that you purchase  
22 is reported in the NASS survey? That is that cheese that is  
23 destined solely for processing? Is that reported in the  
24 NASS survey?

25 A I assume -- It's voluntary, but I assume that much

1 of it is.

2 MR. BERDE: Thank you.

3 JUDGE HUNT: Mr. Yale?

4 BY MR. YALE:

5 Q I want to follow up on what Mr. Berde was talking  
6 about.

7 You make in your cheese plants, you're looking at  
8 the end consumer and the product that the end consumer  
9 receives and that they're pleased with, right?

10 A Yes.

11 Q Would you not agree with me that the product that  
12 you manufacture in your plants is a high quality product?

13 A Yes.

14 Q And it's an added value product?

15 A I think the product in our plant as well as the  
16 plants that we procure from would be that way.

17 Q But you made a business decision to add sweet  
18 cream into your cheese to make a different product than what  
19 is required in the ordinary production of cheddar cheese, is  
20 that right?

21 A Our assessment was that's what the consumer wants,  
22 and ultimately we've all got to sell this stuff some place.

23 Q And you then in turn sell that product at a higher  
24 price than what a simple, in the end, per pound, it's a  
25 higher price than what a simple cheddar cheese would cost

1 per pound at the consumer price, right?

2 A I guess you could probably say our aged cheddar  
3 does command a higher price, to some cheeses. Other cheeses  
4 we're very, it's a very competitive market.

5 Q So you understand that we've got a situation where  
6 we're talking about a NASS survey of cheddar cheese block or  
7 barrels that's reported in a price and we're subtracting a  
8 make allowance to determine what producers got. You  
9 understand that. That's the simple formula, right?

10 A Right.

11 Q None of your plants report to the NASS survey.

12 A None of our producing plants.

13 Q Why should your make allowance be used then to  
14 adjust, to determine what the costs would be to the  
15 producers?

16 A I think what we're saying is that should be  
17 representative of all cheese plants. The NASS survey, I  
18 don't have a number I can report to the NASS survey, but I  
19 still make cheese and compete for cheese based on those  
20 prices. It doesn't change my competitive position.

21 Q But your cheese is a higher value cheese than the  
22 NASS product cheese.

23 A There's a lot of cheese also from our contract  
24 plants that are in the NASS survey that are made to the same  
25 standards and quality that our own plants make. So we buy

1     that cheese, but we also compete with those cheeses and I  
2     think I also mentioned that we've closed a number of plants  
3     over 20 years, so if we can't compete with that cheese we  
4     may end up buying more of it.

5           Q     But you can't speak to the make allowances of  
6     those cheese plants, can you?

7           A     No. All I can is my Canton plant.

8           Q     Do you instruct those plants to use added sweet  
9     cream in the production of their cheese?

10          A     There would be certain plants that we would do  
11     that with and others not.

12          Q     Do you pay a premium for that over the regular  
13     cheddar cheese?

14          A     No. We do it formally on what that's worth on the  
15     added cost and pay them accordingly.

16          Q     In other words, their cost to add that sweet cream  
17     to produce that special cheddar, they get reimbursed from  
18     the market, right?

19          A     And reported in the NASS survey, I assume.

20          Q     You assume.

21          A     We encourage our supply plants to participate.

22          Q     As I understood your testimony you only handle  
23     internally and purchase 500 pound barrels, is that right?

24          A     We only --

25          Q     Purchase or deal with. You don't make 40 pound

1 blocks.

2 A Internally?

3 Q Yes.

4 A We do not make 40 pound blocks.

5 Q Do you purchase 40 pound blocks?

6 A No. Only on rare occasions.

7 Q Isn't it true, Mr. Reinke, that to package, to  
8 physically wrap, the cost of wrapping 12 40 pound blocks is  
9 more than a 500 pound barrel?

10 A Yeah, and we think that's about a half a cent.

11 Q But you don't make 40 pound blocks, so how do you  
12 know what the packaging cost is for a 40 pound block?

13 A We have conversations with our suppliers that do  
14 both.

15 Q It costs more to move 12 40-pound blocks than one  
16 500 pound barrel, doesn't it? More labor.

17 A In the plant?

18 Q In the plant, from the plant to some place else.  
19 The physically putting it on the truck, taking it off,  
20 handling, unwrapping.

21 A That's in that one penny.

22 Q Let's talk a second about the deal with the  
23 moisture, and I'm going to walk through some simple math,  
24 and I hope we can keep this straight. I'm going to make a  
25 few simple assumptions.

1           We're going to make 100 pounds of cheese. I've  
2   got to keep the math simple. At 36 percent moisture, and  
3   the make allowance is \$1. I'm saying that's a great make  
4   allowance, I'm not suggesting you agree that that's the make  
5   allowance we should have, but I want to just for this math,  
6   it's a dollar make allowance.

7           A    You're at 36 moisture?

8           Q    Thirty-six percent moisture, all right? It's  
9   barrels.

10           You would agree with me to make that 100 pounds,  
11   that the -- it probably should be per 100. But let's just  
12   say it's \$100 to make that 36 percent moisture. I  
13   multiplied it high, and I apologize. But it's been a long  
14   week and my mind has gone mush.

15           A    So you made 100 pounds --

16           Q    A hundred pounds of cheese at 36 percent moisture  
17   and it's a dollar make allowance. What would it cost to  
18   make that 100 pounds of cheese? That's a simple  
19   multiplication, right?

20           A    Yeah. A hundred bucks.

21           Q    Under the NASS, this adoption, we adjust this  
22   moisture, to 39 percent, right?

23           A    Yes.

24           Q    To compute the amount of weight of cheese that was  
25   produced at 36 percent moisture, if you adjust it to 39

1 percent moisture, aren't you increasing the weight of that  
2 cheese by five percent?

3 A Are you saying you have the same amount of milk?

4 Q No. We've got a 36 percent moisture cheese, and  
5 we're going to adjust it to 39 percent, right?

6 A Right.

7 Q Doesn't that imply that now you take what is it,  
8 one minus 36 and divide that by one minus 39 and that gives  
9 you the ratio?

10 A Yeah. I think that's what we showed here. You do  
11 get more cheese, you can see that on the calculation.

12 Q So you'd get 105 pounds under that adjustment,  
13 right?

14 A From that same amount of milk.

15 Q Does it cost you now, does it still cost you \$100  
16 to make that cheese? Right?

17 A Close to that. I guess my only point in all this  
18 is if we're going to get that finite on these formulas then  
19 we need to look at every aspect of them. I think that's,  
20 for a regulated price that's getting awful finite.

21 Q I don't know how finite it is.

22 If you take the make allowance and apply it and  
23 subtract it off of the value of the 105 pounds, aren't you  
24 inflating the make allowance?

25 A This was the same comment that Dr. Barbano [ph]

1 had yesterday and I think I'd stand by what I just said,  
2 that if the regulated price is to get that finite on that  
3 one aspect, then we need to make sure we're that finite on  
4 make allowance, fat recovery losses, block barrel spread,  
5 everything else. It still is a regulated price.

6 Q Let me talk a moment about your mozzarella yield,  
7 your butterfat yield.

8 Correct me if I'm wrong, in general in this  
9 process of handling mozzarella, when raw milk comes into the  
10 plant it comes in at test. Some butterfat test, right?  
11 That's correct, right? I want to get that started.

12 One of the first steps, and I'm sure there's other  
13 processes, and I really want to simplify this, is that you  
14 separate off what you know is going to be excess cream  
15 that's going to go into that moz process, right?

16 A If we're not making whole milk moz, yeah.

17 Q But most of it's part skim, high moisture, low  
18 moisture cheese, isn't that the primary moz that's produced?

19 A In our plants we produce significant quantities of  
20 both, but if we're going to make low moisture, part skim, we  
21 would separate if that's your question.

22 Q So you have a value of fat that you keep and it's  
23 sweet cream and you can sell it, right? Or do whatever you  
24 want to with it.

25 A Right.

1           Q     Then what's left, you say you get a butterfat  
2 recovery of 86 percent?

3           A     No, we said --

4           Q     What is your number? I'm sorry.

5           A     I think it was around 87, 88. That's what the  
6 plant told me.

7           Q     So if we take that times the butterfat that's  
8 left, that's the amount of butterfat that you got marketable  
9 in the cheese, and as I understand the rest of it, you can't  
10 use. It's not of any real value out of the moz whey, is  
11 that what your testimony was?

12          A     No. I said we do separate out whey cream on a moz  
13 whey also, and we have the same dilemma we have with the  
14 Canton cheddar whey.

15          Q     But let's for a moment separate that. You can add  
16 the sweet cream that you received, that you've already  
17 separated, to the recovered fat in the moz cheese and adds  
18 those together and divided that by the total fat that came  
19 into your plant and that will tell you what your fat  
20 recovery was in that plant, right?

21          A     Total fat recovery, yeah. But it's kind of  
22 getting --

23               MR. VETNE: Excuse me, let me interpose an  
24 objection here because the question as presented  
25 extraordinarily confuses the record.

1           We have talked to fat recovery in cheese making as  
2   the fat that comes out of the whey.

3           The question I guess intends to make a new  
4   definition of fat recovery. It includes the sweet cream  
5   that's separated as well as the whey cream that comes out of  
6   cheesemaking. If I'm correct. And if so, the witness, at  
7   least I'm confused, and the record ought to reflect that we  
8   have a new definition of fat recovery in the question.

9           JUDGE HUNT: Your objection is noted for the  
10   record.

11          Mr. Yale?

12          MR. YALE: Do I need to respond to the objection  
13   or just --

14          JUDGE HUNT: It's up to you.

15          MR. YALE: The point we're coming at is not so  
16   much in the technical definition -- he's right. It's not in  
17   the technical definition of fat recovery in the cheese, but  
18   it's a fat recovery in the plant that the producer, we're  
19   trying to find out what the value is that the plant receives  
20   for fat that's going to be used in these formulas.

21          BY MR. YALE:

22          Q   Let's take another step with this moz, though.

23                  The mozzarella cheese, though, is sold based upon  
24   the cheddar prices, is it not?

25          A   I can't really -- I'd be speculating. I don't get

1 involved with our sales of mozzarella.

2 Q Your Table 1 I believe it is, with the milk  
3 components, what area is that from?

4 A The Upper Midwest.

5 Q Does that include all the milk, or is that milk  
6 only milk pulled on the Upper Midwest order or does that  
7 include all milk that they had results for and producers in  
8 that marketing?

9 A From what I understood it was the same components  
10 that were used in the calculation of the old Class 3 price.

11 Q But you didn't do a study to see what that impact  
12 was on producers and other orders.

13 A No, I guess my assessment was that's what averaged  
14 milk looked like, that's what this was going to do to  
15 averaged milk.

16 Q Did you do any analysis to determine what that  
17 would have been prior to June of 1998?

18 A There was no NASS survey data to do that kind of  
19 analysis.

20 Q Would you disagree with the premise that the  
21 applied make in late 1998, 1999 significantly exceeded the  
22 implied make prior to then?

23 A I'm not sure I would agree. I think when we  
24 looked at, after we adjusted for the error and after we  
25 adjust for this 20 cents, it's significantly less.

1           The Upper Midwest has always been a highly  
2 competitive milk region and I think in the last two years  
3 there's been a recognition of pressures from the West, and I  
4 think that's also reflective in why there's a difference.

5           Q     One final areas. There was talk, maybe it was an  
6 answer to Mr. Beshore, that possibly -- Let me back up.

7                     You're suggesting that all your plant costs get  
8 covered, right?

9           A     They should be included --

10          Q     They should be included.

11                    One of the complaints I think on the RCBS study  
12 was there was no plant manager cost, right?

13          A     That was one of them.

14          Q     When you did the survey did you include plant  
15 manager costs?

16          A     Yes.

17          Q     Would that include a company car?

18          A     Our plant managers don't have company cars.

19          Q     Do they have expense accounts?

20          A     They have expense accounts when they travel for  
21 company business. Yes.

22          Q     Would you suggest that the accounts receivable  
23 losses also be included in these costs?

24          A     They would be. They weren't in our plant numbers.

25                   MR. YALE: I have no other questions.

1 JUDGE HUNT: Mr. Vetne?

2 REDIRECT EXAMINATION

3 BY MR. VETNE:

4 Q There are three questions that were asked that I  
5 think need to be clarified so the record is not confused.

6 Mr. Reinke, when you referred to Exhibit 30, page  
7 three, the barrel versus block calculations. In the first  
8 square of the upper left hand corner of the exhibit you  
9 referred to a price there as \$1.03.

10 A I'm sorry.

11 Q You didn't intend to change the number in the  
12 exhibit. It's 1.3 dollars, not \$1.03, is that correct?

13 A It's \$1.30.

14 Q You did not mean to say \$1.03.

15 A No.

16 Q Secondly, in response to a question from Mr.  
17 Beshore, you agreed with him when he said that NASS cheese  
18 is not held for aging. Did you mean by that that the cheese  
19 surveyed by NASS was not aged?

20 A The NASS criteria says it has to be cheese between  
21 40 and 30 days of age.

22 Q You did not intend to imply in your answer to that  
23 question that the buyers of cheese that are included in the  
24 survey do not hold the cheese they buy for aging. You did  
25 not intend that.

1 A No.

2 Q Thirdly, there were two questions by Mr. Yale  
3 referring to use of sweet cream to fortify producer milk to  
4 make cheddar cheese.

5 In one question Mr. Yale, and I think you reed or  
6 implicitly agreed with his question by your response, he  
7 questioned to the effect, or stated to the effect that you  
8 make something other than is required for cheddar cheese.

9 Are you aware of any requirement in cheese  
10 standards or from any other regulatory source to recycle  
11 whey cream into whey cheddar cheese?

12 A Required?

13 Q Required.

14 A No.

15 Q Secondly, I think he used the term special  
16 cheddar. Is there a recognized special variety of cheddar  
17 which is made from, supplemented with sweet cream rather  
18 than whey cream?

19 A Not identified as such, no.

20 MR. VETNE: Thank you.

21 JUDGE HUNT: Ms. Reed?

22 MS. REED: Thank you.

23 RECROSS-EXAMINATION

24 BY MS. REED:

25 Q In response to a question that Mr. Beshore asked

1     you previously, you said that Kraft sometimes sells bulk  
2     cheese when its inventories are excessive. Is any of that  
3     cheese sold on the CME?

4             A     On occasion.

5             Q     Do any of the contracts that Kraft has with plants  
6     from which it buys cheese refer to CME prices as a factor in  
7     establishing the price?

8             A     I think our pricing is proprietary. I won't  
9     answer that.

10            MS. REED: Thank you.

11            JUDGE HUNT: Mr. Rosenbaum?

12            BY MR. ROSENBAUM:

13            Q     Mr. Reinke, I want to make sure the record is  
14     perfectly clear on how this moisture adjustment works in the  
15     current rule and what the implications are, so I want to  
16     just take it through step by step.

17            Let's say that someone sells 500 pounds of barrel  
18     cheese with 36 percent moisture.

19            A     You're using Bob's or mine?

20            Q     I'm not using either one.

21            A     All right.

22            Q     Just assume with me that someone has sold 500  
23     pounds of barrel cheese that's at 36 percent moisture. And  
24     let's assume that person is a participant in the NASS  
25     survey.

1 A Correct.

2 Q And that person sold it for \$1.20 a pound.

3 A Okay.

4 Q In reporting to NASS, that person will report the  
5 \$1.20 per pound price, correct?

6 A Correct.

7 Q And they'll also report that it was at 36 percent  
8 moisture, correct?

9 A Yes.

10 Q That's in the NASS reporting form, correct?

11 A Yes. He will report the cheese at 36 percent  
12 moisture and a price received at 36 percent moisture.

13 Q Yes. And how many pounds he sold, of course.

14 A Yes.

15 Q So he will list \$1.20, correct?

16 A Yes.

17 Q NASS will then take that \$1.20 price and adjust it  
18 as if the cheese had been 39 percent moisture, correct?

19 A Correct.

20 Q And that will result in this example, NASS  
21 treating that price as if it was \$1.14, roughly.

22 A Okay. I'll accept your math.

23 Q Whatever the relationship is between 39 and 36  
24 percent, it will, that will be applied to reduce that price  
25 from \$1.20 to a lower price, okay?

1           A     Correct.

2           Q     Accept with me that it's \$1.14. Anybody can do  
3 the math on it on a calculator.

4                     So that's now the NASS reported price for that  
5 cheese, correct?

6           A     Correct.

7           Q     Under the current rule what AMS does is they take  
8 that \$1.14 and they add three cents to it for purposes of  
9 calculating finished product prices that go into the minimum  
10 price formula, correct?

11          A     Correct.

12          Q     The question here is whether or not that three  
13 cent adjustment is appropriate or not, correct?

14          A     Correct.

15          Q     As we've seen, NASS has already adjusted for  
16 moisture in changing from the \$1.20 to the \$1.14, correct?

17          A     Correct.

18          Q     The question is whether by adding three cents back  
19 onto the price AMS is adjusting for something that's already  
20 adjusted because in fact most of that three cents is  
21 moisture related.

22          A     Yes. What we're saying is that it was assumed it  
23 was make allowance and two of it was not, it was moisture.

24          Q     I want to make clear, and this is something I  
25 think Mr. Yale was getting at. When you apply the make

1 allowance to that 100 pounds of cheese in our example, you  
2 still only have 100 pounds of cheese, right?

3 A Correct.

4 Q Any adjustments that have been done by NASS  
5 haven't given the cheese manufacturer any more cheese,  
6 correct?

7 A That's the point I was trying to allude to is you  
8 still have 100 pounds of cheese. What's reported as the  
9 sale was the pounds of cheese, not the milk you made it from

10 Q Right. And the make allowance then is applied  
11 against that, correct?

12 A Correct.

13 MR. ROSENBAUM: Thank you.

14 JUDGE HUNT: Mr. Beshore?

15 BY MR. BESHORE:

16 Q On the third page of Exhibit 30, Mike, just  
17 questions about two numbers.

18 In the upper right hand -- The last page of your  
19 total package. You've got four calculation blocks there.  
20 The upper right hand block that says block moisture to make  
21 block return equal barrel.

22 A Uh huh.

23 Q Is the 37.56 percent number the result of your  
24 calculation there?

25 A Yes, it's to get it back to then a yield that

1 gives you the same return. It's just another way of looking  
2 at what you'd have to adjust the barrel or the block yield  
3 to at that price to get you equal returns.

4 Q So that's a number that was derived or calculated.

5 A Yes.

6 Q By the way, what's the average moisture of the 640  
7 blocks that you make at Canton?

8 A Right around 38.

9 Q Do you know exactly what it is?

10 A No, I don't.

11 Q In the VanSlyke formula at the top of the page,  
12 you use 91. Is 91 the value for fat recovery -- Is that the  
13 value that Kraft generally uses in its internal calculations  
14 when it uses this?

15 A I ran it at 92, I ran it at 91. It didn't change  
16 the numbers dramatically. It varies by plant.

17 Q Different plants use different numbers for their  
18 internal purposes?

19 A They do whatever their fat recovery is. You can't  
20 say a plant has 93 fat recovery if they don't have it.

21 Q Wouldn't you use calculations of this sort to test  
22 the efficiency of the plant, not just reflect it?

23 A I guess what I'm saying here is you could change  
24 the fat to different levels. You're still going to get  
25 approximately the same answer. You can apply this formula

1 to this specific plant if you're talking to them, or you can  
2 apply it to this plant. I used 91.

3 MR. BESHORE: Thank you.

4 JUDGE HUNT: Ms. Brenner?

5 BY MS. BRENNER:

6 Q Looking at your exhibits first, Mr. Reinke, on the  
7 first page of Exhibit 30, the far right column, can you read  
8 those numbers?

9 A Starting with January?

10 Q Well the whole column. The copy I have they're  
11 very obscured by some apparently copier problem, and none of  
12 us here have readable --

13 A They are obscured on mine also. Part of my  
14 dilemma is that it's a copy of a fax.

15 JUDGE HUNT: Can you supply cleaner copies to  
16 everybody?

17 THE WITNESS: Yes. I'll have a hard time doing  
18 it --

19 MS. BRENNER: To everybody, but maybe we can --  
20 Maybe you could send it into the Department and we'll post  
21 it on the Internet or --

22 MR. VETNE: Your Honor, we will get an original  
23 copy from the Market Administrator's office and provide  
24 copies for the record as a replacement of the identical  
25 thing, but with more legible numbers.

1 JUDGE HUNT: Can you do it today?

2 MR. VETNE: Again, we're dealing with a fax.

3 Let's see if the Market Administrator's office can scan it  
4 and e-mail it to us. I'll try that.

5 JUDGE HUNT: All right. Thank you.

6 BY MS. BRENNER:

7 Q On page three of Exhibit 30, the only blocks  
8 included in this exhibit then are 640 pound blocks? Is that  
9 your -- I think you said that's all that Kraft makes.

10 A No, I guess what I'm saying is this is a  
11 comparison when we look at a contract plant that we buy  
12 cheese from that makes both 40s and barrels or 640s and  
13 barrels. We have contract plants that we buy from that make  
14 both, so this is an analysis we use. So it would apply to  
15 40s also.

16 Q Would that imply that the price of cheese in 40  
17 pound blocks and the price of cheese in 640 pound blocks is  
18 equivalent?

19 A It should be very close, yeah.

20 Q There's no adjustment for larger sizes or  
21 something like --

22 A No. We use 640s for what other people use 40s  
23 for.

24 Q Okay. And you get the same price is involved per  
25 pound of cheese in both sizes.

1           A     Yeah.

2           Q     I notice that you're assuming a fat recovery of  
3     .91 here and somebody else mentioned that. This is an  
4     internal Kraft kind of analysis?

5           A     Yeah, I mentioned that we would probably take this  
6     analysis, and whatever contract plant it was, they may have  
7     .9, they may have .93, whatever that was, we would plug that  
8     recovery in here to do the calculation. But I ran it at a  
9     couple of different levels and it didn't change the numbers  
10    way out in the hundreds or mils or hundredths of a percent.

11          Q     Then your testimony that your Canton plant's fat  
12    recovery plant of 88 percent, you would apparently consider  
13    that low, is that correct?

14          A     We started adding fat in the last couple of years.  
15    Canton's vats are 20-some years old. They're not the  
16    horizontal stolting or shirping vats, so our recoveries have  
17    probably not, were some of the I guess what I think more  
18    technical, capable recoveries that Dr. Barbano talked about.  
19    I think even before we added fat our recoveries were not  
20    reaching those type of standards.

21          Q     You also bring up the question of mozzarella and  
22    other kinds of cheeses and several other people have too.

23                 Are you aware of the basis for the choice of  
24    certain specified cheddars for inclusion in the Class 3  
25    price and limiting it to only those cheeses?

1 A For the Class 3 price calculation?

2 Q Uh huh.

3 A Yes.

4 Q Can you mention what they are and why comparing  
5 fat recovery in mozzarella might not exactly pertain to the  
6 calculation of a Class 3 price?

7 A I'm not sure I'm understanding your question.

8 JUDGE HUNT: Excuse me, Ms. Brenner.

9 Mr. Vetne?

10 MR. VETNE: If the question asks the witness to go  
11 through his memory of the final decision and the rationale  
12 for including cheddar then I think the question is  
13 unnecessary because the final decision I think was  
14 officially noticed. Including the final decision's  
15 reference to lower fat recovery in mozzarella as a factor to  
16 be considered in the formula price. If it's not then it's  
17 not unnecessary, but that's how I understand the question.

18 I'm sorry, Ms. Brenner, I'm confused and perhaps  
19 the witness is. But it's not my confusion, it's the  
20 witness' confusion that would be important.

21 JUDGE HUNT: Ms. Brenner?

22 MS. BRENNER: What I was asking for is in terms of  
23 the relative -- We've talked a little about the relative  
24 costs of making mozzarella and cheddar. Are the prices the  
25 same?

1           THE WITNESS: We make a retail mozzarella and  
2   Pollyo, but I'm really not aware of how we price -- That's  
3   the only mozzarella we make, so I really can't talk about  
4   how bulk mozzarella is sold.

5           BY MS. BRENNER:

6           Q   Are you aware of whether there is any really  
7   uniform kind of mozzarella made that --

8           A   It was my understanding that it would be one of  
9   the reasons why it would be very difficult to include moz in  
10   the survey of prices, because what is mozzarella?  
11   Mozzarella to one pizza customer may be different mozzarella  
12   to another pizza customer. Therefore you couldn't really  
13   categorize it in one category.

14          Q   In many cases is mozzarella produced specifically  
15   for the standards of the customer?

16          A   Yes. We buy moz for our pizza company and it's a  
17   specific formulation for us.

18          Q   So it's generally not a standard product.

19          A   Right.

20          Q   I notice one of your plants makes butter.

21          A   The Visalia plant, yes.

22          Q   Do you make any Grade A butter there or is it all  
23   AA?

24          A   I think it's AA, but I'm not sure. I don't get  
25   real involved with the sale of butter there.

1           Q     Does Kraft generally, I'm not aware of Kraft  
2 butter being a product that you'd buy in the grocery store.  
3 Does Kraft sell much butter?

4           A     We used to have a butter business, Breakstone,  
5 which we sold, I'm not sure if it's ten years ago now or  
6 not, but we do not have any packaged butter business.

7           Q     So you make butter for sale to other companies?

8           A     No. What it is is that when we bought the Newsome  
9 facility we also bought a dryer/evaporator, and it's a  
10 cottage cheese, primarily cottage cheese, sour cream  
11 operation, so we generate excess fat. And it's a way to  
12 manage that excess fat. Kind of balance the operation.

13          Q     But it probably results in a AA butter.

14          A     Yeah. But we basically just sell it in bulk form.

15          Q     You were asked a question about something called  
16 salt whey. Can you give me a little more information about  
17 what that is and how big a percentage of the --

18          A     I don't know the percentage. What it is is after  
19 you salt the cheese that's in the vats, you drain that whey  
20 off and, or you drain off some from the vats and sometimes  
21 from even the 640s or the barrels as they hang and knit  
22 together. That's got some fat in it, some whey in it, some  
23 salt in it, which is because of all those compositions, is a  
24 very hard product to recover any value from. Actually you  
25 lose money disposing of it, but I don't know the percentage

1 of it.

2 Q So the regular whey comes off before the salt's  
3 added?

4 A Yeah. You separate the whey from the curd, and  
5 that goes in the stream and you separate the fat off of that  
6 and condense or dry the whey. Then the curd that goes into  
7 the 640 or the barrel, then those usually, there's whey that  
8 comes off of those. Or like in our farm plant. That has a  
9 salt content in it and some fat in it. That becomes a  
10 disposal problem.

11 MS. BRENNER: That's all I have.

12 JUDGE HUNT: Anyone else?

13 (No audible response)

14 JUDGE HUNT: Thank you very much, Mr. Reinke, for  
15 your testimony.

16 Before we take a break, I talked to some of the  
17 people who would like to testify today because they have  
18 plane reservations to leave today.

19 The tentative schedule is, our first witness after  
20 the break is Mr. Pacheco, and then Mr. Gulden, and then Mr.  
21 Christ and Mr. Schad, and I think Mr. Rosenbaum indicated  
22 that Mr. Schiek and Mr. Lenahan, Mr. Eastham, and then Mr.  
23 Olsen, you had Mr. Venkat, Williams and Throne? And then  
24 Mr. Grand also would like to testify today too.

25 Is there anybody else that has definite

1 reservations that would like to leave today that would like  
2 to testify? I can't assure everyone that we'll get to you,  
3 but we'll make an effort to accommodate you.

4 Okay, so we'll proceed with that order.

5 A ten minute break.

6 (Recess taken)

7 JUDGE HUNT: Back on the record.

8 Whereupon,

9 FRANCIS PACHECO

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

12 JUDGE HUNT: Mr. Pacheco, would you state and  
13 spell your name, please, for the record?

14 THE WITNESS: Francis Pacheco.

15 F-R-A-N-C-I-S P-A-C-H-E-C-O.

16 DIRECT EXAMINATION

17 THE WITNESS: I am Francis Pacheco. I am the  
18 Pacific Regional Director for National Farmers Organization,  
19 also known as NFO.

20 National Farmers Organization represents  
21 independent producers nationwide in negotiating contracts  
22 and other terms of trade for milk, grain, and livestock.

23 NFO's purpose is to help independent farmers  
24 extract the dollars they need to cash flow their operations,  
25 pay their expenses, and earn a living from what they produce

1 and sell.

2           The current dairy policies have brought turmoil to  
3 the dairy industry. The Class 3 price received by dairy  
4 producers has decreased from \$16.26 per hundredweight in  
5 September '99 to the Class 3 announcement for April 2000 of  
6 \$9.54 per hundredweight. This equates to over a 40 percent  
7 drop in the milk price that dairy producers receive.

8           However, the Consumer Price Index for cheese and  
9 related products for April 2000 calculated by the U.S.  
10 Department of Commerce was stated at 162.3, which equates to  
11 only a decline of 1.4 percent for the same time line period.

12           The milk price today is far below milk production  
13 costs of dairy producers in this country.

14           An increasing amount, currently over half, of  
15 America's milk production is being utilized for the  
16 production of dairy products. The majority of dairy product  
17 production is in Class 3 and in Class 4 products. That is  
18 why this milk price hearing is so crucial to this country's  
19 dairy producers.

20           National Farmers Organization would like to thank  
21 Congress for mandating this hearing to be held and the U.S.  
22 Department of Agriculture for conducting this hearing to  
23 reconsider the Class 3 and Class 4 milk pricing formulas.

24           The hearing was called pursuant to the provisions  
25 of the Agricultural Marketing Act of 1937 with the political

1 rules of practice and procedure governing the formulation of  
2 marketing agreements and marketing orders.

3 In the hearing notice it was stated that the  
4 purpose of the hearing was to receive evidence with respect  
5 to the economic and marketing conditions which relate to the  
6 reconsideration of the Class 3 and Class 4 milk pricing  
7 formulas.

8 The Agricultural Marketing Act of 1937 requires in  
9 Section 608(c)(18) that the establishment that the  
10 establishment of milk prices consider the national parity  
11 prices for milk if it does not adequately reflect the prices  
12 of feeds and available supplies of feeds and other economic  
13 conditions which affect market supply and demand for milk in  
14 the marketing area to which the marketing agreement order  
15 relates, he shall fix such a price that will reflect such  
16 factors in ensuring sufficient quantity of pure, wholesome  
17 milk and be in the public interest.

18 The current milk pricing policy being followed by  
19 USDA failed to take into account dairy producers' costs of  
20 production as a factor to determine or adjust the value of  
21 milk. The issue of public interest concerning the dairy  
22 industry today has changed. Public interest no longer only  
23 involves the supply for fluid consumption. Increases in  
24 American consumers' consumption of dairy products show this  
25 to be true. America's consumers are relying on manufactured

1 dairy products as well as fluid milk to be readily available  
2 in stores at reasonable prices.

3 USDA's federal order milk marketing program has in  
4 the past viewed milk used for manufacturing of cheese,  
5 butter, and non-fat dry powder as reserved milk. This milk  
6 has as much value to today's consumers as milk utilized in  
7 the fluid market.

8 A milk pricing system that is balanced requires  
9 that dairy product prices, producers' cost of production,  
10 and plants' cost of production all be given consideration  
11 when determining the value of milk. Each of these items  
12 send signals to one another in a free market environment so  
13 that proper adjustments can be forthcoming.

14 In the current milk pricing system one of these  
15 entities has an unfair consideration. The make allowance is  
16 set at a certain fixed level. The make allowance situation  
17 allows the processing segment of the industry to be  
18 unconcerned with market signals.

19 The dairy industry that is balanced and market  
20 oriented should be a vital goal of an milk pricing hearing.  
21 However, market signals need to be given to both the  
22 producing and processing sectors of the industry for this  
23 goal to be realized. Economic and marketing conditions are  
24 an important element of the hearing.

25 Nonetheless, the current USDA Class 3 and Class 4

1 milk pricing formulas based on dairy product commodity  
2 prices lack the full accountability of economic and  
3 marketing factors and the establishment of producer milk  
4 prices.

5           The main factors involved in establishing USDA's  
6 current producer milk price formulas are dairy product  
7 price, the product yield, and plant make allowance.

8           The dairy product price responds by increasing or  
9 decreasing according to economic and marketing conditions.

10           The product yield could be considered as changing  
11 in terms of marketing if marketing was viewed in the terms  
12 of changes according to moisture content and composition of  
13 milk.

14           The remaining factor is the processor make  
15 allowance. The make allowance is the plant production cost  
16 for manufacturing the dairy product which is then subtracted  
17 from the dairy commodity price to the term and the value of  
18 the milk in the product.

19           The dilemma with USDA's milk pricing concerning  
20 plant make allowance consideration is that the make  
21 allowance is a fixed number.

22           Economic rationale is one of the criteria the USDA  
23 takes into consideration when making milk pricing formula  
24 policies. USDA must remember that the purpose for this  
25 hearing is to price producers' raw milk.

1               Currently milk is not being priced as milk  
2 directly. Milk is being priced indirectly as a dairy  
3 product. The current end product pricing formula alone does  
4 not find the true value of raw milk. Raw milk has a value  
5 before it is processed into a dairy product.

6               An economic rational approach to pricing raw  
7 milk's value would be to include some type of consideration  
8 for milk production costs such as hay, grain, equipment,  
9 utilities, labor, insurance and so on.

10              For proper milk price adjustments to be  
11 forthcoming, the current milk pricing system requires a  
12 variable plant make allowance to be instituted. USDA's  
13 current policy on plant make allowances -- make allowances  
14 set at a fixed level -- has given processors an unfair  
15 consideration. The make allowance situation allows the  
16 processing segment of the industry to be unconcerned with  
17 market signals in terms of dairy product prices caused by  
18 supply and demand conditions.

19              Market signals need to be given to both the  
20 producing and the processing sectors of the industry.

21              The current milk pricing policy for Class 3 and  
22 Class 4 allows manufacturing plants of butter, non-fat dry  
23 milk, and cheese a cheap source of milk with a fixed  
24 operating profit margin which will continue to negatively  
25 impact the dairy product prices nationally.

1           This is a vicious cycle in the dairy industry,  
2   that an end product pricing mechanism with a fixed make  
3   allowance magnifies. When dairy product prices are too low  
4   due to large supplies, it results in decreases to milk  
5   prices for dairy producers. Dairy producers look at ways to  
6   increase cash flow. The easiest way for dairies to increase  
7   cash flow is to produce more milk from the same dairy  
8   facility.

9           Processing plants with a fixed make allowance are  
10   happy to accommodate the increase in milk production. The  
11   processing plants have several benefits from the increased  
12   milk production in the way of increases in plant profits as  
13   well as improvement in plant efficiencies. Processors are  
14   not directly affected by the resulting decline in product  
15   prices from the products that they produced from their  
16   plants.

17           The dairy industry is an industry of checks and  
18   balances that rely on different segments of the industry to  
19   work in unison to achieve a viable industry. The current  
20   pricing system, however, does not give equal consideration  
21   between the producing segment and the processing segment of  
22   the industry. The processing segment of the industry has a  
23   built-in cushion into the system known as a make allowance  
24   which the producing segment does not have.

25           If the make allowance is not subject to adjustment

1 for market signals, then the whole mission of having a  
2 market-oriented dairy industry is void.

3 The California dairy industry history and current  
4 performance indicate that the national dairy industry under  
5 the current U.S. milk pricing system will be, and I stress  
6 this, production oriented and not supply and demand  
7 oriented.

8 California's Class 4A and Class 4B milk pricing  
9 formulas and now USDA's Class 3 and Class 4 isolate one  
10 segment of the industry from receiving true market  
11 conditions which will eventually devastate the dairy  
12 industry and government programs.

13 National Farmers Organization is submitting make  
14 allowance proposals for consideration that is fair and  
15 reasonable in attempting to have a free market oriented  
16 pricing system for milk to manufacture butter, non-fat dry  
17 milk, and dry whey powder as well as cheese.

18 National Farmers Organization proposes that the  
19 Class 3 make allowance for cheese and whey be established in  
20 the following market-oriented fashion.

21 The cheese make allowance and dry whey powder are  
22 to have a base make allowance level which are set at the  
23 weighted average manufacturing cost determined by USDA Rural  
24 Business Cooperative Service. Currently cheese is at 1.292  
25 dollars per pound, and powder is at .1271 dollars per pound

1 to be adjusted on an annual basis plus a marketing cost of  
2 .0015 dollars per pound and a return on investment of .0103  
3 dollars per pound on cheese and .0174 on whey powder.

4 The base make allowance level for cheese will be  
5 1.41 dollars per pound and for dry whey will be .1460  
6 dollars per pound.

7 These base make allowances are to be adjusted  
8 according to the relationship between cheese whey powder  
9 reference price which is based on currently calculated NASS  
10 monthly cheddar price and the NASS monthly whey price to the  
11 producers' cost of production. The producers' cost of  
12 production amount is to be the most recent California  
13 Department of Food and Agriculture milk production cost  
14 index. A document explaining the California Department of  
15 Food and Agriculture milk production cost index and a recent  
16 index sheet are attached to the back of the testimony as  
17 Exhibit 1.

18 The effects of the adjustable make allowance for  
19 cheese and dry whey powder would be a market-oriented  
20 approach to determining what the make allowance should be  
21 for plants.

22 Chicago Mercantile Exchange monthly average prices  
23 would be preferred in calculations instead of the NASS  
24 monthly price.

25 The cheese whey powder reference price is to be

1     calculated on a hundredweight standard of 3.1815 crude  
2     protein equivalent to 2.9915 percent true protein, and  
3     5.6953 other solids content with the yields based on a  
4     modified VanSlyke formula (See Exhibit 2) in the following  
5     manner with formula adjustments to recover fat recovery set  
6     at 93 percent and casein to true protein set at 82.954  
7     percent.

8             The sum of the two following formulas -- the price  
9     per hundredweight computed by the formula using NASS monthly  
10    cheddar price multiplied by the yield factor of 9.9095 then  
11    subtract the amount equivalent to 9.9095, multiplied by the  
12    adjusted make allowance of the prior month. The price per  
13    hundredweight computed by the formula using the NASS monthly  
14    whey powder price multiplied by the yield factor of 6.1618  
15    then subtract the amount equivalent to 6.1618 multiplied by  
16    the base whey make allowance.

17            The calculated cheese whey powder reference price  
18    is then divided by the most recent CDFA milk production cost  
19    index to determine the make allowance adjusting factor.

20            The USDA Rural Business Cooperative Service  
21    weighted average manufacturing costs of cheese and whey  
22    powder are then multiplied by the make allowance adjusting  
23    factor to determine the current months make allowance to be  
24    used in calculations.

25            The following is an example for March 1999. The

1 NASS monthly cheddar price was \$1.364, the NASS monthly whey  
2 powder price was .1917 dollars per pound. CDFA milk  
3 production cost index for that time period was \$13.40.

4 When the formula is applied you will take the  
5 \$1.364 times the 9.9095 and you will subtract the make  
6 allowance factor of 9.9095 times the base make allowance of  
7 .1410 plus the whey value which would be .1917 dollars times  
8 the yield of 6.1618 minus the make allowance factor of  
9 6.1618 times .146 dollars to give you what is called as a  
10 reference price, the cheese whey powder reference price of  
11 \$11.83.

12 Now that \$11.83 is going to be used to calculate  
13 the make allowance adjusting factor. You would take the  
14 \$11.83 divided by the producer's cost of production  
15 established by CDFA of \$13.40 to give you an adjusting  
16 factor of 88.25 percent.

17 Basically this equates for the March adjusted make  
18 allowance equal to .1418 times the 88.25 percent will give  
19 you a make allowance for the month of .1244 dollars per  
20 pound and the March adjusted powder make allowance would be  
21 equal to .146 dollars per pound times the 88.25 percent will  
22 give you a make allowance for the month of .1288 dollars per  
23 pound.

24 National Farmers Organization proposes that the  
25 Class 4 make allowance for butter and non-fat dry milk be

1 established in a market-oriented fashion as well. The  
2 butter and non-fat dry milk make allowance are to have a  
3 base level which is set at the weighted average  
4 manufacturing cost determined by USDA Rural Business  
5 Cooperative Service.

6           Currently butter is at .0938 dollars per pound,  
7 and powder is at .1271 dollars per pound to be adjusted on  
8 an annual basis, plus the marketing cost of .0015 dollars  
9 per pound, and a return on investment of .0073 dollars per  
10 pound for butter, and .0174 dollars per pound on powder.

11           The base make allowance level for butter would be  
12 .1025 dollars per pound and the powder would be .146 dollars  
13 per pound.

14           These base make allowances are to be adjusted  
15 according to the relationship between the butter, non-fat  
16 powder reference price which is based, currently calculating  
17 NASS monthly butter and non-fat milk powder prices to  
18 producers' cost of production. The producers' cost of  
19 production, again, would use CDFA's milk production cost  
20 index.

21           The effects of the adjustable make allowance for  
22 butter and non-fat dry milk would again be a market-oriented  
23 approach to determining what the make allowance should be  
24 for plants. Chicago Mercantile Exchange monthly averages  
25 prices would be preferred in the calculations instead of the

1 NASS monthly price.

2           The butter, non-fat dry milk reference price is to  
3 be calculated based on a hundredweight standard of 3.5 fat,  
4 3.1815 crude protein and 5.6935 other solids equating to  
5 8.875 percent solids non-fat content in the following  
6 manner.

7           The yield factors would be 1.219 for butter, and  
8 1.02 for powder.

9           The sum of the two following formulas will equal  
10 your reference price for butter and non-fat dry milk. The  
11 price per hundredweight computed by the formula using NASS  
12 monthly butter price multiplied by the yield factor of  
13 4.268, then subtract the amount equivalent to the 4.268  
14 multiplied by the adjusted butter make allowance for the  
15 prior month.

16           The price per hundredweight computed by the  
17 formula using the NASS monthly non-fat dry milk powder price  
18 multiplied by the yield factor of 9.025, then subtract the  
19 amount equivalent to the 9.025 multiplied by the adjusted  
20 non-fat milk make allowance for the prior month.

21           The calculated butter, non-fat dry milk powder  
22 reference price is then divided by the most recent  
23 California Department of Food and Ag milk production cost  
24 index to determine the make allowance adjusting factor.

25           The USDA Rural Business Cooperative Service

1 weighted average manufacturing costs of butter and non-fat  
2 dry milk are then multiplied by the make allowance adjusting  
3 factor to determine the current month's make allowance to be  
4 used in calculations.

5 MR. ROSENBAUM: Excuse me, Your Honor. Steve  
6 Rosenbaum. I'm sorry to interrupt. I've been following  
7 along the testimony.

8 I find the testimony to have proposals in them  
9 that simply are not reflected in the notice. This  
10 organization did provide two or three proposals with respect  
11 to yield factors and some of his testimony addresses that  
12 and I have no objection to that portion coming in, but these  
13 adjusters that he's putting in based upon California cost of  
14 production and based upon relationships between a variety of  
15 factors that I'm having difficulty even to follow the  
16 concepts of, are simply not in the proposals and as a result  
17 are nothing that my client has ever had a chance to analyze  
18 the economics of, and we can't do that on the fly as he  
19 testifies.

20 So I'm going to object to this testimony at this  
21 time and move to strike.

22 JUDGE HUNT: Mr. English?

23 MR. ENGLISH: Charles English. I join in that  
24 objection and note that while National Farmers Organization  
25 mentioned cost of production, they did not provide a

1 specific proposal with respect to that so I object to the  
2 extent that the notice, based upon their proposal, did not  
3 provide us adequate opportunity.

4 Beyond that, these proposals plainly go way beyond  
5 what was anticipated in the hearing notice and I therefore  
6 join the objection and move to strike or move to exclude  
7 even in advanced.

8 JUDGE HUNT: Mr. Yale?

9 MR. YALE: We vehemently disagree.

10 We came to this hearing knowing that make  
11 allowances was the issue. We came to this hearing knowing  
12 that cost of production was an issue because it was  
13 mentioned. Cost of production shall be considered. That's  
14 part of the hearing notice. And everybody who's been  
15 involved in federal order hearings knows that as you come to  
16 this hearing these things mix based on the testimony and  
17 there's modifications and adjustments and stuff and the like  
18 and we all anticipate that coming, but we all knew that we  
19 were facing an issue of make allowance, we were facing  
20 formulas to devise make allowances, and we were faced with  
21 the issue of cost of production being involved in there.

22 And the fact that he mixes it this way is well  
23 within that notice, and I think his testimony should  
24 consider. The Secretary is fully capable of taking this  
25 testimony with the rest of it and making a proposal that's

1 consistent with the Act and it shouldn't be stricken.

2 JUDGE HUNT: Mr. Beshore?

3 MR. BESHORE: I just want to interject one note.

4 The hearing and all participants took testimony  
5 from the gentleman from National Farmers Union who presented  
6 the same concept, not in all the particulars, but the same  
7 issues. It's already in the hearing notice.

8 To deny Mr. Pacheco the opportunity now to comment  
9 upon the same concepts that have already been taken here,  
10 which relate to make allowances which are in the hearing  
11 notice would be extremely unfair and should not be done.

12 MR. ROSENBAUM: Your Honor, just to focus the  
13 objection, on page five there is discussion of base make  
14 allowances of various dollar amounts for cheese and dry whey  
15 to be adjusted based on a relationship between a cheese whey  
16 powder reference price which has something to do with a NASS  
17 monthly cheddar price and a NASS monthly whey powder price,  
18 adjusted for producer cost of production based upon the most  
19 recent California numbers. None of this appears in any  
20 hearing notice and none of this is reflected in any of these  
21 proponents or any other proponents' proposals.

22 With respect to other proposals we've had the  
23 opportunity for several weeks now to address the financial  
24 implications, the implications for the industry as a whole,  
25 make a conclusion as to whether they should be supported,

1 and if opposed to present testimony as to why they should be  
2 opposed. But none of those things apply with respect to  
3 this testimony, and that's the basis for our objection.

4 JUDGE HUNT: Mr. Berde?

5 MR. BERDE: Your Honor, as all counsel assembled  
6 here know, it is permissible to accept a proposal that can  
7 be characterized as any appropriate modification of any  
8 proposal that is articulated already in the notice of  
9 hearing. It comes down to this question which I would like  
10 to hear the views of the Secretary's council on, would the  
11 Secretary consider what is now being proposed as an  
12 appropriate modification of any of the proposals that are  
13 contained in the notice of hearing?

14 JUDGE HUNT: Do you wish to address that Mr.  
15 Cooper or Ms. Brenner?

16 MR. COOPER: I think it was Mr. Contente from  
17 National Farmers Union who testified as to something that is  
18 basically the same as Mr. Pacheco here is discussing, which  
19 was addressed to proposal number 29 which is a rather  
20 vaguely defined -- Incorporate cost of production into Class  
21 3 and Class 4 formulas.

22 That was not an NFO proposal, it was an NFU  
23 proposal. The witness, who I believe was Mr. Contente,  
24 already addressed that in a manner similar to where Mr.  
25 Pacheco seems to be going.

1           Mr. Pacheco goes a little further and is  
2    embellishing it some and adding a little more to the  
3    formulas, but it would strike me this is probably something  
4    that could properly be characterized as an appropriate  
5    modification of the NFU proposal.

6           As the hearing notice states and as is typical in  
7    these things, we do accept appropriate modifications of  
8    existing proposals.

9           JUDGE HUNT:   Mr. English?

10          MR. ENGLISH:   Perhaps we ought to be objecting to  
11   proposal number 29 as the government attorney has just  
12   acknowledge as a rather vague proposal.   The purpose of a  
13   notice of hearing, of course, is to put the participants on  
14   notice as to what the nature of the proposals really are.  
15   To say you're going to incorporate costs of production is a  
16   rather meaningless provision of notice, and that's certainly  
17   not the Secretary's fault.   It is the fault of the proponent  
18   who submitted the proposal.

19          But beyond that, we have this wonderful term of  
20   art, an appropriate modification.   Well Your Honor, I submit  
21   this is not an appropriate modification.   This goes way  
22   beyond the scope of even what was testified about yesterday  
23   which was merely an adjuster.   Now we have in addition to  
24   the adjuster a number of price series for which we have had  
25   no discussion up until now.   We've had a number of witnesses

1 who have already departed who may very well have wanted to  
2 comment on this issue had they known that this issue was  
3 going to be opened.

4 I think that the objection is very well taken.

5 JUDGE HUNT: It does appear to be beyond the  
6 modification, as Mr. English says. I'm not that conversant  
7 and don't claim to be, about the order and all the  
8 intricacies of the proposals.

9 I'm going to allow Mr. Pacheco to continue with  
10 his testimony, but it does clearly appear to be a proposal  
11 that's not within the scope of those that were in the  
12 register.

13 As I did with Dr. Barbano's testimony, I'll allow  
14 it in and let the Secretary's representative who's going to  
15 make the determination to disregard the testimony to the  
16 extent, Mr. Pacheco's testimony to the extent that it does  
17 not fall within the scope of the proposals.

18 JUDGE HUNT: Mr. Yale?

19 MR. YALE: Your Honor, I appreciate your ruling.  
20 On the other hand it does create a conundrum.

21 JUDGE HUNT: I understand.

22 MR. YALE: The conundrum is --

23 JUDGE HUNT: Do you respond to it.

24 MR. YALE: -- do you respond to it.

25 I think we've got to separate our disagreements

1 with what their approach is from what's being done here.  
2 The AMAA is, one of its factors is to be concerned with  
3 producers. And this is one way in which the producers'  
4 interests is being presented. One of the few ways in which  
5 it's actually being directly presented in terms of cost of  
6 production which is consistent with the cost of feeds and  
7 other factors that are required under the AMAA.

8 I would respectfully request that to allow it in  
9 and the proposal and then the Secretary is in the position,  
10 without having to call a new hearing, or recall one if they  
11 find that some of these proposals maybe should have been  
12 considered, and then we've got to go through this process  
13 again.

14 JUDGE HUNT: I understand your problem. We ran  
15 into that with Dr. Barbano, how much was his testimony  
16 relevant to the proposals and how much concern his proposal,  
17 which was not being considered, and how much did you have to  
18 go into -- There's a lot in the record that's undoubtedly  
19 not going to be relevant or be considered.

20 Unfortunately, that's how it's going to be. I've  
21 made my ruling, so I'll allow Mr. Pacheco to continue with  
22 his testimony.

23 Mr. Pacheco?

24 THE WITNESS: The following is an example of a  
25 March 1999 calculation to establish the butter powder

1 reference price for Class 4 which would then be adjusted by  
2 the cost of production.

3 The NASS butter price was \$1.3019. The NASS non-  
4 fat dry milk price was \$1.0169. California again, milk  
5 production cost index was \$13.40 for the most recent  
6 published time.

7 The equation is listed there. For the sake of  
8 time and respect of other people that are waiting to  
9 testify, I will go beyond that. It basically calculates in  
10 the same manner using different factors. For this one,  
11 however, you would have a make allowance adjusting factor  
12 for the Class 4 being \$13.03 divided by -- the \$13.03 would  
13 be the butter powder reference price divided by the \$13.44  
14 for the cost production index, which would give you a 97.29  
15 percent adjustment factor.

16 So basically what it's saying is the March  
17 adjusted butter make allowance would be the 1.26 dollars per  
18 pound base make allowance times the .9721 equalling a .0997  
19 dollar per pound make allowance for that prescribed month.

20 The March adjusted powder make allowance would be  
21 the base make allowance of .1460 times the adjusted make  
22 allowance for that month of .9721 to equal a .1419 dollars  
23 per pound make allowance for powder.

24 NFO's make allowance proposal is directed by  
25 market conditions -- something that the current formula

1 lacks. The current formula lacks market price volatility on  
2 the producers' milk pay price.

3 This type of approach to establish plant make  
4 allowances would share, and I stress share, the market price  
5 volatility effects financially on both the producer and the  
6 process.

7 The processor should receive the same stability or  
8 instability from the market as do the producers.

9 The adjustable make allowance response to factors  
10 that have direct effects on the dairy system.

11 The make allowance changes proposed by the NFO  
12 would bring about a market-oriented system that is needed in  
13 today's dairy industry.

14 Since dairy producers' raw milk prices are to be  
15 determined by dairy product prices, the processors as well  
16 as the producers need to be responsible for achieving stable  
17 and equitable dairy product prices.

18 National Farmers Organization recommends that USDA  
19 change the form of the dairy product price discovery from  
20 cheese and butter and non-fat dry milk from the NASS survey  
21 to the Chicago Mercantile Exchange. The NASS survey is a  
22 survey of manufacturing plant product prices that are not  
23 audited and not reported as being mandatory.

24 This raises serious concerns among dairy producers  
25 due to the direct effects of this decision on producers'

1 milk price calculation. Plants basically look at the  
2 Chicago Mercantile Exchange as their reference price since  
3 it is traded on a daily basis.

4 National Farmers Organization recommends USDA  
5 adopt --

6 MR. YALE: Your Honor, to the extent that he has  
7 proposals to use the CME over the NASS, is your ruling  
8 saying that that proposal is not admitted in the record?

9 JUDGE HUNT: Which one?

10 MR. YALE: His proposal includes the use of the  
11 CME versus the NASS. Has that part of the proposal been  
12 stricken and not to be considered by the Secretary? I just  
13 want a clarification.

14 JUDGE HUNT: Was the objection to all his  
15 proposals?

16 Mr. Rosenbaum was objecting. Were you objecting  
17 to all of them, Mr. Rosenbaum?

18 MR. ROSENBAUM: I see no reason why this witness -  
19 - This witness is certainly entitled to testify in favor of  
20 using the CME instead of NASS. That's a noticed proposal.  
21 Whether it's his or not I don't even know, but that's a  
22 noticed proposal.

23 JUDGE HUNT: You don't object to that then.

24 MR. ROSENBAUM: I view that as testimony in favor  
25 of Mr. Yale, which I didn't object to Mr. Yale's witness'

1 testimony.

2 MS. BRENNER: -- proponent of the --

3 MR. ROSENBAUM: Whether he is or not, I think he's  
4 obviously entitled to testify in favor of proposal number  
5 one.

6 MR. YALE: I just wanted to make that clarified so  
7 that we didn't find out that everything kind of got thrown  
8 out with the baby and the bathwater.

9 JUDGE HUNT: All right, Mr. Yale.

10 Mr. Pacheco?

11 THE WITNESS: National Farmers Organization  
12 recommends USDA adopt the following Class 3 milk pricing  
13 formula changes.

14 The butter fat price for the Class 3 milk price  
15 would be as follows: You would take the CME monthly average  
16 butter price minus the adjusted make allowance -- the  
17 adjusted make allowance would be the factor there that I  
18 guess you're trying to throw out -- divided by the .82  
19 equals the fact value.

20 The protein price would equal the CME monthly  
21 average 40 pound cheddar cheese price minus again the  
22 adjusted make allowance times the 1.45 plus the CME monthly  
23 average 40 pound cheddar cheese price minus again the  
24 adjusted make allowance, multiplied by the factor of 1.635.  
25 This would, minus the calculated fat price, times the 1.28

1 factor. This will give you the protein value.

2 The other solids price would be the NASS whey  
3 powder survey price minus the adjusted make allowance  
4 divided by the .968.

5 The following is an example for March 1999.

6 The butter price, using the factors of \$1.319  
7 minus the adjusted make allowance, and that's why these  
8 numbers are not going to correlate to any numbers if you  
9 don't accept the adjusted make allowance, but the adjusted  
10 make allowance would have been .0997 divided by .82 for a  
11 butter fat price of \$1.466 dollars per pound.

12 The protein price would have equaled \$1.33 minus  
13 the adjusted make allowance for the month of 1.244 dollars  
14 per pound times the 1.405 plus \$1.33 minus the .1244 times  
15 the 1.635, again minus the butter fat value of \$1.466 per  
16 pound, multiplied by 1.28, would have given you a protein  
17 value of \$2.34.

18 Other solids price would have been the .1977  
19 dollars per pound, whey powder minus the .1498, 1419, which  
20 would have been the adjusted make allowance of the month,  
21 divided by the .968 equals .0514.

22 The adjusted butter fat yield of 1.635 used above  
23 was calculated as follows. You took the .35 with the  
24 recovery value, multiplied by the recovery value of .93,  
25 multiplied by the 1.09 divided by the moisture of .68, .62,

1 38 percent moisture being the factor there, equalling the  
2 1.635.

3 National Farmers Organization believes USDA should  
4 adjust the fat recovery in the VanSlyke formula from the 90  
5 percent to the minimum of 93 percent. Today's cheese  
6 manufacturing plants are efficient in recovering at least  
7 this amount in butter and the cheese making process. Many  
8 of the cheese making plants are recovering the whey cream  
9 into the vats to increase production and efficiency at the  
10 plant.

11 On Class 4 milk pricing, concerning the level of  
12 non-fat dry milk yield from the pound of solids non-fat,  
13 needs to be addressed. The current formula uses a dividing  
14 factor of 1.02 pounds on the NASS non-fat dry milk price  
15 minus the make allowance. This basically implies that only  
16 .98 pounds of non-fat dry milk is yielded from a pound of  
17 solids non-fat.

18 To have a dividing factor of .012 is an obvious  
19 mistake in the Class 4 milk pricing formula. National  
20 Farmers Organization would like to withdraw the original  
21 proposal of using a dividing factor of .99. NFO would like  
22 to submit a proposal to use a multiplying factor of .1.02 on  
23 the CME non-fat dry milk price minus the make allowance.

24 This basically implies that 1.02 pounds of non-fat  
25 dry milk is yielded from the pounds of solids non-fat in

1 milk. CDFA, Department of Food and Agriculture, did a  
2 report on butter and powder yields. This report shows the  
3 weighted average. Powder yield was 1.025 from the selected  
4 California plants in the survey as shown in Exhibit 3.

5 National Farmers Organization would support any  
6 yield factor adjustment that yields 1.02 pounds or higher.

7 The questionable health of America's dairy  
8 industry due to the past dairy policy is very plain to see  
9 looking at the exodus of dairy operations over the years.  
10 According to the American Farm Bureau in 1992 there were  
11 131,535 commercially operating dairy farms. In 1999 this  
12 number decreased to 87,669 farms. Over this period of time,  
13 43,846 dairy operations went out of business.

14 Simply put, one-third of America's dairy  
15 operations from 1992 to 1999 went out of business and  
16 stopped being part of this country's dairy infrastructure.

17 The current milk prices are causing many more  
18 dairy producers to exit the industry. National Farmers  
19 Organization urges USDA to adopt the proposals presented in  
20 our testimony today so an equitable and stable dairy  
21 industry can be established in this country.

22 JUDGE HUNT: Any questions of Mr. Pacheco?

23 Mr. Rosenbaum?

24 MR. COOPER: Can I get a clarification first?

25 JUDGE HUNT: Yes, Mr. Cooper.



1           MR. COOPER: Does anyone want to address the three  
2 exhibits attached to it as to what they should be too,  
3 before we get into Cross-Examination?

4           JUDGE HUNT: It's been offered right now.

5           MR. COOPER: Okay.

6                           CROSS-EXAMINATION

7           BY MR. ROSENBAUM:

8           Q   Mr. Pacheco, I want to have you turn, if you  
9 would, to page nine in your testimony. The last paragraph  
10 which deals with the question of the yield factor that's  
11 built into the formula. Specifically the dividing factor of  
12 1.02 which you think ought to be changed. Correct?

13          A   Yes.

14          Q   You're saying instead of dividing by 1.02 you  
15 would multiply by 1.02 but off of a different price  
16 consistent with your view that it should be CME rather than  
17 NASS, correct?

18          A   Correct.

19          Q   You say the dividing factor of 1.02 was a mistake,  
20 but have you read the explanation that was given in the  
21 final rule for why they used that number?

22          A   I guess I could say I disagree with it maybe.  
23 Everybody can justify their own decisions. I just disagreed  
24 with it and I figured it was a mistake.

25          Q   You say here that the dividing factor of 1.02

1 implies that only .98 pounds of non-fat dry milk is yielded  
2 from a pound of solids not fat in milk, do you see that?

3 A Uh huh.

4 Q But you will acknowledge that it was not that  
5 assumption that drove USDA to reach the 1.02, correct?

6 A Again, I don't know what their assumption was.  
7 I'm just putting down the way that I and National Farmers  
8 Organization views this factor of yield.

9 Q You agree that the formula determines the price to  
10 be paid for milk going into non-fat dry milk -- excuse me.  
11 Restate that.

12 Yes, the price to be paid for non-fat dry milk,  
13 for milk going into non-fat dry milk is the price of non-fat  
14 dry milk on the market minus the make allowance divided by  
15 the 1.02. That's how the formula now works.

16 A That's how it works.

17 Q Now it's true, though, isn't it, that some of that  
18 non-fat solids don't end up in non-fat dry milk, but end up  
19 in buttermilk powder.

20 A As was presented yesterday, yes, that is the case.

21 Q And you would agree with me as well -- But there's  
22 no survey done of buttermilk powder, that's not part of the  
23 process, correct?

24 A To the best of my knowledge.

25 Q Is it your understanding that USDA felt that the

1 best way to account for the fact that not all of the milk  
2 ended up in non-fat dry milk, but some of it ended up in  
3 buttermilk powder, that that reality would be reflected by  
4 using the 1.02 divisor rather than some lower divisor. That  
5 was how they would adjust for that phenomenon.

6 A The point being?

7 Q You're aware that that's the theory that went into  
8 the 1.02.

9 A That's their theory.

10 Q Yes. You're aware of that.

11 A Yes, I would assume that.

12 Q And you certainly agree with the reality that some  
13 of that milk ends up in buttermilk powder rather than non-  
14 fat dry milk.

15 A That would be the case.

16 Q And you would agree with me that buttermilk powder  
17 is a substantially lower valued product than non-fat dry  
18 milk.

19 A Depending on market conditions, that can be true.

20 JUDGE HUNT: Are you finished, Mr. Rosenbaum?

21 MR. ROSENBAUM: No, Your Honor.

22 Your Honor, I have a document I'd like to have  
23 marked as an exhibit if I could.

24 (Pause)

25 JUDGE HUNT: While they're conversing, Mr.

1 Pacheco, to follow up on the point that Mr. Cooper made,  
2 which is a very relevant point. These exhibits attached to  
3 your testimony, they need to be identified. What are those  
4 exhibits specifically? Can you identify them?

5 THE WITNESS: Yes. Exhibit 1 in the testimony is  
6 the milk production cost index that California Department of  
7 Food and Agriculture Department has been doing since 1955.  
8 It's an explanation of this survey that they do.

9 JUDGE HUNT: An official publication by  
10 California?

11 THE WITNESS: Yes, it is. That's Exhibit 1, and  
12 it contains four pages of explanation.

13 Exhibit 2 --

14 JUDGE HUNT: Page 2 of Exhibit 30 [sic] --

15 THE WITNESS: Oh, page two --

16 JUDGE HUNT: This is all Exhibit 30 [sic] -- Now  
17 you're referring to these attachments.

18 THE WITNESS: My exhibit referred to in the  
19 testimony of Exhibit 1 containing four pages. The first  
20 page of that is explanation. The second page would be a  
21 four-column chart which basically has it for 1978, 1988,  
22 1997, 1998, and reflects what their cost index were on  
23 average of the annual costs.

24 JUDGE HUNT: Who prepared that?

25 THE WITNESS: California Department of Food and

1     Agriculture prepared this.

2                 If that is the factor, if I may say this, if that  
3     is the factor of the objection of inputting this type of  
4     testimony --

5                 JUDGE HUNT:  No, this is just to identify these  
6     documents.

7                 THE WITNESS:  Okay.

8                 Then there's a glossary of terms because on the  
9     chart it has the terminology of what these numbers  
10    represent.

11                JUDGE HUNT:  Is that page three?

12                THE WITNESS:  Page three as well as page four are  
13    the glossary of terms of what those numbers represent.

14                And I'd like to say, the proposal does not  
15    necessarily need in terms of an adjusting factor of make  
16    allowance adjustments, does not need to be done with  
17    California Department of Food and Agriculture.  It can be  
18    done with any producer, milk production cost survey.

19                So if part of the objection to the testimony is  
20    that oh, you're using California numbers, we're not looking  
21    at California numbers.  You can use any numbers.  It's the  
22    logic of the philosophy of having a market-oriented make  
23    allowance that should be submitted for the Secretary's  
24    consideration.

25                Where the numbers came from, what reports it came

1 from, I don't think that's the issue. I think it's the  
2 issue of having make allowance which I thought this hearing  
3 was supposed to be about, and having an approach to  
4 determining the proper make allowance. As far as where it  
5 came from, the surveys used to determine the adjustment  
6 factor I think is irrelevant.

7 JUDGE HUNT: All these attachments now that you've  
8 marked as Exhibits 1 and 2, they're all publications of the  
9 California Department of Food and Agriculture.

10 THE WITNESS: Except for in the testimony Exhibit  
11 No. 2 which is basically a chart, which is a formulation  
12 chart.

13 JUDGE HUNT: Who prepared that?

14 THE WITNESS: I did. Well, actually, I shouldn't  
15 say that. Actually I took it off of Dr. Barbano's  
16 spreadsheet. I changed the numbers that I wanted. I  
17 changed the recovery to 78 percent and I changed the number  
18 to 93 percent and his formula is the one who calculated the  
19 numbers on there. So I shouldn't say that I did the  
20 formula.

21 JUDGE HUNT: Thank you, Mr. Pacheco.

22 Mr. Rosenbaum, please.

23 MR. ROSENBAUM: Your Honor, if I could have  
24 Exhibit 32, I think it will be.

25 JUDGE HUNT: Yes, Exhibit 32 marked for

1 identification.

2 (The document referred to was  
3 marked for identification as  
4 Exhibit No. 32.)

5 BY MR. ROSENBAUM:

6 Q Before you started describing your exhibits you  
7 started testifying that you agree that some of the solids  
8 not fat in fact do not end up in the non-fat dry milk but  
9 end up in dry buttermilk, correct?

10 A That is correct.

11 Q What I've given you is a document that comes off  
12 the AMS web site that tracks for, well reports for 1999 the  
13 price of non-fat dry milk and dry buttermilk as well as some  
14 other things, but that's what I want to focus on. Do you  
15 see that it reports that the average price for Chicago,  
16 low/medium heat non-fat dry milk, central market, was on  
17 average \$1.0347?

18 A I do see that.

19 Q Do you see that the central states price for dry  
20 buttermilk for that year, which is the most recent year we  
21 have figures for, is 0.760 cents?

22 A I do see that.

23 Q So that the price that a manufacturer could obtain  
24 in the marketplace for dry buttermilk was 25 percent less  
25 than the non-fat dry milk price on average over that year.

1           A     Yes.

2           Q     So you would agree with me that if we're pricing  
3 non-fat solids that we have to somewhere adjust for the  
4 fact, strike that.

5                     If we're pricing non-fat solids off of the non-fat  
6 dry milk price, which is how the formula works, there has to  
7 be some adjustment for the fact that some of that non-fat  
8 solids ends up in a product that's actually substantially  
9 less valuable than non-fat dry milk, don't we?

10          A     That would be true. And the amount of adjustment  
11 is what's in question here.

12          Q     That is the adjustment that --

13          A     I'm not saying I don't agree with you. I'm just  
14 saying that my opinion of the amount of adjustment would be  
15 the figures that I proposed.

16          Q     Your adjustment is based upon what you say is the  
17 powder yield from a pound of solids not fat, correct?

18          A     Powder yield from that portion of what's left  
19 after butter is being processed, yes.

20          Q     But the price that's been paid is based upon the  
21 milk that you've picked up at the farm, right? Under the  
22 federal system.

23          A     Yes.

24          Q     On page nine again, you testify as to what kinds  
25 of recoveries are being obtained in cheese manufacturing

1 plants. I assume you don't actually run such a plant, am I  
2 right?

3 A No, I do not.

4 Q You're simply relying upon what you've heard from  
5 other people?

6 A That's correct.

7 Q Under the current system, well I assume cheese  
8 prices have gone up and down over the last three months to  
9 some extent.

10 A A very small extent.

11 Q You are not suggesting that a cheese manufacturer  
12 will turn down a higher price for cheese that someone will  
13 offer to him, are you?

14 A Well, the question is this. If I accepted it, I  
15 didn't necessarily have to report it, because if I reported  
16 it my raw product costs would have gone up. So I have the  
17 election of either reporting it or not reporting it under  
18 the current collection of data.

19 Q My question was a very different one.

20 A Oh, I'm sorry.

21 Q If a cheese manufacturer is offered a higher price  
22 in the market for its cheese, you're not suggesting it's  
23 going to turn that down.

24 A No, I probably would say he wouldn't.

25 Q And you're not suggesting, are you, that if demand

1 suggests that there's less need for cheese than the people  
2 who buy cheese, well, let me turn that around.

3 If the demand for cheese falls, then the buyers of  
4 cheese are going to offer less to cheese manufacturers,  
5 correct?

6 A I don't know if I would say demand for cheese  
7 drops because we haven't really seen a demand in cheese  
8 dropping.

9 Q The relationship between what a purchaser of  
10 cheese will pay and what a seller -- Well, let me rephrase  
11 that.

12 What a purchaser will pay for cheese is determined  
13 by the demand for cheese, isn't it?

14 A It's not only based on demand for cheese. It's  
15 based on market condition of supply and demand.

16 Q The demand for cheese is not affected by the  
17 adoption of the new system, you would agree with that.

18 A I'm sorry, I don't --

19 Q The demand for cheese among consumers in America  
20 is not itself affected by the product price formula.

21 A I really -- That's a very vague question that in  
22 the product price formula could affect the demand.

23 Q How much consumers want cheese and what price  
24 they're willing to pay for it is not affected by the formula  
25 in the federal system. Do you agree with that much?

1           A     I can see how on the consumption of cheese, and  
2     this goes back to the consumer price index and all the  
3     retail side of things. The consumers are still purchasing  
4     cheese today and the producers haven't seen any response of  
5     where their prices have been established after the last  
6     three, four months. I don't know if that's the point you're  
7     getting to, but that needs to be tied in there somewhere.

8           Q     I'm simply asking whether you agree with me that  
9     the demand for cheese is one part of the equation that sets  
10    the cheese price and that is unaffected by the minimum  
11    pricing system that the federal government adopts.

12          A     I still don't --

13          Q     Well, you've made the statement that the current  
14    system makes the processing segment unconcerned with market  
15    signals. I'm trying to see whether the market signal of  
16    consumer demand for cheese remains in place.

17          A     In that sentence there, what that means is that if  
18    I got paid --

19          Q     But that's my question. You may have other points  
20    to make, but --

21          A     The intent of that line --

22                     JUDGE HUNT: Wait until he finishes the question.

23                     BY MR. ROSENBAUM:

24          Q     If you can just answer that we'll move on, which  
25    is whether you agree that the consumer demand for cheese is

1 independent of the pricing formula.

2 A There are so many factors there, it could be one  
3 of the factors.

4 Q So you're disagreeing with me.

5 A I slightly agree, I slightly disagree. I'm saying  
6 there are many factors.

7 Q Are you located in California itself?

8 A Yes, I am.

9 Q And California has lived under a product price  
10 formula system for some years now, correct?

11 A That is true.

12 Q The adjuster for cost of production is not found  
13 in the California formula, is that right?

14 A At this time.

15 Q And California production of milk has exploded  
16 over the last 30 years, correct?

17 A The numbers would dictate that.

18 MR. ROSENBAUM: That's all I have. Thank you.

19 JUDGE HUNT: Mr. Marshall?

20 MR. MARSHALL: Thank you, Your Honor.

21 Good morning, Francis.

22 THE WITNESS: Good morning, Doug.

23 BY MR. MARSHALL:

24 Q The only reason for my rising here is in hopes  
25 that I can help with a clarification of your testimony which

1 is now itself an exhibit, and what you might mean by the  
2 discussion of powder yields that Mr. Rosenbaum was just  
3 asking about.

4 If I understand you correctly, you have inserted  
5 the yield study from the California Department of Food and  
6 Agriculture as your primary source for your suggestions  
7 about yields.

8 A That is true.

9 Q I assume you rely on the Department's audits and  
10 are comfortable with their numbers.

11 A As far as I know they are audited and done in a  
12 businesslike manner, yes.

13 Q So would you accept then that whatever that report  
14 from CDFA shows is what you would want the Department to  
15 consider?

16 A Since this report may be updated, whatever would  
17 be an updated report.

18 Q But for purposes of your testimony you're saying  
19 that's the best reference source --

20 A At this time.

21 Q Let me just ask you to turn to the last page of  
22 your written testimony, it's numbered ten. I point out here  
23 as a preliminary to my question that the term powder is  
24 vague and typically when we talk about butter powder we're  
25 talking about butter and non-fat dry milk powder, but there

1 are also whole milk powders and buttermilk powders.

2 I refer you to your second and third new sentences  
3 on page ten. "The California Department of Food and  
4 Agriculture did a report on butter and powder yields. This  
5 report shows that the weighted average powder yield was  
6 1.0252 for selected California plants."

7 Do you see that?

8 A Uh huh.

9 Q Let's actually look at that report over on the  
10 very, very last page of your exhibit, and I believe you're  
11 referring to the very bottom there where you see a powder  
12 yield of 10252 as the upper left most number in that table.

13 A That is correct.

14 Q Then as you move across that table you see that  
15 that is the sum of the non-fat dry milk powder yield and the  
16 buttermilk powder yield, is it not?

17 A I do see that.

18 Q So would you accept then that the, at least from  
19 the standpoint of this study, the weighted average yield in  
20 the California plants included in the survey was 97 percent  
21 yield on non-fat and five percent yield on buttermilk  
22 powder?

23 A On this study that seems to be the case.

24 Q All right.

25 Let me just ask you now to refer back to page

1 nine, the very bottom of page nine, the beginning of that  
2 paragraph. You're discussing the 102 factor. You say in  
3 your third sentence, "This implies that only .98 pounds of  
4 non-fat dry milk is yielded from a pound of solids non-  
5 fattened milk," and you go on to characterize that as an  
6 obvious mistake. But isn't that in fact what this table  
7 from CDFA shows?

8 A It does.

9 Q So would you ask then that your testimony be  
10 interpreted in light of the numbers in the California  
11 report --

12 A This was a study that was available. There may be  
13 other studies. At the time I had not investigated to the  
14 fullest extent on that part.

15 Q I'm simply inviting you to suggest that your  
16 testimony should be modified to the extent necessary to  
17 conform to the California study.

18 A I would accept that, yes.

19 MR. MARSHALL: Thank you very much.

20 JUDGE HUNT: Other questions?

21 Mr. Yale?

22 BY MR. YALE:

23 Q Mr. Pacheco I want to take you back a little bit  
24 of time with National Farmers Organization. Wasn't there a  
25 time in which the National Farmers Organization opposed the

1 National Cheese Exchange?

2 A Yes.

3 Q But now you're supporting the Chicago Mercantile  
4 Exchange?

5 A Yes.

6 One of the other factors why we oppose NASS being  
7 used, especially for cheese, is because a significant part  
8 of cheese which is on NASS which as testified to earlier  
9 that Kraft purchases come out of the West, comes out of  
10 California.

11 Here you have a California pricing system setting  
12 the raw value of that milk that is then going to be sold and  
13 accounted for in the pricing system of the federal order.

14 So unless NASS does not accept cheese sales out of  
15 California as part of the formulation of the value of milk,  
16 then I would say we definitely need to use the CME.

17 Q And National Farmers Organization does not have  
18 concerns that the CME is subject to manipulation like the  
19 National Cheese Exchange?

20 A Any type of market can be subject to manipulation.  
21 I can't say it is or isn't. But the possibilities are  
22 always there.

23 Q There was some discussion with several of these  
24 about accounting for the fact that some of the solid non-fat  
25 is buttermilk, or dry buttermilk powder?

1           A     Correct.

2           Q     You don't disagree that there is a reduction for  
3     that as I understand your testimony.

4           A     No.

5           Q     But you also don't believe it should be given away  
6     free.

7           A     Definitely not.  If anything is to be done it  
8     should be a weighted adjustment so there is inclusion of  
9     that value.  Any time you're dealing with end product  
10    pricing, any value that is perceived that comes out of the  
11    producer's raw milk supply should be accounted for.

12          Q     This may be an unfair question because you  
13    probably need to talk with the powers that be, I understand  
14    you're a messenger sometimes, but in light of the fact that  
15    your proposal at this point is not to be considered, do you  
16    know if National Farmers Organization would support the  
17    proposal that was presented by Mr. Vanden Heuvel yesterday?

18          A     Significant factors of that proposal, and I cannot  
19    speak for the organization as is well known, but I would not  
20    see that proposal being objective in much of an extent.  I  
21    would say the Western States, Mr. Vanden Heuvel, did a very  
22    good presentation in terms of the faults in the current  
23    pricing system.

24          Q     I want to turn to your Exhibit No. 1, page two.  
25    The milk production cost index.

1 A Yes.

2 Q There's an extensive program by CDFA to look into  
3 the costs of production in California, is there not?

4 A There is.

5 Q In fact it's mandated by law?

6 A Yes, it is.

7 Q Looking on the far column, 1998, and come down to,  
8 there's just two numbers I want to point out, and I just  
9 want to answer your question. The bottom one, the big bold  
10 one obviously everyone looks at and that's the 13.39?

11 A That's correct.

12 Q So that's saying that as a return of all the costs  
13 as well as return on investment, return on management, that  
14 the blend price or the price the producer receives needs to  
15 average out at 13.39?

16 A For that year, 1998, that was a state-weighted  
17 average of all areas that was being accounted for, it was  
18 \$13.39.

19 Q But isn't it true that most people tend to look at  
20 the number coupled up above there where it's the total feed  
21 labor and miscellaneous costs which is kind of the out of  
22 pocket expenses somebody might say in a loose term where it  
23 says 11.41?

24 A Yes, I do see that number. 11.41.

25 Q Isn't 11.41 the one, once it gets below that the

1 producers are actually incurring actual out of pocket cash  
2 flow loss?

3 A That is true.

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

6 JUDGE HUNT: Ms. Brenner?

7 BY MS. BRENNER:

8 Q Mr. Pacheco, one of the issues that we run into in  
9 talking about using cost of production as a factor in these  
10 kinds of prices is who's cost of production? I know you  
11 said it doesn't matter, but for instance you've used the  
12 California dairy, the California Department of Food and  
13 Agriculture costs, for a period that's somewhat the same as  
14 the, for which an ERS cost of production for the Pacific  
15 region is under \$10 for the total economic cost of  
16 production. Then there's some other areas of the country  
17 where it's almost \$10 more than that.

18 That would make really large differences in this  
19 formula you have here, a variation of cost from say \$9.50 to  
20 \$19.50. And it's not only between regions. Those kinds of  
21 differences also show up within regions.

22 Whose cost of production should be used when  
23 you're looking at that kind of an issue?

24 A That's a very good question. At this time -- One  
25 of the reasons why I implied [sic] California cost of

1 production index is because it is audited. They do this on  
2 15 percent of the dairies in that state. There's close to  
3 300 producers, that five auditors that the department pays  
4 to go on a bi-monthly basis and audit these numbers. These  
5 numbers are not just called in. They check receipts. So  
6 I'm very secure on this type of process, that these numbers  
7 can be validated.

8           The numbers that USDA currently uses is based off  
9 of a census that sets a statistical value. I spoke with, I  
10 believe her name was Sarah Short. She told me that the  
11 census was done back in 1990, the last one. The numbers  
12 haven't been adjusted since then. There's another one  
13 that's supposed to be coming up either the end of this year  
14 or in 2001 that they're going to send out another survey.  
15 However, their amount of participation when she told me the  
16 number, it was very discouraging.

17           On the whole, I shouldn't even say, but it was  
18 very minuscule. That's why until USDA actually can put  
19 together a program that can justify what costs are on a  
20 uniform basis, not just on a statistical basis, based on  
21 corn going up or this going up or going to increase. I  
22 really do encourage USDA to put together some type of cost  
23 of production similar to what California does. In the gist  
24 of the whole matter, this issue of producers' cost of  
25 production is not going to go away. The reason why we see a

1 lot of producers going out of business is simply because  
2 they're better off going out of business. They're losing  
3 equity. Especially right now. Even though there were a  
4 couple of good years of milk prices, they're saying do I  
5 really want to lose everything that I've gained because  
6 things are going back so quickly?

7 That's where the cost of production factoring  
8 comes in, and I hope I answered your question, Ms. Brenner.  
9 I think we need to develop -- USDA needs to develop a better  
10 accountability for cost of production factoring.

11 Q Several places in your testimony you supported use  
12 of the CME instead of the NASS. I know you were giving Mr.  
13 Yale some reasons for that. What do you regard as the real  
14 strong positive about using the CME?

15 A The CME is on a daily basis. That's where people  
16 are going and viewing as the market value of cheese on a day  
17 to day basis. This is what I received from when the  
18 question was asked of the gentleman from Kraft, do you base  
19 your purchases off of a CME plus up, and he did not respond.  
20 Well I took that as chances are, I know it's proprietary  
21 information, chances are, a lot of the buyers use that as a  
22 factor to establishing what they're going to be paying for  
23 cheese. They're not going to wait for a NASS survey that's  
24 a couple of weeks late. They're going to look at that CME  
25 and base it off of that.

1           So that's where I look at where should the price  
2   for dairy products that are going to be determined in  
3   calculation be viewed from? That's the CME.

4           I think Mr. Vander Heuvel yesterday pointed out  
5   the responsiveness. The NASS is slow to follow the CME on  
6   the upturns. But because of the timing delay, it's much  
7   quicker to respond on the down turns.

8           These all affect, using end product pricing, these  
9   all affect the return to the producer. I'm just saying I  
10   know it's a smaller market, but I think because of its  
11   factoring in the value of the buyers' decisions on buying  
12   cheese, I think that's the market we need to go from.

13          Q    In the sense of it being a smaller market, at  
14   times given the idea that a market needs a buyer and a  
15   seller, at times it's a non-existent market, isn't it?

16          A    At times it can be. And that sometimes is because  
17   there's nobody willing to sell at that particular price or  
18   buy at that particular price.

19                The market signals do transfer onto that market  
20   place.

21                MS. BRENNER: That's all I have.

22                JUDGE HUNT: Thank you very much, Mr. Pacheco.

23                Oh, your proposed Exhibit 31, you'd like to have  
24   that entered into the record?

25                THE WITNESS: Yes, I would.

1 JUDGE HUNT: Any objections to Exhibit 31 being  
2 part of the record?

3 (No audible response)

4 JUDGE HUNT: No objection, Exhibit 31 will be  
5 received in evidence.

6 (The document referred to,  
7 having been previously marked  
8 for identification as Exhibit  
9 No. 31 was received in  
10 evidence.)

11 MR. ROSENBAUM: I'd move Exhibit 32 into the  
12 record.

13 JUDGE HUNT: Any objections to Mr. Rosenbaum's  
14 Exhibit 32?

15 (No audible response)

16 JUDGE HUNT: All right, 32 will be admitted as  
17 well.

18 (The document referred to,  
19 having been previously marked  
20 for identification as Exhibit  
21 No. 32 was received in  
22 evidence.)

23 JUDGE HUNT: Mr. Gulden?

24 MR. ROSENBAUM: Your Honor, Mr. Gulden has  
25 deferred to Dr. Schiek because he has the soonest plane, so

1 if that's all right.

2 JUDGE HUNT: Thank you Mr. Gulden.

3 Whereupon,

4 WILLIAM SCHIEK

5 having been first duly sworn, was called as a witness herein

6 and was examined and testified as follows:

7 JUDGE HUNT: State and spell your name please, to  
8 make sure we get it correct for the record.

9 THE WITNESS: My name is William Schiek. That's  
10 S-C-H-I-E-K.

11 DIRECT EXAMINATION

12 BY MR. ROSENBAUM:

13 Q Dr. Schiek, do you have a prepared statement?

14 A Yes, I do.

15 Q I've distributed copies of that statement for the  
16 participants, so if you could please read it into the  
17 record.

18 A Okay.

19 My name is William Schiek and I am the economist  
20 for Dairy Institute of California. Dairy Institute is a  
21 trade association representing about 40 milk processors and  
22 dairy product manufacturers which operate plants in the  
23 State of California. Dairy Institute's offices are located  
24 at 1127 11th Street, Suite 718 in Sacramento, California.

25 I have served as the economist for Dairy Institute

1     since June 1997. My responsibilities include member  
2     education with respect to dairy marketing and economic  
3     issues, providing member companies with current market  
4     conditions and trends, and assisting the Institute's Board  
5     members with regard to the formulation of policy positions  
6     pertaining to milk pricing and pooling issues.

7             I am the person primarily responsible for  
8     formulating testimony in support of the Institute's  
9     positions for California milk pricing and pooling hearings,  
10    supporting such testimony with economic analysis and  
11    presenting testimony at California hearings.

12            Prior to joining the staff of Dairy Institute I  
13    was Assistant Professor of Agricultural Economics at Purdue  
14    University in West Lafayette, Indiana from 1991 to 1997. At  
15    Purdue my responsibilities included teaching courses in  
16    agricultural marketing and marketing policy, international  
17    food and agribusiness marketing, and food distribution  
18    management.

19            My research focused on various aspects of dairy  
20    marketing, food marketing, and promotion and international  
21    marketing of value-added food products. Before joining the  
22    Purdue faculty I was a graduate research assistant in the  
23    Department of Food and Resource Economics at the University  
24    of Florida in Gainesville.

25            At the University of Florida my graduate thesis

1 research projects dealt with marketing impacts of  
2 concentration technologies for fluid milk and the changing  
3 regional structure of the U.S. dairy industry.

4 Before undertaking graduate study at Florida I was  
5 cooperative relations specialist and economist with the New  
6 York/New Jersey Milk Market Administrator's Office, that's  
7 pre-reform Federal Order No. 2, from 1982 to 1985. My  
8 primary responsibilities with the market administrator  
9 included administration of the order's cooperative payment  
10 provisions including coop qualifications and assisting with  
11 various research projects conducted by the market  
12 administrator's staff.

13 I received a BS degree in applied economics and  
14 business management from Cornell University in 1982, and MS  
15 and PhD degrees in food and resource economics at the  
16 University of Florida in 1988 and 1991 respectively.

17 The purpose of my testimony is to describe the  
18 dairy product manufacturing cost studies that are conducted  
19 annually by the California Department of Food and  
20 Agriculture. Cost data generated by these studies were  
21 cited by USDA in its final decision on federal order reform  
22 as one of the pieces of information that was considered in  
23 establishing the manufacturing allowances in the Class 3 and  
24 Class 4 pricing formulas which became effective January 1,  
25 2000.

1           My purpose in testifying is not to advocate one  
2   position over another with respect to these formulas.  
3   Indeed, Dairy Institute has no formal position with respect  
4   to the proposals being addressed at this hearing. Rather  
5   I'm here simply to describe why the cost studies are  
6   undertaken in California, how the studies are constructed,  
7   and how the information resulting from the studies is used  
8   within the context of the California pricing system.

9           Such information is useful for evaluating the  
10   appropriateness of including CDFA cost study data in the set  
11   of factors that are considered in establishing manufacturing  
12   allowances used in the Class 3 and Class 4 pricing formulas  
13   in the federal milk marketing orders.

14           My presentation today is based on my professional  
15   expertise as a dairy economist, my personal experience as a  
16   participant in the California state milk price hearing  
17   process, as well as information contained in three documents  
18   put out by the manufacturing cost unit of the Dairy  
19   Marketing Branch, California Department of Food and  
20   Agriculture.

21           The first of these is Manufacturing Cost Annual  
22   2000; The Non-fat Butter, Bulk Butter and Cheddar Cheese  
23   Cost for Selected Periods January 1997 to April 1999; and  
24   the Manual of Auditing Cost Procedures for Dairy  
25   Manufacturing Plants. Official notice of each of these

1 documents was taken earlier in this hearing.

2 Information was also drawn from the many contacts  
3 I've had with CDFA's staff during the course of my duties at  
4 Dairy Institute including numerous conversations with Mr. Ed  
5 Hunter, Supervising Auditor of the Dairy Manufacturing Cost,  
6 Dairy Marketing Branch at CDFA.

7 Background on CDFA cost studies. The California  
8 Department of Food and Agriculture has employed end product  
9 pricing formulas to establish prices for milk used in  
10 manufacturing butter and non-fat dry milk powder since 1955.  
11 A separate end product pricing formula for milk used to make  
12 cheese has been used since 1989.

13 Key components of these pricing formulas are the  
14 manufacturing allowances that reflect the cost of converting  
15 milk into butter, non-fat dry milk powder and cheese  
16 respectively.

17 The California Food and Agricultural Code, Section  
18 61441(d) and 62076(c) specifies that CDFA must consider  
19 manufacturing costs in determining appropriate minimum  
20 prices for products categorized as Class 4A, that's butter  
21 and dry milk products, and Class 4B, which is cheese milk.  
22 And it requires manufacturers to keep records of such  
23 manufacturing costs.

24 After the advent of milk pooling in California,  
25 audited cost studies were initiated by CDFA in 1974 for

1 butter and non-fat dry milk powder. Studies have been  
2 conducted since 1984 for cheese.

3           These cost studies provide information that is  
4 used to establish reasonable manufacturing cost allowances  
5 through the public hearing process. Manufacturing cost data  
6 which are accurate, complete, and allocated in a consistent  
7 manner across all milk plants studied enable end product  
8 pricing formulas to reveal the appropriate value for raw  
9 milk used in dairy product manufacturing.

10           CDFA cost studies are performed by professional  
11 auditors specializing in dairy cost accounting practices.  
12 The auditors work closely with plant management to determine  
13 precise and consistent allocation of plant expenditures to  
14 each product produced at the processing plant. CDFA's  
15 manufacturing cost audits commence only after the plant's  
16 books have been audited by an outside accounting firm, and  
17 the results of the outside audit are made available to CDFA  
18 audit staff.

19           Auditors review manufacturing plant records on  
20 site at each plant in the study. Each auditor's work is  
21 reviewed by another auditor as well as the audit supervisor  
22 to ensure complete and consistent allocation of all relevant  
23 costs.

24           CDFA has opted for an audited survey over  
25 voluntary cost reporting to ensure both the inclusion of all

1 direct costs and a consistent allocation of all relevant  
2 indirect costs. All audit staff currently employed in the  
3 CDFA cost studies have a minimum of ten years experience.  
4 CDFA currently has on staff five dairy manufacturing cost  
5 auditors covering the 20 plants currently in the survey.

6 Cost audits are performed annually on a 12 month  
7 basis. Most plants are audited based on calendar year data.  
8 However, some plants' costs are based on 12 month periods  
9 that represent some basis other than a calendar year.

10 The most current survey includes eight butter  
11 plants representing 99.5 percent of the butter produced in  
12 the state; 10 powder plants accounting for 98.9 percent of  
13 the non-fat dry milk produced; and nine cheese plants  
14 representing 97.6 percent of the monterey jack and cheddar  
15 cheese produced in California.

16 The state's largest manufacturing plants are  
17 included in the studies every year. The various smallest  
18 plants participate in the study on a rotating basis.

19 Cost categories analyzed. The major cost  
20 categories analyzed and reported in CDFA cost summaries  
21 include the following: processing labor; processing other  
22 than labor, or non-labor; packaging; purchased ingredients;  
23 return on investment; and general and administrative  
24 expenses.

25 CDFA auditors allocate costs directly to the

1 various products manufactured whenever possible. Indirect  
2 costs are calculated on a per pound of fat and solids not  
3 fat basis, and allocated to finished products based on the  
4 pounds of fat and solid non-fat in those products. Each of  
5 the major cost categories will be discussed in more detail.

6           First, processing labor. Processing labor  
7 includes the total wages, payroll taxes and fringe benefits  
8 of all plant employees. This category includes direct plant  
9 labor such as powder bagging and butter labor, and indirect  
10 plant labor such as working foremen, fieldmen, lab  
11 technicians, and plant superintendents. Labor data are  
12 obtained from payroll and from a job analysis of employees  
13 performed by plant personnel and CDFA auditors.

14           Processing non-labor. Processing costs other than  
15 labor include all direct and indirect plant expenses except  
16 those pertaining to payroll costs. Examples of these  
17 expenses are utilities, depreciation, repairs and  
18 maintenance, laundry, supplies, and plant insurance. Every  
19 attempt is made by the CDFA auditors through careful  
20 analysis to allocate expenses directly to the appropriate  
21 finished products.

22           Expenses that are too general to allocate directly  
23 are collected in a general plant category and allocated to  
24 products based on their fat and solid non-fat usage.

25           Examples of these general expenses include

1 chemical supplies, building maintenance, and lab expenses.  
2 Expenses related to non-processing functions such as sales  
3 and marketing expenses or delivery costs are excluded from  
4 the non-labor processing cost functions.

5           One non-labor processing cost that merits  
6 additional discussion is depreciation. A depreciation  
7 schedule for all long term assets is constructed based on  
8 their original cost and date of acquisition. Depreciation  
9 schedules are computed on a straight line basis based on the  
10 useful life of the asset in question. Like other costs,  
11 depreciation is allocated to products directly where  
12 possible, and on a fat and solid non-fat basis when direct  
13 allocations cannot be made.

14           General and administrative expense. General and  
15 administrative expense includes the expense incurred in the  
16 direction, control, and administration of the company. It  
17 does not include expenses related to the selling or  
18 marketing of the finished product or with respect to  
19 servicing producers.

20           With respect to those processors that have a  
21 headquarters expense, CDFA manufacturing cost audit manuals  
22 suggest that auditors determine through interviews with  
23 headquarters personnel the allocation of each individual  
24 headquarters expense between processing plant functions and  
25 other functions.

1           Packaging costs. Packaging costs include carton  
2 costs and other packaging material costs based on the latest  
3 available invoice price plus freight, if any. Costs include  
4 all non-returnable items used to package the product such as  
5 cartons, boxes, bags, liners, tape, glue, tie string, shrink  
6 wrap and non-returnable pallets. Packaging associated labor  
7 is included in the processing labor category rather than in  
8 the packaging category.

9           Purchased ingredients. Purchased ingredient costs  
10 are based on the latest available prices for non-dairy  
11 ingredients added in the manufacturing processes. Purchased  
12 dairy ingredient costs are included in this category only to  
13 the extent that the ingredient cost contains an up-charge  
14 relative to its raw milk equivalent value. Ingredient costs  
15 are broken out and reported separately for cheese and butter  
16 plants only, and include products such as rennet, color,  
17 salt and starter culture.

18           Return on investment. The return on investment  
19 allowance represents interest at the prime rate that the  
20 company could earn if its capital was not tied up in land,  
21 buildings and equipment. In other words, it is a minimum  
22 opportunity cost or alternative source of income if the  
23 company invested that capital elsewhere. All long term  
24 interest is adjusted out of the company's books and excluded  
25 from the cost categories reported in the CDFA cost studies.

1           Long term interest is the interest paid on loans  
2   for the purchase of land or depreciable assets. The return  
3   on investment allowance thus replaces the long term interest  
4   expense.

5           Short term interest is the interest paid on loans  
6   to finance inventories or to provide cash flow. Therefore,  
7   short term interest cost is included in the cost studies  
8   under general and administrative costs.

9           The return on investment allowance is calculated  
10  by subtracting a cumulated depreciation from the original  
11  cost of the asset. The remaining book value is multiplied  
12  by the yearly weighted average prime interest rate of major  
13  banks. The return on investment allowance is allocated to  
14  products in the same manner as depreciation.

15          Costs that are not included. Several cost  
16  categories are not included in the CDFA cost studies. These  
17  include all costs associated with the selling or marketing  
18  of manufactured dairy products, the delivery of finished  
19  product, the raw milk value associated with shrinkage, and  
20  the long term interest expense associated with processing  
21  operations.

22          Use of manufacturing cost data information in  
23  policy decisions. Data from the CDFA manufacturing cost  
24  studies provide a basis for making informed decisions about  
25  the appropriate level of manufacturing allowances in the

1 Class 4A and 4B pricing formulas. However, CDFA is under no  
2 statutory obligation to tie the level of manufacturing  
3 allowances to the weighted manufacturing cost or to any  
4 other specific cost level reported in those studies.  
5 Basically the manufacturing allowance has been viewed by  
6 CDFA as one of several policy tools that can be used in  
7 establishing reasonable manufacturing milk price levels  
8 pursuant to a public pricing hearing.

9 Other factors that CDFA considers in establishing  
10 prices include producer income needs, the supply and demand  
11 of milk and dairy products, the competitiveness of  
12 California processors in the national marketplace, and the  
13 reasonableness of prices to consumers. In considering all  
14 of these factors, CDFA policymakers may choose to set the  
15 manufacturing allowance at a level that covers a higher  
16 percentage of all plants' manufacturing costs at some point  
17 in time, and a relatively lower percentage at other times  
18 when marketing conditions are different.

19 One argument that has been advanced by various  
20 industry representatives is that manufacturing allowances  
21 should be set high enough to ensure adequate manufacturing  
22 capacity within the state relative to milk production.

23 CDFA has the latitude to consider all of these  
24 factors and select a manufacturing allowance that it deems  
25 most appropriate.

1           The periodic reports of dairy product  
2   manufacturing costs released by CDFA detail costs for each  
3   product -- cheese, butter, and non-fat dry milk -- in two  
4   ways. In the first comparison plants are grouped according  
5   to their total processing cost, and the groups are ranked  
6   from lowest cost to highest cost.

7           The second view presents a theoretical range in  
8   manufacturing costs by ranking the plants from least cost to  
9   highest cost for each category of expense.

10          A theoretical lowest cost plant is constructed by  
11   taking the lowest cost for each expense category and putting  
12   them together as if they were achieved within the same  
13   plant. The same procedure is used for the second lowest  
14   cost in all categories, the third lowest cost, and so on.  
15   Based on this ranking, the theoretical lowest cost plant is  
16   more efficient than the actual lowest cost plant, while the  
17   theoretical highest cost plant is less efficient than the  
18   actual highest cost plant.

19          The data are grouped this way to provide industry  
20   representatives with benchmark cost ranges without  
21   inadvertently divulging individual plant costs.

22          In summary, Dairy Institute and its staff have a  
23   high degree of confidence with the cost numbers reported by  
24   CDFA, that they are representative of plant costs in  
25   California.

1           While Dairy Institute has not always agreed with  
2   CDFA regarding the costs that are included, or more  
3   specifically, excluded such as selling and marketing costs  
4   which we have always advocated should be included, we  
5   believe that the procedures used in the cost studies result  
6   in a consistent and relatively complete allocation of  
7   pertinent costs across all plants in the study.

8           That concludes my testimony.

9           JUDGE HUNT: Thank you.

10          Any questions of Dr. Schiek?

11          Mr. Coughlin?

12                           CROSS-EXAMINATION

13           BY MR. COUGHLIN:

14          Q    Good morning, Dr. Schiek.

15          A    Good morning.

16          Q    Based on your testimony, you made it obvious at  
17   the end that you have a very high degree of confidence in  
18   the cost numbers that CDFA reports.

19           The previous witness reported on some cost numbers  
20   that CDFA reported on the producers side. Do you have a  
21   similar impression with respect to those numbers?

22          A    At various meetings that I've attended where CDFA  
23   staff have addressed these cost numbers, they do [...break  
24   in tape...] collecting these numbers, but CDFA maintains  
25   that these numbers are merely an index that's used to track

1 changes in production costs. That they are not purported to  
2 be a weighted average or cost of production for an average  
3 producer in California. They're an index that's used to  
4 track costs.

5 Q I'm just working off the numbers which Mr. Pacheco  
6 presented which seemed to show an absolute number which they  
7 calculated. It wasn't an index in relationship back to some  
8 other year.

9 A That's true. What they do is they'll put the  
10 numbers together based on their audits, but due to either  
11 the sampling procedures or the sample size, the CDFA staff  
12 have never been comfortable characterizing that as being  
13 representative of the actual cost. They've characterized it  
14 as an index.

15 Q I take it then you're not comfortable with that --  
16 Is it done by the same people?

17 A No, it's a different staff. The manufacturing  
18 cost audit staff is a different group of people than the  
19 production cost audit staff.

20 Q Is it a group that has similar experience?

21 A Yes, that's my understanding.

22 Q I notice that in your testimony here one of the  
23 things you've talked about is that CDFA has the latitude to  
24 consider all of the factors and select the manufacturing  
25 allowance that it deems most appropriate. You having worked

1 in a milk audit program at one time, do you feel the  
2 department has latitude? Or are they going to have to take  
3 the evidence that's presented at this hearing and make a  
4 decision based upon what is heard here?

5 A I'm not an expert on the administrative procedures  
6 of USDA. I only know specifically that the food and  
7 agricultural code in California does not tie California to  
8 setting, California Department of Food and Agriculture to  
9 setting manufacturing cost based on solely one factor. But  
10 it does require that they consider them.

11 Q Thank you.

12 JUDGE HUNT: Anyone else?

13 Mr. Beshore?

14 BY MR. BESHORE:

15 Q Dr. Schiek, in considering, in setting make  
16 allowances in California, the CDFA Has not moved them on any  
17 regular basis in response to the surveyed cost information,  
18 isn't that correct?

19 A Well it would depend on your definition of  
20 regular.

21 Q The current make allowance for manufacturing make  
22 allowances were established in what, 1997?

23 A 1997.

24 Q Since that time the plant cost survey information  
25 for the various products has moved both up and down.

1           A     They would not, they don't automatically go in and  
2     call a hearing every time a new manufacturing report comes  
3     out, that's correct.

4           Q     They don't have a hearing scheduled now, do they?

5           A     They do not.

6           Q     Have you observed that the cost of making  
7     different products has sometimes gone up in one category  
8     while it's gone down in the other? The cost of making  
9     butter powder, for instance, has gone up in some of the  
10    survey observations in the same timeframe when the cost of  
11    producing cheese has gone down.

12          A     There's been I guess more up and down fluctuation  
13    in the numbers, and if you look at those documents that were  
14    noticed you'll see that the butter and powder costs do tend  
15    to go up and down a bit whereas the cheese costs have been  
16    trending more steadily downward. That is basically a  
17    function of the fact that the butter powder industry is much  
18    more of a mature industry in the state whereas the cheese  
19    industry has been a young industry, an input industry,  
20    really in the mid-80s and starting out with much higher  
21    costs. As plants have gained in size and scale and  
22    efficiency, that has come down.

23          Q     You've referred in your testimony to cost  
24    allocation procedures being done where necessary on a solids  
25    or fat basis, or a solids and fat basis.

1           A     Right.

2           Q     Can you explain how that would be accomplished?

3           A     Sure.

4           Q     Let's take a butter powder plant. The costs of  
5 receiving milk, how are they allocated?

6           A     Let's say you've got a receiving bay cost in a  
7 butter powder plant, you're going to allocate it to butter  
8 and powder products, and you've got to decide how to  
9 allocate it. You would basically take that cost category,  
10 whatever that total cost is over the period that you're  
11 looking at, and you would determine the pounds of solid and  
12 fat received, and then that solids non-fat, and fat would be  
13 followed through to the product content, final product  
14 content, and allocated based on the final content, the  
15 pounds of solids in the final content. Final product.

16          Q     So that in a butter powder plant if you take a  
17 hundredweight of milk, you get how many pounds of butter?  
18 Let's just say you get four pounds of butter. I'm sure  
19 that's not right, but if you got four pounds of butter and  
20 nine pounds of powder, how would the costs be allocated?

21          A     Four pounds of butter -- You're saying --

22          Q     If you had \$100 of cost.

23          A     If the milk comes into the plant and it's got four  
24 pounds of butter fat in it and nine pounds of solids not  
25 fat, essentially you'd add those together. They don't

1 assign the cost category on a different value based on  
2 solids non-fat and fat. So it would be 13 pounds of total  
3 solids. If the expense was \$10,000 you would divide that by  
4 the 13 pounds. That would be a lot for 13 pounds.

5 If the cost of that hundredweight was \$10, you'd  
6 divide that by the 13 pounds and that would give you the  
7 cost per pound of solid. Then you would determine how those  
8 pounds moved through the plant to the finished product, and  
9 you would, let's say all the, just for this example, all the  
10 butter fat ended up in the butter and all the solids ended  
11 up in the powder, then it would be 9/13 would be allocated  
12 to the powder and 4/13 would be allocated to the butter for  
13 that receiving cost.

14 Q How do they allocate cheese and whey?

15 A The whey allocation I believe, and I can look this  
16 up. I believe there's some discussion in their  
17 manufacturing cost manual on this, but there is a  
18 determination first if the whey is converted into a viable  
19 product. If the whey ends up being a disposal cost, then  
20 that cost ends up back in the cheese because it's a cost of  
21 doing business. If a viable product can be made, then the  
22 cost of the whey, excuse me. There is a cost allocation to  
23 the whey if it's a viable, saleable product, based on the  
24 whey solids, is my understanding.

25 Q Thank you.

1 JUDGE HUNT: Mr. Marshall?

2 BY MR. MARSHALL:

3 Q I think just one quick question, Mr. Schiek,  
4 relying on your background as an economist. I'd like to  
5 pick up on the point you made towards the end of your  
6 testimony that there are certain categories and costs that  
7 are not excluded that you have perhaps criticized at times,  
8 and I'd just like to have your comment on the return of  
9 investment calculation described on page four.

10 As I interpret it, the term return on investment  
11 is used here to refer to the capital cost of undepreciated  
12 book value, is that correct?

13 A Uh huh.

14 Q And that book value then would be based on  
15 historical costs, not necessarily current costs.

16 A Right. It would be the original cost depreciated.

17 Q And the depreciation, of course, would have been  
18 expensed and would be accounted for somewhere else in the  
19 cost survey, but the undepreciated part would be the capital  
20 that is still on the books at least in the operation, is  
21 that correct?

22 A Right.

23 Q Then by applying merely an interest rate cost to  
24 that factor, you are equating that to merely the interest  
25 expense on the undepreciated book value, are you not?

1           A     Right.

2           Q     Those are real costs, aren't they?

3           A     Yes. In a sense, as I tried to say in my  
4 testimony, this is really a minimal cost regarding return on  
5 investment or the alternative opportunity costs that a  
6 processor might have.

7           Q     Let me just take you back to your academic  
8 training as an economist. Would the term return on  
9 investment be considered merely to be the cost of capital?

10          A     No. Typically in a financial standpoint it's the  
11 financial return, profits made on the invested capital.

12          Q     And that would be the profits after considering  
13 such expenses as the cost of capital, would it not?

14          A     Typically, yeah.

15          Q     So would you characterize the term return on  
16 investment as a mischaracterization then of --

17          A     This is, right. It's not equivalent to the long  
18 term interest expense. I guess in the testimony when I said  
19 it replaces it, it was more to explain why the long term  
20 interest expense was adjusted out. It was a swap that was  
21 done when return on investment was put in as a category in  
22 the study.

23                 This is not a financial measure of return on  
24 investment. It is in no way representative of what plants  
25 could or would earn if they invested their capital in

1 alternative enterprises. At the very best thing you could  
2 say is it's money in the bank. It's the cost of capital.

3 Q Then setting aside for a moment the categories and  
4 names that the State of California places on these costs.  
5 Assuming hypothetically that a plant were able to operate  
6 without equity capital, and were operating solely with  
7 borrowed capital, would it not be true that what is showing  
8 on the California books as a return on investment would in  
9 fact show on the books of a hypothetical fully leveraged  
10 company as interest expense?

11 A I'm not sure if I understand your question, but  
12 for example if a firm was, if you had a new firm that was  
13 highly leveraged, had borrowed a lot of money for its plant,  
14 equipment --

15 Q Let's say 100 percent of the money.

16 A Say 100 percent. In this particular case those  
17 kinds of plants would be, their costs would be much lower  
18 under this scenario than they would be, yeah, I think so.  
19 They'd be lower under this scenario than they would be --

20 The reported cost from the survey, as I understand  
21 it, since you're adjusting out long term interest expense --

22 Q I'm not asking about the survey. Let's go back to  
23 my question and let me restate it. I was asking you to set  
24 aside the categories and the nomenclature of the California  
25 audit and report and to speak as an economist. And to

1 consider the fact then that a fully leveraged company that  
2 had to expense its interest costs that were associated with  
3 the loan to cover the undepreciated net book value, would --

4 A A fully leveraged company, state that again.

5 Q A fully leveraged company would have to borrow,  
6 would it not, all of its cost of capital to finance the  
7 undepreciated net book value?

8 A Yeah, that sounds right.

9 Q And the point I'm simply driving towards is that  
10 the net book value reflects capital tied up in the operation  
11 that has not yet been expensed, but for which there is a  
12 capital cost.

13 A Right.

14 Q That capital cost would in an economic sense be  
15 correlated to the interest rate being paid on that capital,  
16 would it not?

17 A Yeah.

18 Q And that's in fact what the California study calls  
19 a return on investment, isn't it?

20 A Yes.

21 Q So as a result of that in a highly leveraged plant  
22 that would merely be an expense with absolutely no return on  
23 investment.

24 A That sounds right. Mathematically that would be  
25 how it would work out.

1           Q     And again, that leads me to the conclusion, and I  
2     ask if you agree, that this is not in fact a return on  
3     investment, but merely a recategorization of the cost of  
4     capital that has been invested in the property and plant and  
5     equipment of a plant being surveyed under the California  
6     survey.

7           A     I would say that it would be fair to characterize  
8     it that way.

9           Q     Thank you very much, sir.

10           JUDGE HUNT:   Mr. Galarneau?

11           BY MR. GALARNEAU:

12           Q     Clay Galarneau with Michigan Milk.

13                    Good morning, Bill.

14           A     Good morning, Clay.

15           Q     Bill, are you also familiar with the make  
16     allowance calculations for the Class 4A and 4B formulas and  
17     how those are different from the Class 2 and 3 California  
18     formulas?

19           A     How the make allowances are different?

20           Q     Yes.

21           A     My understanding of those formulas is there's a  
22     make allowance in 4A and 2 and 3 is simply a differential  
23     added to an average 4A cost.  So it would essentially be the  
24     same make allowance plus a differential.

25           Q     And that differential is what, 3.7 cents and 3.93

1 cents?

2 A On fat, that sounds right.

3 Q Then we end up in a situation where the Class 2  
4 and 3 products butter fat value is priced higher than the 3  
5 and 4 butter fat values.

6 A That's been the historical relationship of the way  
7 those formulas are constructed, yes.

8 Q Are you aware of this having caused any marketing  
9 difficulties in the distribution of milk?

10 A I would have to defer frankly to some of my  
11 members on that issue.

12 Q Earlier testimony was that having a difference in  
13 price would cause disorderly marketing. Have you any  
14 knowledge of disorderly marketing in California as a result  
15 of this difference in butter fat prices?

16 A I guess I have no specific knowledge that there is  
17 or none that there isn't. In particular, part of the issue  
18 might relate to how the firms source their fat, whether it's  
19 sourced in producer milk or whether it's sourced from a  
20 cooperative and what they pay in the way of premiums on  
21 cream they buy from cooperatives of charges.

22 As you probably know, the cooperative milk supply  
23 in California is a significant share, and I'm not really  
24 sure how those pricing arrangements work.

25 Q So I could summarize and say you're not aware of

1 any disorderly marketing consequences?

2 A No, I'm not.

3 Q Thank you.

4 JUDGE HUNT: Mr. Rosenbaum?

5 REDIRECT EXAMINATION

6 BY MR. ROSENBAUM:

7 Q Dr. Schiek, you have been here for the bulk of the  
8 hearings, correct?

9 A Yes.

10 Q And you recall there's been some discussion of the  
11 difference between a weighted average and a simple average  
12 manufacturing costs?

13 A Yes.

14 Q And you agree with the basic premise that if the  
15 weighted average is higher than the simple average, that  
16 means the plants with the largest production have the  
17 highest costs, correct?

18 A Right.

19 Q That has not been the situation recently, in any  
20 recent years, for the California studies, is that correct?

21 A That would be correct.

22 Q Are you aware that at one point in the late '80s I  
23 think maybe the first cost study that was ever done for  
24 cheese did reflect such a situation where the weighted  
25 average actually exceeded the simple average?

1 A Yes.

2 Q And are you familiar with the reasons why that was  
3 the case?

4 A Yeah. There was one new plant that had come on  
5 line that had significantly higher expenses, ran into  
6 significant startup problems in regard to being able to run  
7 the plant at capacity, being able to dispose of waste  
8 products from the plant which basically greatly inflated the  
9 cost of that plant. It was unforeseen, had a lot of bad  
10 things that happened to them that resulted in those costs  
11 being quite high.

12 Q Thank you.

13 JUDGE HUNT: Mr. Olsen?

14 RECROSS-EXAMINATION

15 BY MR. OLSEN:

16 Q One quick, question, Mr. Schiek.

17 On the return on investment series of questions  
18 that Mr. Marshall was asking you, I think we got to the  
19 point where the return on investment that's characterized  
20 under the CDFA study is essentially the return on capital  
21 cost.

22 A Right.

23 Q And under the CDFA cost study, that's at a prime  
24 rate?

25 A Right.

1           Q    If you're a highly leveraged company you're  
2 unlikely to be able to borrow at the prime rate.

3           A    That would, I would assume you'd be a greater  
4 credit risk, and the banks might charge you more.

5           Q    Does that lead then to an unrecovered cost, if you  
6 will?

7           A    Yeah, sure. If they couldn't borrow at the prime  
8 rate.

9           Q    I have no further questions.

10           JUDGE HUNT: Mr. Berde?

11           BY MR. BERDE:

12           Q    How do you adjust or compensate for the level of  
13 plant capacity utilized by your responding clients?

14           A    To my understanding, as I've looked through the  
15 studies and how those costs have changed over the years, the  
16 costs will vary on a per pound basis based on utilization.  
17 If you have a year when usage is down significantly in the  
18 plant, that will cause the per pound cost to go up.

19           Q    I guess my question is directed to whether you  
20 inquire of your responding clients when they respond as to  
21 their make allowances, as to their cost of processing, what  
22 level of plant capacity were they utilizing at the time that  
23 they responded to your survey.

24           A    The -- I would say internally CDFA probably has  
25 those numbers. Internally they probably have the

1 utilization of the plant. But they do report the pounds on  
2 the studies, the numbers that come out, the pounds in each  
3 plant category are listed on their pounds processed or  
4 volume processed. By tracking that, we don't have precise  
5 numbers, public numbers on utilization, but one can make  
6 some assumptions that less plant capacity is being utilized  
7 one year versus another based on knowledge of the industry.

8 Q You would agree it makes a difference, wouldn't  
9 you, what the level of plant capacity utilized was at the  
10 time of the responding plant?

11 A It will affect the bottom line cost numbers, yeah.

12 JUDGE HUNT: Mr. Beshore?

13 BY MR. BESHORE:

14 Q Dr. Schiek, in response to Mr. Rosenbaum, you  
15 described or purported to explain a statistical result of a  
16 1988 or 1989 California CDFA cost study on plants.

17 Now as I understand your Direct testimony in terms  
18 of your background, you were in graduate school at the time  
19 that study was prepared, correct?

20 A That's correct.

21 Q And in fact you didn't move to your present  
22 position in California until 1997.

23 A That's correct.

24 Q You weren't involved in generating any of the data  
25 or presenting any of the data in that '88 or '89 study,

1 correct?

2 A Right.

3 Q So whatever information you have you obtained for  
4 purposes of that question from Mr. Rosenbaum from sources  
5 somewhere in California, I assume.

6 A Yes.

7 Q Thank you.

8 JUDGE HUNT: Anyone else?

9 (No audible response)

10 JUDGE HUNT: Thank you very much, Mr. Schiek.

11 At this time we'll take an hour for lunch. Be  
12 back here at 1:00 o'clock.

13 MR. YALE: Your Honor?

14 JUDGE HUNT: Yes, we're still on the record.

15 MR. YALE: We do have the copies of those two  
16 tables on which we had the error. We will give six to the  
17 Court Reporter and I'll put some, I'll give a couple to the  
18 government and we'll put the rest back here on the table.

19 JUDGE HUNT: Thank you, Mr. Yale.

20 Anything else?

21 (No audible response)

22 JUDGE HUNT: All right, we'll break for lunch.

23 (Luncheon recess taken at 12:00 p.m., to reconvene  
24 at 1:00 p.m. this same day, Thursday, May 11, 2000.)

25 //



1     been to oversee AMPI's interest in the federal milk  
2     marketing order program and represent our dairy farmers at  
3     federal order hearings.

4             AMPI represents approximately 5,000 dairy farmers  
5     in seven Midwest states. Currently our milk is pooled on  
6     Federal Orders 1030, Upper Midwest, and 1032, the Central  
7     order. I'll discuss the merit of Proposal 25.

8             This proposal represents the compilation of  
9     processing costs from three AMPI non-fat dry milk plants  
10    from 1995 through 1999. These plants have an average  
11    capacity of one million pounds of milk per day. In 1999  
12    they produced 82 million pounds of non-fat dry milk.

13            The weighted average processing and packaging  
14    costs for this five year period was .1254 dollars per pound.

15            In addition to processing and packaging costs we  
16    believe the make allowance for non-fat dry milk must include  
17    the cost of marketing and a return on investment. The 1999  
18    costs in pounds of non-fat dry milk produced were used for  
19    these calculations.

20            Our marketing costs came to .0024 dollars per  
21    pound of non-fat dry milk. These costs include salaries for  
22    sales, order, billing personnel, computers, other office  
23    expenses, brokerage costs, just to name a few.

24            Return on investment came to .026 dollars per  
25    pound of non-fat dry milk. These were calculated using a 12

1 percent targeted return on investment on the current value  
2 of our three non-fat dry milk plants. We feel return on  
3 investment is a necessary part of the make allowance in  
4 order to continue to invest in plants and equipment.

5 Let me summarize the pieces used to arrive at our  
6 make allowance for non-fat dry milk. .1254 processing and  
7 packaging costs; .0024 marketing costs; .0260 return on  
8 investment for a total of .1538 per pound non-fat dry milk.

9 If you read the notice of hearing, this is  
10 actually .0025 less than our proposed proposal, and that was  
11 due to some corrections on our original marketing costs and  
12 return on investment.

13 This concludes my statement.

14 JUDGE HUNT: Any questions of Mr. Gulden?

15 Mr. Beshore?

16 CROSS-EXAMINATION

17 BY MR. BESHORE:

18 Q Neil, do your AMPI plants serve as balancing  
19 plants for the fluid markets that you service?

20 A I guess you could characterize it that way,  
21 Marvin.

22 Q The amounts of butter -- Are they butter powder  
23 plants? Or are they just --

24 A These are strictly powder plants. We have a  
25 central churning operation at New Ulm, Minnesota.

1 Q What is the location of the three plants?

2 A There's two in Iowa. One's in Northeast Iowa at  
3 Arlington, Iowa; and there's one in Northwest Iowa at  
4 Sibley, Iowa; and one in Southeast South Dakota at Freeman,  
5 South Dakota.

6 Q Do the volumes of milk received and processed at  
7 the drying plants vary seasonally and relating to  
8 dispositions of milk to the fluid market place?

9 A We have a pretty steady flow, Marvin. The only  
10 seasonality to it would be the seasonality involved in the  
11 milk production itself. In the producer milk production.  
12 Otherwise it's a pretty steady flow of milk.

13 Q Of skim milk to the dryers?

14 A Yes.

15 Q Do you know at what level of capacity the plants  
16 were operating?

17 A Approximately 80 percent over this entire period.

18 Q The 12 percent return on investment, what was that  
19 calculated on? What investment?

20 A That was basically, Marvin, is a return that we  
21 have used for years in our annual and long range budgeting  
22 process, and it's the market value that we have -- And the  
23 12 percent, I admit, is arbitrary. But we think that a 12  
24 percent return on investment which is more than debt service  
25 is reasonable for these plants, and it's baaed on the market

1 value of these plants.

2 Q That's what I was really trying to understand,  
3 what value the 12 percent was applied to, and it's applied  
4 to the current market value as opposed to depreciated book  
5 value or any other --

6 A That's correct.

7 Q Do your processing and packaging costs, I would  
8 assume, include costs of amortizing and depreciating the  
9 equipment used in your plants?

10 A Yes, there would be some in there.

11 Q Are you, do you process any specialty products at  
12 these plants? Any special blends or any whole milk powders,  
13 anything of that sort?

14 A No, strictly non-fat dry milk.

15 Q Is any of that instantized?

16 A We have a separate instantizing plant at Mason  
17 City, Iowa. Some of the powder is shipped there for  
18 instantizing purposes.

19 Q Thank you.

20 JUDGE HUNT: Mr. Marshall?

21 BY MR. MARSHALL:

22 Q Briefly, Mr. Gulden, what are the ages of the  
23 three plants that you included in your survey?

24 A Probably older than me.

25 (Laughter)

1           A     That's getting pretty old.

2                     Let me say they've been there since I have been  
3     there, which is a little over 30 years now. You don't see  
4     new powder plants popping up in the Midwest, but we do keep  
5     them modern, we do keep them efficient, and our investment  
6     in them is continual.

7           Q     With respect to buttermilk powder, do you dry  
8     buttermilk powder in any of those three plants?

9           A     No.

10          Q     The cream that goes to New Ulm I assume is churned  
11     there?

12          A     Yes.

13          Q     And out of that churn I assume you have some  
14     buttermilk. How do you dispose of the buttermilk?

15          A     The buttermilk is condensed at New Ulm. We use it  
16     internally in ice cream mix.

17          Q     Thank you very much.

18                     JUDGE HUNT: Mr. Coughlin?

19                     BY MR. COUGHLIN:

20          Q     Are you proposing that this manufacturing  
21     allowance that's incorporated in the audit be based on your  
22     plants alone?

23          A     No, not necessarily, Ed. My purpose here was to  
24     give the department, who has an onerous job of deciding,  
25     another viewpoint. And since there's only, I believe, seven

1 plants in the RBCS survey, this would add three more, almost  
2 40-some-percent more plants available for numbers, for the  
3 analysis.

4 Q I take it, you mentioned before you operate a  
5 butter plant. You didn't submit any data for the butter  
6 plant?

7 A No.

8 Q Can you give us a reason why?

9 A We just chose not to. There's no bulking going on  
10 at that plant. It's strictly a print operation and other  
11 operations. Further processing of butter other than bulk.

12 Q Do you operate any cheddar cheese plants?

13 A Oh, yes.

14 Q You didn't submit any data for those. Can you  
15 give us a reason why?

16 A I chose not to. No particular reason, Ed. We've  
17 got seven cheese plants. Roughly 80 to 85 percent of that  
18 is 640 pound blocks. Fifteen percent or so is barrels. We  
19 just didn't think we wanted to get into that at this  
20 hearing.

21 Q Do you have any knowledge of the cost structure of  
22 those plants?

23 A Limited.

24 Q Thank you.

25 JUDGE HUNT: Anyone else?

1           Mr. Rosenbaum.

2           BY MR. ROSENBAUM:

3           Q    Are 640 pound blocks a significant part of the  
4 cheddar cheese market, in your estimation?

5           A    Not very significant. I have limited knowledge of  
6 that, but my limited knowledge is that they are not very  
7 significant.

8           Q    Thank you.

9           JUDGE HUNT: Any other questions?

10          Mr. Yale?

11          Do we have to give Harvard equal time?

12          (Laughter)

13          MR. YALE: If you wish. Although you'd have to  
14 bring a lot of Harvard grads to equal one of us Yalies, so -  
15 -

16          JUDGE HUNT: Point well taken.

17          (Laughter)

18          MR. YALE: I don't think we've got time for all of  
19 them.

20          BY MR. YALE:

21          Q    Mr. Gulden, do you report sales to NASS?

22          A    No, we don't.

23          Q    Why don't you?

24          A    If it was up to me, we'd do it. But my boss  
25 doesn't want to do it. So -- No, I'm just kidding.

1           No, that is the reality of it, but --

2           (Laughter)

3           Q     Have you advised him that the Internet is on and  
4     his boss is probably listening to him speak?

5           (Laughter)

6           A     That's all right. He'd understand.

7                 No we don't report, seriously, but seeing as,  
8     we're seeing the information now, and seeing all these  
9     esteemed colleagues and competitors of mine here, and seeing  
10    how the information is used, we would probably think about  
11    reconsidering that.

12          Q     But you do look at the information?

13          A     Yes.

14          Q     Do you use that in any way in factoring your sales  
15    or determining your sales price or anything?

16          A     No, not at all.

17          Q     Run any kind of comparisons between what you sell  
18    your product for and what the NASS is?

19          A     No, just the obvious of looking at it -- Sure, we  
20    look at it, and we can see the obvious differences.

21          Q     I take it that you don't report it for any of the  
22    butter or the cheese as well.

23          A     That's right. The butter we wouldn't report  
24    anyway, Mr. Yale, because it's print.

25          Q     Print, continentals, or whatever.

1 A Chips. Yeah.

2 Q Are you involved in any way in the selling of the  
3 cheese?

4 A No, sir.

5 Q At this powder plant, butter powder plant, and I  
6 tried to catch the question and answer with Mr. Beshore and  
7 I'm not sure if I fully understood it, do you make any  
8 special mixes or anything at that plant?

9 A No, sir.

10 Q Make any ice cream mix?

11 A Not at those plants.

12 Q It's just strictly powder and butter?

13 A Strictly powder at the powder plants, and we have  
14 a central churning operation that the cream gets shipped to.

15 Q Do you sell any of the cream separately? Any  
16 fluid cream?

17 A Very little. Spot. Just on a spot basis.

18 Q Nothing further, thank you.

19 JUDGE HUNT: Mr. Christ.

20 BY MR. CHRIST:

21 Q Neil, you mentioned that you're not reporting for  
22 NASS, and you also said that your cheese production is 85  
23 percent 640s. Are you aware that 640s are not part of the  
24 NASS survey?

25 A Yes.

1 Q So you would not report that in any event.

2 And also, is a significant share of the remaining  
3 15 percent used in your own operation, such as in cheese  
4 processing?

5 A Yes.

6 Q Are you aware that the NASS survey does not report  
7 internal transactions?

8 A Yes.

9 Q So it's likely that the amount of cheese that you  
10 could report would be trivial.

11 A It would be very small.

12 Q Okay. Similarly, you've stated that the butter is  
13 all print so you would not report that.

14 With respect to powder, is a significant share of  
15 your powder production used internally for consumer  
16 packaging?

17 A I'd say about half of it.

18 Q And in fact very little in your production is  
19 eligible for reporting?

20 A Correct.

21 JUDGE HUNT: Mr. Yale?

22 BY MR. YALE

23 Q Now the 640s in terms of -- are they on a contract  
24 basis?

25 A No, sir.

1           Q     And you actually make up certain reporting blocks  
2     for inventory for sales?

3           A     Yes, sir. We use them internally.

4           Q     You use them internally?

5           A     Yes.

6           Q     What about the composition of this 640 is very  
7     significant that you try to -- within the block itself  
8     between the core and the outside.

9           A     I don't have any knowledge of that, Mr. Yale.

10          Q     Thank you.

11                 JUDGE HUNT: Mr. Beshore?

12                 BY MR. BESHORE

13          Q     One other question, Neil.

14                 You mentioned I think in response to Paul Christ's  
15     question that about half the powder is packaged for consumer  
16     sales.

17          A     Yes.

18          Q     Are those packaging costs included in the total  
19     processing and packaging --

20          A     No, sir. These are strictly costs from the powder  
21     plants themselves for conversion of skim to non-fat dry  
22     milk.

23          Q     But it includes processing and packaging costs.

24          A     Putting it in a tote.

25          Q     That's the end of the packaging cost.

1           A     We do some bagging.

2                     JUDGE HUNT:  Ms. Brenner?

3                     BY MS. BRENNER:

4           Q     I was looking at your numbers here, and it seems  
5     to me that two of the biggest differences between those and  
6     what we've seen in other examples of make allowances or  
7     manufacturing costs involve the marketing cost and the  
8     return on investment.  They both seem to be significantly  
9     higher in your example here than they are in for instance  
10    the California study.  Of course the RBCS doesn't have those  
11    costs.

12                    When you add those costs to their study you end up  
13    pretty close to the California number, and you're still  
14    almost two cents below yours.

15                    Do you have some reason, or do you know what to  
16    attribute the discrepancies there?

17           A     I don't know why the discrepancies.  I've seen the  
18    California numbers, I know what you're talking about.  But  
19    those are the only numbers that I think anybody's seen.  
20    This is just our compilation of marketing costs based on our  
21    expenses for marketing that product, and based on the pounds  
22    of powder attributable to it.  So it's just a straight  
23    calculation on my part.

24           Q     I think the IDFA numbers on marketing costs were  
25    somewhat lower than that, too.

1           A     I wasn't sure IDFA, I thought they used  
2     California.

3           Q     I don't know, I was just looking through there and  
4     found their cheese and whey, but I didn't find their powder.  
5     But I think they used the same for both of those.

6                     That's all I have.

7           JUDGE HUNT: All right, thank you very much, Mr.  
8     Gulden.

9           Mr. Christ, or Mr. Schad?

10          MR. CHRIST: Your Honor, I'm Paul Christ. Dennis  
11     Schad and I from Land O'Lakes have three sets of testimony  
12     on three proposals. We'd like to present them in order.  
13     I'd like Mr. Schad to present testimony on proposal number  
14     eight and proposal number three, and then I would like to  
15     present testimony on proposal number 14.

16          JUDGE HUNT: All right.  
17     Whereupon,

18                     DENNIS SCHAD  
19     having been first duly sworn, was called as a witness herein  
20     and was examined and testified as follows:

21          JUDGE HUNT: State and spell your name please, Mr.  
22     Schad.

23          THE WITNESS: Good afternoon. My name is Dennis  
24     Schad, S-C-H-A-D. Dennis is D-E-N-N-I-S.

25                     DIRECT EXAMINATION

1 BY MR. CHRIST:

2 Q Mr. Schad, would you describe quickly your  
3 responsibilities for Land O'Lakes?

4 A I am Manager of Regulatory Affairs. I work in the  
5 Carlisle office. My duties are on national policy issues.  
6 I work with Arden Hill's office, but I do most of my  
7 regulatory work in the state orders and federal orders in  
8 the Northeast.

9 Q Is it correct to say that you have extensive  
10 experience in evaluating the federal milk marketing orders  
11 in the Northeast?

12 A Yes.

13 Q Can you describe the nature of the Land O'Lakes  
14 operations in the Northeast?

15 A Land O'Lakes is a -- The Northeast Division of  
16 Land O'Lakes is a 3,000 member dairy cooperative marketing  
17 in excess of three billion pounds a year. We own and  
18 operate a butter powder plant. We sell a majority of our  
19 milk to third party sales.

20 Q The butter powder plant operated by Land O'Lakes  
21 in the Northeast, is this a large plant or a new plant? Can  
22 you describe that briefly?

23 A The original plant was built around 1970, has been  
24 added onto since that time. I would characterize it as a  
25 large butter powder plant.

1 Q You have a position on proposal number eight?

2 A Yes, I do, sir.

3 Q Would you care to read that, please?

4 A Testimony of Land O'Lakes, Inc. in support of  
5 proposal number eight.

6 Land O'Lakes, Inc. supports the National Milk  
7 Producer Federation's position on proposal number eight.  
8 USDA should establish a price for Class 4 butter fat as the  
9 butter fat as the butter fat prices less six cents per  
10 pound.

11 For 16 months, between September 1998 and December  
12 1999, USDA provided information through which a comparison  
13 of producer butter fat prices developed under the federal  
14 order formula could be compared with butter fat prices  
15 developed by a formula contained in the final rule.

16 During those 16 months the average NASS butter  
17 price was nearly identical to the average CME butter price.

18 The 16 month NASS butter price was \$1.4510 while  
19 the CME average was \$.4499 [sic] per pound. However, while  
20 there was equality in the price surveys there was a  
21 difference of nearly six cents per pound between the basic  
22 butter fat prices generated by the final rule and the  
23 formula used during the time period.

24 MR. CHRIST: Your Honor, I would like to have  
25 marked the attachment to Mr. Schad's statement. I think

1 it's nine pages of information. I'll quickly identify it.

2 The first page says Class Butter Fat Prices  
3 Utilizing Announced NASS Product Prices.

4 The second and third page are the decision,  
5 Determination of Equivalent Milk Price Series, a USDA  
6 document. The following three pages, I'm sorry.

7 The fourth page is Importance of Cream From  
8 Standardizing Fluid Milk Products as a Source of Butter Fat  
9 for Producing Butter.

10 The fifth page, sixth I think, Calculation of the  
11 Percentage of U.S. Butter Production Originating from Cream,  
12 Standardized from Fluid Milk Products.

13 The final page is Butter Fat Test of Major Uses of  
14 Producer Milk Under Federal Milk Marketing Orders.

15 JUDGE HUNT: We'll mark that as proposed Exhibit  
16 33.

17 (The document referred to was  
18 marked for identification as  
19 Exhibit No. 33.)

20 MR. CHRIST: Thank you.

21 BY MR. CHRIST:

22 Q Mr. Schad, continue please.

23 A Any other comparison of fat prices would be  
24 irrelevant because the former federal order fat differential  
25 formula requires the BFP at test and after December 1999.

1 That statistic is no longer reported. And there was no NASS  
2 survey for butter prices prior to September 1998.

3 During the period of time in which the department  
4 was formulating the final rule, the CME suspended the  
5 trading of Grade A and Grade B, and butter. Since the  
6 federal orders at the time required a Grade A price to  
7 determine the butter fat differential, USDA determined an  
8 equivalent butter price mechanism. (Docket DA 98-06).  
9 Effective June 26, 1998 USDA determined that the CME Grade  
10 AA butter price less nine cents per pound was equivalent to  
11 the Grade A butter price.

12 The department rejected a suggestion offered by  
13 Michigan Milk Producers that an equivalent Grade A price was  
14 Grade A minus 13.2 cents divided by .82. The Secretary  
15 concluded, "The CME Grade AA butter price for the month less  
16 nine cents should be used as an equivalent price for the  
17 purposes of establishing minimum prices under all federal  
18 orders. The new butter price series is expected to yield a  
19 price generally equal to the suspended butter price series."

20 There is no discussion in the proposed or final  
21 rule which articulated any rationale for changing the  
22 relationship between the butter fat price and the butter  
23 price. Discussion in the decisions was limited to the  
24 proper yield and make allowances. The yield was determined  
25 in the proposed rule as .82 because that is "the percent or

1 quantity of butter fat in a pound of butter", Proposed Rule  
2 page 248.

3 The make allowance was determined in the final  
4 rule as to weighted average of the RBCS and California plant  
5 cost surveys, Final Rule page 180.

6 The increase in butter fat price also represents  
7 an increased cost to fluid milk processors. Cream buyers  
8 continue to buy surplus cream at the same terms as in the  
9 past. They pay a multiple, such as 1.20 or 1.30 times a  
10 reference butter price, usually the Chicago Mercantile  
11 Exchange cash price for AA butter.

12 If the butter price is the same during the past,  
13 then the price offered for surplus cream has not changed.  
14 The economics of buying surplus cream and selling butter are  
15 the same as in the past.

16 Fluid milk processors are affected, however. They  
17 pay roughly six cents per pound more for butter fat and  
18 surplus cream sold to butter manufacturers.

19 Thus revenues from these sales have not changed.  
20 The result is increased cost that either must be passed on  
21 in the form of higher prices for fluid milk products, or  
22 reduced profits.

23 Thus harm has been done to the fluid milk  
24 processors. This harm can be remedied by reducing the Class  
25 4 butter fat price by six cents.

1           Butter manufacturers who account to the federal  
2   order pools for producer milk used to produce butter are  
3   also affected. The six cent increase in butter fat costs as  
4   a result of the new orders effective January 1, 2000 creates  
5   a competitive disadvantage for these plants relative to  
6   plants purchasing surplus cream.

7           Cream buyers avoid the increased regulated butter  
8   fat prices by continuing to pay a multiple over the  
9   referenced butter price that reflects the price of butter  
10  and the cost of procuring cream and processing butter.

11          A purchase of producer milk cannot avoid the  
12  increased butter fat price. Such a handler incurs a higher  
13  butter fat cost than his cream-buying competitor, but incurs  
14  the same manufacturing costs and receives the same  
15  competitive price for butter.

16          As a result, a producer milk buying butter  
17  manufacturer incurs a competitive disadvantage relative to  
18  the cream buying butter manufacturer.

19          The facts support a lower butter fat price for  
20  Class 4 milk than the other classes of milk. Nearly all  
21  Class 1, Class 23 milk, and Class 3 milk is processed into  
22  finished products on the same premise as was received as  
23  producer milk direct from producer dairy farms.

24          In the case of Class 4 butter fat, most of it is  
25  processed into finished product at a different location than

1 the plant of first receipt as producer milk.

2 Our calculations illustrated in the exhibit lead  
3 us to conclude that 65.8 percent of U.S. butter production  
4 is made from surplus cream from fluid milk processors, so  
5 nearly two-thirds of the butter fat used to produce butter  
6 incurs significant extra costs in handling, transportation,  
7 transaction management and recordkeeping.

8 We have collected data from three Land O'Lakes  
9 butter plants on handling and transportation costs for  
10 purchased cream. They are Kent, Ohio; Carlisle,  
11 Pennsylvania; and Madison, Wisconsin. Cream is purchased  
12 from a wide range of origins, some of which are more than  
13 1,000 miles away. The weighted average transportation cost  
14 of the three plants was \$0.0457 per pound of butter fat for  
15 the month March 2000. The three plants also estimated the  
16 costs associated with receiving, storing, and repasteurizing  
17 cream. These averaged \$0.0040.

18 If we add the transportation costs on the cream  
19 purchases to the extra handling costs we get \$0.0497 per  
20 pound of butter fat.

21 There are additional costs associated with cream  
22 purchases that are not included in the above total. They  
23 are transaction management and recordkeeping. Both parties  
24 to a cream transaction incur the cost, time and management  
25 talent in negotiating cream sales. These costs would not be

1 incurred if butter was produced on the same premises by the  
2 same handler who purchased the producer milk from which the  
3 cream was separated.

4 Also, both parties to a cream sale must keep  
5 records of transactions. There are costs associated with  
6 recordkeeping. The costs incurred by the cream buyer would  
7 not exist if the butter was produced on the same premises as  
8 where the cream was purchased.

9 Given the costs enumerated above, we believe the  
10 six cent reduction in butter fat price for Class 4 milk is  
11 warranted.

12 Q Mr. Schad, in the second paragraph on the first  
13 page, about in the middle, the sentence reads, "A 16 month  
14 NASS butter price \$1.4510 while the CME average was" and you  
15 had read \$.4499. Did you mean \$1.4499?

16 A Yes, sir.

17 Q Thank you.

18 Let's review the documents in the exhibit.

19 Can you describe the first document, Current  
20 Butter Fat Prices Utilized in NASS Product Prices.

21 What was this designed to show?

22 A This is designed to show a comparison of the  
23 butter price and the butter fat price per pound for the 16  
24 months where NASS reported butter prices, and the  
25 predecessor federal orders were in operation at the time.

1 They showed that on a 16 month average the NASS butter price  
2 was \$1.45, and during the same period the CME butter price  
3 was \$1.4499, virtually identical.

4 On the next two columns it shows comparing the  
5 butter fat price per pound that would have been generated by  
6 the final rule had the final rule been in operation during  
7 those 16 months, against what the order, I believe it was  
8 the order 30, producer butter fat price was, during the same  
9 months. They show that the average producer price for  
10 butter fat was \$1.6304 while the current, this was written  
11 not during the time, but the predecessor federal order  
12 butter fat price per pound was \$1.5707.

13 Q The third, fourth and fifth pages of the exhibit  
14 are the Determination of Equivalent Price Series.

15 What is that designed to show?

16 A This is to show that during the period that was  
17 covered by the proposed rule and the promulgation of the  
18 final rule, the department looked at the issue of butter fat  
19 pricing and determined an equivalent price for butter fat.

20 Q The fifth page is Importance of Cream from  
21 Standardizing Fluid Milk Products as a Source of Butter Fat  
22 for Producing Butter.

23 Could you read what this part of the exhibit  
24 illustrates?

25 A Yes. This illustrates that 65 percent of, it's

1 our estimate. There are no statistics on this. It is our  
2 estimate that 65 percent of the butter produced in the  
3 country is produced from cream sources rather than producer  
4 butter fat prices.

5 Q Can you go to the documentation supporting that?

6 A Yes, sir.

7 Q The first number on the next page, Calculation of  
8 Percentage of U.S. Butter Production Originating from Cream,  
9 Standardized from Fluid Milk Products. Can you tell me  
10 where that first number, 500,872,000 pounds came from?

11 A Yes, that comes from Table 46 in the FMOS 98.

12 Q And that is the Annual Summary of Federal Milk  
13 Order Statistics for 1998, is that correct?

14 A That's correct.

15 Q The second number is 81.51 percent. Can you tell  
16 me how that number was derived?

17 A Yes. That comes from producer deliveries used in  
18 Class 1, again from the annual survey, Table 16, divided by  
19 commercial disappearance of fluid milk products.

20 Q That number would have been divided by the total  
21 fluid milk sales in the United States. Is that correct?

22 A Yes.

23 Q That would give us the 81.51 percent?

24 A Yes.

25 Q And then the third number, 614,491,000. That is

1 the amount of butter fat used in butter if all Class 1 sales  
2 were federal order sales, correct?

3 A That's correct.

4 Q And this is an estimate rather than an actual  
5 measurement.

6 A Yes.

7 Q And then can you follow the following numbers.  
8 The fourth number, pounds of butter produced at the 81.11  
9 percent butter fat.

10 A That would be the resulting pounds of butter  
11 produced at the yield of 81.1.

12 Q The fifth number, total U.S. butter production.  
13 Where did that number come from?

14 A Dairy products annual survey, 1998.

15 Q And the sixth number is percent of U.S. butter  
16 production originating from cream standardized from fluid  
17 products. How did you derive that number?

18 A That's a division of line four and line five, the  
19 pounds of butter produced from those sources that we  
20 estimate. And against the total production.

21 Q What was the resulting quotient from that  
22 division?

23 A 65.81 percent. It shows that our proof of our  
24 assumption, that 65.81 percent of the butter produced in the  
25 United States comes from cream sources rather than --

1 Q And you believe this is a reasonable estimate?

2 A Yes, sir.

3 Q And the next page, Butter Fat Test of Major Uses  
4 of Producer Milk Under Federal Milk Marketing Orders.

5 The first number on that document says Producer  
6 Deliveries. What is that number, and where does that come  
7 from?

8 A Again, the annual statistics for 1998. All these  
9 numbers come from there. It shows that the average producer  
10 deliveries were 3.65 percent.

11 Q The second number on that page is fluid milk  
12 items. What is that number?

13 A That's the average butter fat producer milk going  
14 to that use.

15 Q Producer milk going to that use. Does that imply  
16 that cream would have been separated from that producer milk  
17 in fluid uses? Is that correct?

18 A Yes.

19 Q The third number is fluid cream items. What is  
20 that number?

21 A That's the percent butter fat and producer milk  
22 going to that class use. It would imply, in this case, that  
23 it would be a net taker of fat. You would not --

24 Q So fluid cream items would be used, producer milk  
25 as it comes to the farm plus a source of fact such as

1 surplus cream.

2 A Uh huh.

3 Q Is that correct?

4 A Yes.

5 Q The fourth item, manufactured uses other than  
6 butter.

7 A Again, 3.85, it shows that's a higher butter fat  
8 than producer milk, so the expectation is it would be a draw  
9 of butter fat rather than a provider of butter fat from  
10 butter.

11 Q Some butter fat from a source other than direct  
12 producer milk would have been used in that.

13 Finally, the last number on this page relates to  
14 butter. What does that represent?

15 A Butter fat content of milk that goes to butter.

16 Q So the butter fat number on the first page of this  
17 explanation, could that butter fat have originated from any  
18 source of these major use categories other than fluid milk  
19 products?

20 A No.

21 MR. CHRIST: That's the end of the exhibit, Your  
22 Honor. I guess I would offer it in evidence.

23 JUDGE HUNT: Any objections to Exhibit 33 being  
24 made part of the record?

25 (No audible response)

1 JUDGE HUNT: No objections, then Exhibit 33 will  
2 be received into evidence.

3 (The document referred to,  
4 having been previously marked  
5 for identification as Exhibit  
6 No. 33 was received in  
7 evidence.)

8 BY MR. CHRIST:

9 Q One of the issues that arose yesterday was the  
10 question of whether Class 4 products would be substituted  
11 for Class 1, 2 or 3 products if there's an adjustment to the  
12 Class 4 butter fat price but not to other butter fat  
13 prices. Do you recall that discussion?

14 A I believe so, yes.

15 Q Has the Class 2 butter fat price, would your  
16 proposal change the Class 2 butter fat price?

17 A No.

18 Q Would your proposal have any effect on the butter  
19 price which is a Class 4 product?

20 A No.

21 Q Would you expect there to be any change in the  
22 relationship of the price of Class 4 products to the price  
23 of Class 2 butter fat to encourage substitution?

24 A No. Well, --

25 Q Okay. If the Class 4 butter fat price is reduced,

1 would you expect a supply response, a greater quantity of  
2 butter fat being available for Class 4 products?

3 A No. Butter is the residual use for butter fact,  
4 so I would expect because of a change you would not expect a  
5 change of supply.

6 Q Would the uses of butter fat in Class 1, Class 2  
7 or Class 3 be affected by this?

8 A Marginally. Not much at all. We'd expect the  
9 same demand for butter fat would appear as they do now.

10 Q Your proposal reduces a portion of the Class 4  
11 price that goes into the federal pools. Would this affect  
12 producer prices?

13 A Yes.

14 Q Can you give us some estimate of how much?

15 A Yes. For the month of February, if you took all  
16 the Class 4 butter fact, you multiplied those pounds towards  
17 the six cents of our proposal, you would come up with a  
18 value, divided that value by the number of pounds in the  
19 federal orders, you come up with four cents per  
20 hundredweight.

21 Q Is that four cents per hundredweight  
22 characteristics of the year round situation or is it special  
23 to a certain season?

24 A I would expect that that would not represent the  
25 annual average. During the first part of the year, butter

1 being the residual product and low class to demand, that  
2 there is more butter fat going to Class 4 uses than other  
3 uses, and we'd expect that that four cents on an annual  
4 statistic would be less.

5 Q Is there a particular importance to getting the  
6 Class 4 component prices right, given the roll of Class 4 as  
7 a clearing price?

8 A Most definitely. The final rule says in a couple  
9 of different places that Class 4 is designed to be the  
10 market clearing price. IN order to have a market clearing  
11 price you have to have a price that's competitive.

12 MR. CHRIST: Your Honor, that covers the review on  
13 proposal eight. Would you like to hear the testimony on  
14 proposal 23 and then open it for questions? Or would you  
15 want to deal with this proposal first?

16 JUDGE HUNT: I think let's go with 23 and then  
17 they can question on both.

18 BY MR. CHRIST:

19 Q Mr. Schad, you have a position on proposal number  
20 23 as well?

21 A Yes, I do.

22 Q Would you read that, please?

23 A Yes. Land O'Lakes supports the amended National  
24 Milk Producers' position that the non-fat solids make  
25 allowance for Class 4 equals the weighted average of the

1 RBCS survey and the California survey, with a \$0.0174 per  
2 pound included for return to investment and \$0.0015 included  
3 for marketing cost allowance for non-fat dry milk.

4           Additionally, Land O'Lakes supports the National  
5 Milk position that the return on investment for butter be  
6 \$0.0073 and the marketing allowance for butter also be  
7 \$0.0015 per pound.

8           Further, Land O'Lakes supports the current yield  
9 factor of dividing by 1.02.

10           Providing a factor within the make allowance for  
11 return on investment is essential for processors to continue  
12 to provide facilities to process milk into marketable  
13 commodities. Since butter and powder are normally tied  
14 together within the same plant, we will rationalize the  
15 return on investment and marketing allowance within the same  
16 calculation.

17           An estimate by a Land O'Lakes engineering  
18 department places the cost of a two million pound per day  
19 butter powder plant at \$43.2 million without the cost of  
20 land. Exhibit, page 3 of my testimony.

21           This estimate would include milk receiving,  
22 separation and evaporation facilities. Additionally it  
23 would include a dryer for milk powders and a churn to make  
24 butter. Adequate storage and waste water facility  
25 treatments are also included in the cost.

1           The RCBS survey of seven butter powder plants  
2 places the average utilization of those plants at 47.9.  
3 Thus a two million pound per day plant could expect to  
4 receive 350 million pounds of milk per year at average  
5 utilization.

6           If the incoming milk averaged 3.67 butter fat and  
7 8.73 solids not fat, we would expect a total estimate non-  
8 fat solids for the plant to equal 30.555 million pounds and  
9 12.845 pounds of butter fat. Divided by the current federal  
10 order yield of 1.02, we would expect to produce 29.9556  
11 million pounds of non-fat dry milk.

12           Additionally dividing by the current yield of .82,  
13 we would expect to produce 15.665 pounds of butter in this  
14 plant. Multiplying the non-fat dry milk volume times  
15 \$0.0174 equals \$521,923; and multiplying the butter volume  
16 by \$0.0073 equals \$114,314. The sum of these values equals  
17 \$521,923 [sic]. Relating that value to the investment  
18 required to build the plant returns only a 1.2 percent  
19 return on investment.

20           Similarly, Land O'Lakes supports the inclusion of  
21 a \$0.0015 per pound as a marketing cost allowance for both  
22 butter and non-fat dry milk.

23           In the above example the allowance would generate  
24 \$68,430 annually. Such an amount does not approach the  
25 actual cost of a small sales and customer service staff that

1 would sell almost 30 million pounds of non-fat dry milk and  
2 over 15 million pounds of butter per year.

3 Land O'Lakes supports the National Milk Producers'  
4 federal and final rules yield factor of dividing by 1.02 for  
5 non-fat dry milk.

6 Following is the yield calculation for Land  
7 O'Lakes' Carlisle butter powder plant for January, 2000.

8 1. During the month 70.02 percent of the plant's  
9 ticket volume of 86,984,797 pound of milk was manufactured  
10 into butter powder.

11 2. From this volume 5,499,547 pounds of cream was  
12 separated, leaving a residual of 55,407,207 pounds of skim  
13 milk. The cream developed 2,822,438 pounds of butter and  
14 234,461 pounds of buttermilk solid. Contained within the  
15 55,407,207 pounds of skim, were 5,208,381 pounds of solids  
16 not fat which generated 5,233,382 pounds of non-fat dry milk  
17 at an average moisture of 3.47.

18 The resulting yield of non-fat dry milk solids in  
19 the skim milk, to the actual non-fat dry milk produced is  
20 100.3 percent. However, the yield analysis does not account  
21 for the buttermilk solids paid by the Carlisle plant to  
22 dairy farmers at the federal order solids not fat price.  
23 These 234,461 pounds of solids not fat generated, only the  
24 buttermilk powder price for the manufactured product.

25 During 1999 the average mostly [sic] price of non-

1 fat dry milk in the Northeast was \$1.0389 while the average  
2 buttermilk powder price was \$0.7686 per pound. On average  
3 the sales return in the Northeast on buttermilk powder was  
4 74 percent of the sales returned on the non-fat dry milk  
5 during 1999, during Market Statistics annual survey, 1999,  
6 page 81.

7           Additionally it is logical to assume that the cost  
8 of manufacturing buttermilk powder exceeds the make  
9 allowance for non-fat dry milk because of the short  
10 production runs of buttermilk powder as compared to non-fat  
11 dry milk in an efficient butter powder plant.

12           Land O'Lakes agrees with the Secretary's  
13 conclusion in the final rule, page 182, that it is  
14 appropriate to adjust a non-fat dry milk yield to account  
15 for the differing costs of buttermilk powder manufacture and  
16 the lower product prices of buttermilk powder as compared to  
17 non-fat dry milk.

18           Absent a methodology to price non-fat dry milk  
19 solids used to produce buttermilk powder which would utilize  
20 a non-existent NASS buttermilk price series and an  
21 uncalculated buttermilk powder make allowance, Land O'Lakes  
22 supports the adjustment of the non-fat dry milk yield to  
23 reflect the manufacture of buttermilk powder.

24           In the final rule the Secretary concluded, "Use of the  
25 1.02 factor allows the non-fat solids contained in the non-

1 fat dry milk and the buttermilk powder to be accounted for,  
2 and the value of all non-fat solids to be accurately  
3 reflected in the non-fat solids price." Page 182.

4 MR. CHRIST: Your Honor, the third page of Mr.  
5 Schad's statement is a letter with a lot of numbers. Rather  
6 than have that read in can we just identify it as a  
7 potential exhibit?

8 JUDGE HUNT: Yes. That will be 34.

9 (The document referred to was  
10 marked for identification as  
11 Exhibit No. 34.)

12 BY MR. CHRIST:

13 Q Mr. Schad, can you just describe the document, the  
14 letter addressed to you?

15 A Yes. In preparation for this testimony I went to  
16 Land O'Lakes Engineering and asked John Vorchec, the  
17 engineering manager in Carlisle to give me an estimate from  
18 his experience of what a blue, a greenfields butter powder  
19 plant, capable of a two million pound per day capacity, what  
20 that plant would cost. This letter is the result of that  
21 question.

22 Q The numbers in this letter represent a  
23 hypothetical plant rather than a real plant.

24 A Yes, but I will say he does mention that they're  
25 derived from real projects over time at the Carlisle plant.

1 Q Are you acquainted with Mr. John Vorchec?

2 A Yes, sir.

3 Q Has he in fact designed butter powder plants in  
4 the past?

5 A Yes.

6 Q So he's well acquainted, in your opinion, with the  
7 problem.

8 A Yes.

9 Q A couple of quick clarification questions.  
10 You mentioned in your testimony on the second page  
11 ticket volume. Can you explain what ticket volume is?

12 A Yes. That would be the volume of milk that is  
13 accounted for at the federal order. It is the volume of  
14 milk picked up at the farm.

15 Q And it represents farm weights and tests for that  
16 milk, is that correct?

17 A Yes.

18 Q You also used the term average mostly price of  
19 non-fat dry milk. Can you tell us what that means?

20 A Yes, it's a term that comes from I guess NASS  
21 surveys that gives you, while the NASS survey will give you  
22 a range of prices for different commodities, and they will  
23 also tell you where most of the trades are within that  
24 range, and that other range is called a mostly. The first  
25 gives you the extreme range. The other gives you a more

1 narrow range.

2 Q In your yield calculation, what was the numerator  
3 in that calculation where you arrived at 100.3 percent  
4 yield. What was the numerator?

5 A The pounds of non-fat dry milk, 5,223,382.

6 Q What was the denominator in that --

7 A 5,208,381.

8 Q That was the pounds of non-fat solids in the skim  
9 milk that went to the dryer, is that correct?

10 A That's correct.

11 Q You also report that the average moisture test was  
12 3.47 percent, is that correct?

13 A That's correct.

14 Q If 100 percent of the solids would have been used,  
15 what would have been the yield? It would have been 100 plus  
16 3.47?

17 A I don't understand the question.

18 Q If 100 percent of the solids had been used --

19 A Oh, yes.

20 Q Then what would your yield have been?

21 A 103.47.

22 Q And in practice you found a yield of 100.3.

23 A Yes.

24 Q Which implies a shrinkage of the difference  
25 between .3 and 3.47.

1 A Yes.

2 Q Now --

3 A Just so you're clear, the numbers are taken only  
4 at the plant level. I'm deriving the solids not fat from  
5 the skim, not the producer milk.

6 Q It's the skim that has left the separator, is that  
7 correct?

8 A Yes.

9 Q After it's passed through the separator. So  
10 anything that occurred between the farm and the plant and  
11 within the plant until the skim had passed through the  
12 separator, any skim loss or shrinkage in those processes are  
13 not accounted for here. Is that correct?

14 A Uh huh.

15 Q You reported as well a large difference in the  
16 price of non-fat dry milk and dry buttermilk. Would you  
17 characterize that as value shrinkage?

18 A Yes, I would. There is a shrinkage on the return  
19 of products. And this, as you characterize it, values  
20 shrinkage is a good term.

21 A Does a lower value for buttermilk powder show up  
22 anywhere in the federal order price, minimum price for non-  
23 fat milk solids?

24 A No.

25 Q Thank you.

1 MR. CHRIST: Your Honor, that's all I have.

2 JUDGE HUNT: All right.

3 Mr. Schad is open for questioning now.

4 Mr. Rosenbaum?

5 BY MR. ROSENBAUM:

6 Q Mr. Schad, I want to start with proposal number 8  
7 which is the proposal to drop the price for Class 4 butter  
8 fat by six cents per pound, but not to reduce the butter fat  
9 price for other classes. That is the proposal you're  
10 supporting, correct?

11 A Yes, sir.

12 Q You start by talking about the history of how the  
13 Grade A price was replaced by the Grade AA price a few years  
14 ago, correct?

15 A I did.

16 Q That was done by subtracting nine cents from the  
17 Grade AA price, right?

18 A That's correct.

19 Q The effect of that deduction -- strike that.

20 At that time butter was in Class 3, correct?

21 A Yes.

22 Q And Class 1 was Class 3 plus whatever the Class 1  
23 differential was in that particular order, correct?

24 A Basic formula price plus, second previous ones.

25 Q And with that adjustment of the second previous

1 month. And similar to the Class 2 price was an adjustment  
2 off the Class 3 price, correct?

3 A That's correct.

4 Q So when the department determined that it would  
5 subtract nine cents from the AA price, that not only brought  
6 the Class 3 price down by that nine cents, but also brought  
7 the Class 2 and 1 price down as well, correct?

8 A The butter fat price, yes.

9 Q But it affected all classes of milk, correct?

10 A Yes, butter fat used in all classes.

11 Q And when the department, to paraphrase your  
12 testimony, inadvertently --

13 A That wasn't my testimony.

14 Q When the department, without discussing the  
15 rationale, did not include a deductor off the Grade AA price  
16 in the new rule, that impacted all the classes, correct?

17 A Yes.

18 Q But you're only proposing to fix that, if you  
19 will, with respect to one class, Class 4, correct?

20 A Correct.

21 Q Which is, I take it, the class in which Land  
22 O'Lakes has its largest sales. Would that be accurate?

23 A I think the reason would be better characterized  
24 as that Class 4 use, as I said, is a residual use, and  
25 there's a circularity for Class 4.

1           Q     I was just asking the factual question, whether  
2     Land O'Lakes has most of its sales in Class 4.

3           A     Given our cheese operations in the Midwest, I'm  
4     not sure that's exactly true, but I'll give you that we have  
5     significant sales in 3 and 4, and Class 1.

6           Q     You're famous for your Class 4 products,  
7     obviously. Most famous for your Class 4 products.

8           A     For our butter, yes.

9           Q     You talk about how the increase in the butter fat  
10    price represents an increased cost of fluid milk processors  
11    who have to sell their surplus cream, correct?

12          A     To Class 4. Yes. The answer to your question is  
13    yes.

14          Q     But the increased cost that they incur is exactly  
15    the same whether they're selling that surplus to a Class 4  
16    handler or to a Class 2 handler, correct?

17          A     Yes.

18          Q     And you would agree with me that excess cream from  
19    Class 1 operations is a substantial source of the cream  
20    needed to make ice cream, a Class 2 product.

21          A     I think, yes.

22          Q     And of course I think your own statistics show  
23    that Class 2 products obviously need butter fat triple or  
24    more what, how much butter fat there is in the milk itself.

25          A     I think -- I won't characterize the amount, but

1 your previous question talked about the issue and I agree  
2 with you, yes.

3 Q Ice cream, for example, I think by law has to be  
4 at least 10 percent fat, so obviously you're talking about,  
5 maybe triple is a slight exaggeration, but in that range,  
6 correct?

7 A Given that, yes.

8 Q You're asking for a six cent reduction in the  
9 butter fat price based upon what I understand to be these  
10 various calculations of the costs you incur to purchase  
11 cream and transport it, et cetera, is that right?

12 A Yes.

13 Q I'm looking at the second page of your testimony  
14 in support of proposal 8.

15 A Yes.

16 Q But if I understand the calculations you've done,  
17 in fact only two-thirds of the butter you produce incurs  
18 these costs because the remaining one-third is made from  
19 producer milk, not from cream.

20 A That's correct.

21 Q Let me switch now to proposal 23. I'm not asking  
22 questions here that are really going directly to your  
23 calculation, I'm just going to your statement, your  
24 calculation being based on a 1.2 percent return on  
25 investment which sort of --

1           A     That's what the numbers came out to be. My point  
2     is that's a -- If the department chose the numbers in the  
3     RCBS survey, then that is a very low return on investment.

4           Q     That's inadequate really, isn't it?

5           A     Yes, sir.

6           Q     You would not be able to attract investment if  
7     that's the only kind of return you could offer, isn't that  
8     right?

9           A     I'm not sure about that, but I'd say that's a very  
10    low return and the calculation is to show that that which is  
11    included in the RCBS survey is low, reasonable, inadequate.

12          Q     Thank you.

13                JUDGE HUNT: Mr. Yale?

14                BY MR. YALE:

15          Q     Good afternoon, Mr. Schad.

16          A     Good afternoon, Mr. Yale.

17          Q     In your testimony you indicated you thought in the  
18    question and answer with Mr. Christ that there was about a  
19    four cent per hundredweight impact on the producer pool. Is  
20    it my understanding that's nationwide or just in the  
21    Northeast?

22          A     That would be nationwide.

23          Q     And that was just for the month of February?

24          A     Yes, sir.

25          Q     Could you tell us what numbers you used to compute

1 that? What was the total gross dollars that you divided by  
2 the pounds?

3 A I'm afraid I don't have those numbers with me, but  
4 you could do the same thing by going to the 11 federal  
5 orders and finding the volume of Class 4 butter fat.  
6 Multiplying that volume times six cents to get a value.  
7 Divide that value by the total pooled pounds of the 11  
8 federal orders.

9 Q There are about, when you say in February there's  
10 about eight billion pounds of milk pooled nationwide in the  
11 federal order?

12 A I don't remember.

13 Q There's about 100 billion pounds roughly pooled  
14 nationwide annually?

15 A Again, I can't confirm that number for you.

16 Q If it was eight billion, you're looking at  
17 somewhere in the neighborhood of a suggestion of 48 million  
18 dollars to producers nationwide if this proposal is adopted  
19 for one month?

20 Do you know what the math is, how much it comes  
21 out to?

22 A No, sir. I only did the per hundredweight  
23 calculation, and that's --

24 Q I may be off. It may be per year. Per year, \$48  
25 million.

1 A Okay.

2 Q You would agree, would you not, that in solids not  
3 fat, there is dry buttermilk powder. I don't think there's  
4 any question about that, right?

5 A In the incoming solids not fat that comes into a  
6 butter powder plant --

7 Q Right.

8 A -- some of that goes to non-fat dry milk and some  
9 goes to buttermilk solids. Yes.

10 Q In the current rule, and basically it's as you're  
11 proposing, because you're proposing no change, am I right?

12 A Yes.

13 Q How much money is attributable in the price per  
14 pound of solids not fat to dry milk powder?

15 A I don't know the answer to that.

16 Q The answer's zero, isn't it?

17 A Ask the question again.

18 Q How much, out of the -- in the solids, non-fat  
19 price, how much money is attributable to the buttermilk  
20 powder?

21 A I don't know. I don't know the calculations  
22 behind the Secretary's decision on yield.

23 Q You've adopted a 1.02 as a divisor, right?

24 A I did.

25 Q Using your formula, if you take the value of non-

1 fat dry milk and divided it by 1.02 after you've adjusted  
2 for the make allowance, you got a price for solids not fat,  
3 right? Total solids not fat.

4 A When you used the 1.02, now that's my yield? Is  
5 that the number that --

6 Q Are you proposing a different --

7 A No, I'm trying to follow your question.

8 Q Are you using a different yield than the final  
9 rule?

10 A I'm sorry. You're dividing by 1.02.

11 Q I'm dividing by 1.02.

12 A I've got you. Yes.

13 Q And you agree to that, right?

14 A Yes.

15 Q If you take, I want to walk this through, make  
16 sure I'm saying everything correctly. Non-fat dry milk  
17 minus the make allowance and you divide that by 1.02 and  
18 that gives you a price for solids not fat, right?

19 A Yes.

20 Q In that value for solids not fat there --

21 A In the value?

22 Q Per pound.

23 A In the value per pound.

24 Q Of solids not fat, also in that solids not fat  
25 there is buttermilk powder, right?

1           A     Yes.  Conceptually it's easier for me -- You're  
2     paying for incoming milk as solids not fat, that's what  
3     you're paying for.  And those solids not fat in the incoming  
4     milk is multiplied times a factor of powder price less make  
5     allowance divided by 1.02.  Conceptually, that's what I see.  
6     Can you fit your question to --

7           A     All right, let's go with that.

8                     The resulting value is a price per pound of solids  
9     not fat, right?

10          A     Yes.

11          Q     But that value is to include value for buttermilk  
12     powder, right?

13          A     That's correct.

14          Q     If you were to give all of the value, separate out  
15     from the solids not fat the buttermilk powder, and value  
16     that, how much is left over -- and subtract that from the  
17     number you just gave me, how much is left over for  
18     buttermilk powder?

19          A     I don't know the answer.  I don't know what the  
20     Secretary used for the 1.02.  He only speaks to the fact  
21     that because of the difference in buttermilk powder prices  
22     he had to adjust the yield.  I don't know what weighting he  
23     gave to either one.  I can't answer that question.

24          Q     I'm not asking what -- You've agreed with that  
25     same yield.

1           A     I agree.

2           Q     And using your formula, how much is the value of  
3 buttermilk powder?

4           A     My testimony would say that I get, for every pound  
5 of, again, not accounting for farm loss. In the plant for  
6 every pound of solid non-fat that I am sending to the dryer  
7 for non-fat dry milk, I have a one-to-one relationship.  
8 That's what my yield shows. And that's fine. But I also  
9 have 300,000-some-odd of buttermilk solids that are  
10 generated by this process.

11                If I plug those pounds into the formula for non-  
12 fat dry milk and account for that at the non-fat dry milk  
13 price, and a make allowance which I believe is higher than  
14 the non-fat dry milk make allowance then I am losing.

15                It is my believe that the Secretary saw those that  
16 and adjusted the yield to account for that. I don't know  
17 how he did it or what weights he gave.

18           Q     Let's look at your numbers.

19                You indicate on page, your second page here, that  
20 you produced, it's number four, it says contained in the  
21 pounds of skim were 5,208,381 pounds of non-fat solids.

22           A     That's correct.

23           Q     Out of your plant?

24           A     In my plant.

25           Q     I'm sorry, as a result of the work in your plant,

1     yes. Which generated 5,223,382 pounds of non-fat dry milk  
2     at the average moisture of 3.47 percent. Is that right?

3             A     That's correct.

4             Q     If you divide by the 5,208,381 -- Wait a minute.  
5     I want to make sure I've got this right.

6                     (Pause)

7             Q     Okay, but on the other hand you started with --  
8     That would generate by the department's program, that you'd  
9     only generate 5,106,269 pounds and that's what you paid for,  
10    of solids not fat, but yet you yourself indicated you  
11    generated 5,223,382.

12            A     I'm not following your numbers.

13            Q     I'll just put it very simple. It appears by your  
14    numbers that your own yields are generating more solids non-  
15    fat than what the department's yield would produce. More  
16    powder than what the department's formula would provide.

17                     In other words, you got powder that you got out of  
18    your plant that you're selling that you didn't have to  
19    account to in the pool based on these yields.

20            A     Again, remember what I'm doing with the milk is  
21    I'm taking it in the plant. I'm not accounting for farm  
22    losses. I'm not sure what that is. I'm separating the  
23    streams.

24                     You're getting that value of powder, that volume  
25    of powder from the stream that went to skim.

1           To get that, you also have the buttermilk solids  
2   on the other side.

3           My point is if this was only about skim and I  
4   didn't have to pay for the buttermilk powder, then I'm  
5   whole. I'm paying as much as I'm receiving out the other  
6   side. But I have to pay for the buttermilk solids at the  
7   non-fat -- assuming the non-fat make allowance and the non-  
8   fat dry milk price.

9       Q   And you're saying that that exceeds the value of  
10   the buttermilk powder so that in fact it's really not an  
11   addition to the total value that comes out of your plant.

12       A   Yes, sir.

13       Q   You were talking about this Grade A, Grade AA  
14   price. Do you produce any Grade A butter?

15       A   Very little.

16       Q   Do you buy any Grade A butter?

17       A   I don't know the answer to that. We do not in  
18   Carlisle.

19       Q   Isn't it true, Mr. Schad, that between the notice  
20   of changing the pricing series that you have here in this  
21   one exhibit, which I think is part of Exhibit 33, and the  
22   final rule, that the Secretary has recognized that Grade AA  
23   is the value of butter now in the federal order, because  
24   that's really what the market is buying? And that there's  
25   no justification for pricing butter at Grade A prices

1 anymore. It recognizes a shift in the value of the finished  
2 product in the marketplace from the Grade B and Grade A to  
3 mostly Grade AA.

4 A I think it also, as my numbers point out, the  
5 margins narrowed and since we're in a product price formula  
6 there's no place to get that narrowed margin.

7 Q But the only product that's producing this extra  
8 butter fat primarily is coming out of your bottling plants,  
9 right?

10 A I would say it's coming out of bottling plants.

11 Q So you want a make allowance for bottling plants?

12 A I want that -- I'm pointing out that a bottler,  
13 for him to get that six cents back on product that goes to  
14 Class 4, will have to raise his fluid prices to do that.

15 The butter maker, because he is constrained by the  
16 butter price, can't give the six cents back. And if it goes  
17 to another class, there's an opportunity, because the other  
18 classes are based on market prices.

19 In the butter fat we're constrained by butter  
20 price less make allowance divided by yield.

21 Q So maybe the problem's in the make allowance and  
22 the yield on the butter fat price and not so much on the  
23 price that, the cost to the fluid handler.

24 A To get to the six cents you could do it a couple  
25 of different ways. We chose this direction because it

1 limited on Class 4, because as I said, Class 4 there's no  
2 opportunity within the butter fat formula to regain that six  
3 cents.

4 Q Do you sell any butter yourself? Are you involved  
5 in the selling of butter?

6 A Personally?

7 Q Yes.

8 A No.

9 Q Are you aware of how it's priced in your plants?  
10 Priced from your plants.

11 A In broad terms.

12 Q Is it indexed off the CME butter price, AA butter  
13 price?

14 A Now we're going to consumer. I don't know the  
15 answer to that one, no.

16 Q Do you buy cream or butter?

17 A I buy butter. That would be basically, my  
18 individual transactions probably have been from the MERC so  
19 I guess it would be future prices, I guess --

20 Q But you use the CME as the closing price on that?

21 A On the butter? No. I don't think I can give you  
22 the answer you're asking for on butter.

23 Q You don't know how it's indexed or how it's  
24 priced?

25 A Not the butter.

1 Q What about the cream?

2 A I think I can probably give you the answer you're  
3 looking for there. More likely than not it's on the MERC.

4 Q That's the Chicago Mercantile Exchange?

5 A Yes, sir.

6 Q No other questions.

7 JUDGE HUNT: Mr. Christ?

8 MR. CHRIST: Your Honor, I don't believe we  
9 received Exhibit 34. I'd like to move that we receive it in  
10 evidence.

11 JUDGE HUNT: Is there an objection to Exhibit 34,  
12 the letter from Mr. Vorchec being entered into the record?

13 (No audible response)

14 JUDGE HUNT: Hearing no objection, Exhibit 34 will  
15 be received into evidence.

16 (The document referred to,  
17 having been previously marked  
18 for identification as Exhibit  
19 No. 34 was received in  
20 evidence.)

21 REDIRECT EXAMINATION

22 BY MR. CHRIST:

23 Q Mr. Schad, you mentioned the circularity of butter  
24 fat prices for Class 4. Does that mean that in Class 4 the  
25 output price determines the input price of butter fat?

1 A Yes.

2 Q Does that circularity occur for Class 1, 2, or 3?

3 A No.

4 Q Does the output price of Class 1 milk determine  
5 the butter fat input cost?

6 A No.

7 Q Does the output price of Class 2 products such as  
8 ice cream and cottage cheese, determine the butter fat input  
9 cost?

10 A No.

11 Q With respect to Class 3, does the output price of  
12 Class 3 outputs determine the butter fat input price?

13 A No.

14 Q So circularity in your opinion applies only to  
15 Class 4?

16 A Yes.

17 Q In comparing your yield to the Secretary's yield,  
18 I believe in the earlier examination you described the  
19 numerator and the denominator in calculating your yield.

20 A Yes.

21 Q The numerator was the pounds of powder produced  
22 during that month, right?

23 A Correct.

24 Q And the denominator was the pounds of skim solids  
25 that went to the dryer during that same month.

1 A Yes.

2 Q Do you know what the numerator and denominator  
3 were in the Secretary's calculation of yield?

4 A No.

5 MR. CHRIST: I think I'll leave it go at that,  
6 sir. Thank you.

7 JUDGE HUNT: Any other questions?

8 Mr. Beshore?

9 MR. BESHORE: Just one clarifying question.

10 RECROSS-EXAMINATION

11 BY MR. BESHORE:

12 Q Dennis, when you referred to mostly prices I think  
13 you may have referred to them as NASS prices and I don't  
14 think you meant that. You meant mostly are reported by  
15 Dairy Market News?

16 A Yes, I'm very sorry. Dairy Market News.

17 JUDGE HUNT: Ms. Brenner?

18 BY MS. BRENNER:

19 Q Mr. Schad, I just had some questions about mostly  
20 some of your calculations.

21 But first, you did state that butter is the  
22 residual use for butter fat. Is that always the case?

23 A Always the case? I think it is the majority of  
24 the time it is the case. As we point out, -- Okay, yes.

25 Q We've certainly seen some months in the last year

1 or two where the butter price per pound was higher than the  
2 cheese price, haven't we?

3 A Yes.

4 Q And it probably wouldn't be the residual use at  
5 those times, would it?

6 A No. I think the increase in butter price is  
7 probably a function of the scarcity of butter at the time.

8 Q Looking at the Table 2 in your testimony on  
9 proposal number eight, the item there that you have  
10 described as fluid cream items with 11.25 percent butter  
11 fat, that wouldn't include ice cream, would it?

12 A No, I believe not.

13 Q That would only include things like whipping  
14 cream, sour cream --

15 A I think so.

16 Q -- half and half.

17 A That can be clarified by the report itself.

18 Q By what?

19 A That can be clarified by the report itself, I'm  
20 sure, with a footnote.

21 Q Then when you move down to manufactured uses other  
22 than butter with this 3.85 percent, that would include ice  
23 cream, I suppose. But it would probably also include some  
24 things that involve the removal of butter fat from milk such  
25 as yogurt, cottage cheese curd, part skim mozzarella which

1     apparently is almost half the production of cheese. So that  
2     3.85 percent there is composed of a lot of things some of  
3     which do have more than 3.65 percent in the producer milk,  
4     but some of which have quite a bit less, and probably do  
5     generate cream for butter manufacture, would that be  
6     correct?

7           A     I would concede that. That may add to our 65  
8     percent, actually. If the fat has become available not in  
9     the manufactured use for for another use, given -- if you  
10    agree with me that butter is the residual in this whole  
11    thing, then it would mean more butter fat would come from  
12    sources other than producer milk.

13          Q     But the 65 percent is originating from cream  
14    standardized from fluid product. So it would probably  
15    subtract from the 65 percent, wouldn't it?

16          A     Okay.

17          Q     Going on to your testimony on proposal number 23,  
18    I was having a hard time following some of the computations  
19    in the paragraph beginning with the RBCS survey and  
20    following into the next paragraph.

21          A     My intent here was to give a rationalization for  
22    the return on investment and the marketing allowances that  
23    are included in the make allowance calculation for butter  
24    and powder. With that said, do you have a specific  
25    question?

1 Q Well --

2 A I'm trying to determine how much is accrued in  
3 this theoretical plant with the utilization of 47 percent of  
4 capacity which is an RCBS number.

5 Q Okay.

6 A I'm trying to relate those theoretical dollars for  
7 the cost of investment, against a cost of investment which I  
8 show on page three.

9 Q Did you multiply the 29.9556 million pounds of  
10 non-fat dry milk by 1.74 cents? Is that how you got the  
11 521,923?

12 (Pause)

13 A Yes.

14 Q Then you multiplied the butter volume --

15 A By the --

16 Q And I was trying to find that here.

17 A .0073, and that is the return on investment in the  
18 RCBS.

19 Q I was trying to find the butter volume to multiply  
20 that by. I guess it's that 15.665.

21 A Yes.

22 Q Then you get the 114,000.

23 You add that to the 521,923?

24 A Yes. Well, I'm sorry, there is either a  
25 typographical -- I'm not sure whether it's typographical or

1 computational.

2 Q You mean that second 521,923?

3 A I added the 114 to the 521 or the 521 was the sum.

4 So either the first 521 is wrong or the second is wrong.

5 But you described the method of computation.

6 Q So we would follow that through, and then divide  
7 whatever the total is --

8 A Right, by the \$43 million.

9 Q And then to come up with either 1.2 or maybe more  
10 like 1.5 or something.

11 Q I understood you to tell Mr. Beshore that most of  
12 your, nearly all of your butter production is AA as opposed  
13 to A.

14 A Yes, ma'am.

15 Q Do you have any idea about what the relative ratio  
16 of A to AA in the market would be?

17 A Very little Grade A. Very little.

18 Q Would that be a somewhat different situation that  
19 existed at the time that the Grade A butter price was  
20 established as the basis for computing the butter fat  
21 differential?

22 A When was that?

23 Q Probably 10, 15, 20 years ago.

24 A I wouldn't be in a position to answer that  
25 question. I wasn't an employee of Land O'Lakes.

1           Q     But that might be one basis for changing the base  
2 price for the value of butter fat, wouldn't it?

3           A     That could be one reason, for the reason. But the  
4 effect was a six cent, a significant change in the  
5 relationship between butter and the cost of butter fat.

6           Q     And it may have been a change, but if we're using  
7 the price of the product that exists in the market, and if  
8 the make allowance is at least semi-adequate and the yield  
9 factor is correct, I'm still kind of confused as to why  
10 there needs to be a reduction.

11          A     Again, we point out that a large volume comes from  
12 sources other than producer milk. Sixty-five percent may  
13 not be correct, but if we assume that two-thirds. It could  
14 also be, you could also make the assumption that the  
15 different, the fact that cream was sold on the A market and  
16 butter was sold on the AA accounted for the costs of in  
17 between. Those costs which we articulate here, the  
18 transportation as well as the increased handling costs.

19          Q     You had numbers that totaled about five centers  
20 there, and then you indicated there would be something more  
21 for transactions management and --

22          A     I our operation we were able to bring up 4.97  
23 cents from our operation. We are one operation. It could  
24 be high, low, we don't know. We also said there are other  
25 transactional costs that are not reflected in the 4.97

1 cents.

2 Q Things like transportation --

3 A No, transportation is in the 4.9.

4 Q But things like that aren't included in the price  
5 of butter when it's sold in the wholesale market?

6 A No, it's sold on a multiple. And that's our, the  
7 multiple is a function of supply and demand for butter fat.

8 MS. BRENNER: Thank you.

9 JUDGE HUNT: Anyone else?

10 (No audible response)

11 JUDGE HUNT: Thank you very much, Mr. Schad.

12 We'll take a break now --

13 MR. CHRIST: I have to leave at 3:00, if I

14 can --

15 JUDGE HUNT: Sure we, can do it.

16 For the record, state and spell your name, Mr.

17 Christ.

18 THE WITNESS: My name is Paul Christ. First name,

19 P-A-U-L. Last name, C-H-R-I-S-T.

20 Whereupon,

21 PAUL CHRIST

22 having been first duly sworn, was called as a witness herein

23 and was examined and testified as follows:

24 DIRECT EXAMINATION

25 THE WITNESS: I'm Vice President, Risk Management

1 and Economic Analysis at Land O'Lakes. I've worked at Land  
2 O'Lakes for 26 years and have been involved in policy  
3 development, federal milk order activity, Grade A marketing  
4 and risk management.

5 I have a statement in support of proposal number  
6 14 dealing specifically with the point of return to  
7 investment included in the make allowance.

8 Land O'Lakes supports the amended National Milk  
9 Producers Federation position of including a \$0.0103 per  
10 pound to investment in the make allowance for cheese.

11 Land O'Lakes recently announced plans to build a  
12 largescale cheese plant in Tulare, California. The total  
13 capital cost of this operation is estimated to be \$146  
14 million. This includes capital investment, working capital,  
15 and capitalized interest.

16 At full capacity the plant is expected to process  
17 5.4 million pounds of milk per day and produce 195 million  
18 pounds of mozzarella and cheddar cheese per year. A variety  
19 of whey products will also be produced.

20 The capital cost of the project is divided almost  
21 equally between the cheese operation and the whey operation.  
22 Therefore, close to \$73 million is assigned to the cheese  
23 operation.

24 Over time this capital cost will be depreciated.  
25 Such depreciation is included in the RBCS cost study,

1     however the cost of servicing the capital not yet  
2     depreciated is not.

3             If the average non-depreciated capital over the  
4     life of the project is half of the initial capital, then it  
5     would amount to \$36.5 million for the cheese portion of the  
6     Land O'Lakes project. At a ten percent cost of capital this  
7     amounts to \$0.0187 per pound of cheese (\$36.5 million times  
8     .10 divided by 195 million pounds of cheese which will equal  
9     \$0.0187).

10            This number exceeds the \$0.0103 requested by  
11     National Milk Producers Federation, so if anything, the  
12     National Milk proposal is too low to attract adequate  
13     capital to provide manufacturing capacity to produce cheese  
14     under federal milk marketing orders.

15            Thank you, Your Honor. That completes my  
16     statement.

17            JUDGE HUNT: Mr. Yale?

18                            CROSS-EXAMINATION

19            BY MR. YALE:

20            Q     Mr. Christ, on the proposal dealing with the  
21     selling of, the proposal of Land O'Lakes, you're also in  
22     support of that six cent reduction on Class 4, right?

23            A     Yes, that is the Land O'Lakes position in support  
24     of National Milk.

25            Q     If the product goes to -- If you reduce the

1     wholesale cost of the butter by reducing that cost by six  
2     cents, aren't there going to be some plants and some  
3     producers of butter who don't need that six cents and don't  
4     benefit, don't -- I mean they get the full benefit of it,  
5     that they can in turn sell their butter for a cheaper price  
6     and still maintain their existing margins of profit.

7           A     Do you have in mind the butter manufacturers who  
8     buy producer milk relative to butter manufacturers who buy  
9     fluid cream?

10          Q     Right.

11          A     Butter manufacturers who buy surplus cream or  
12     fluid cream from others can avoid the six cents, whether  
13     it's in the federal order or not, by simply paying a price  
14     that reflects the price of butter that they can get for  
15     their product plus the cost of transporting and processing  
16     the cream in the butter. Whereas a butter manufacturer who  
17     buys producer milk cannot avoid that six cents, and  
18     therefore incurs a competitive disadvantage.

19                 The cream buyer is immune either way, but the  
20     butter manufacturer who buys producer milk is not immune,  
21     and he will suffer competitively and do damage.

22          Q     If he gets the six cents or does not get the six  
23     cents?

24          A     If he gets the six cents he will be made whole  
25     with respect to his cream-buying competitors; if he does not

1 get the six cents he suffers a competitive disadvantage.

2 Q I want to ask you a question about the CME. Are  
3 you familiar with the Chicago Mercantile Exchange?

4 A In general terms. I personally don't transact any  
5 business on the Chicago Mercantile Exchange.

6 Q You've been involved in the dairy industry many  
7 years?

8 A Yes, I have.

9 Q Are you satisfied that the CME prices reflect what  
10 the market value is out there?

11 A I'm comfortable with the operation of the Chicago  
12 Mercantile Exchange as well as the NASS survey. They both  
13 basically represent the same market in about the same  
14 values.

15 Q Is it possible for a person to go onto the CME and  
16 truly manipulate it on a long term basis?

17 A My opinion is no. That if someone were to somehow  
18 bid up the price or drive down the price in the short run it  
19 would create arbitrage opportunities for people to buy or  
20 sell butter off the exchange, and then bring it to the  
21 exchange and make a profit.

22 Q And those people who can participate in such an  
23 arbitrage, it's virtually an unlimited number of individuals  
24 -- speculators, producers, processors.

25 A I have no idea how many, but it could be any

1 number of people.

2 Q Anybody who could see a chance to make a buck.

3 A Yes. And of course you need to have some  
4 acquaintance with the business --

5 Q I understand.

6 A -- to do that. But anyone who is swift enough  
7 could do it.

8 MR. YALE: I have no other questions.

9 JUDGE HUNT: Mr. Beshore?

10 BY MR. BESHORE:

11 Q Mr. Christ, does Land O'Lakes manufacture barrel  
12 cheese?

13 A Yes, Land O'Lakes does manufacture barrel cheese.

14 Q And has it for a number of years?

15 A Yes, we have. As long as I've been with Land  
16 O'Lakes which is 26 years, we've manufactured barrel cheese.

17 Q Are you familiar with traditional price  
18 differences between barrel cheese and block cheese and what  
19 they represent in the cheese markets and in the milk  
20 purchasing markets?

21 A We're very sensitive to the price differences  
22 between 40 pound block cheese and barrel cheese.

23 As most of our competitors are selling 40 pound  
24 blocks, and we believe that drives the competitive cost of  
25 milk. And most of our cheese is barrel cheese. So if the

1 two get out of line we either incur a competitive advantage,  
2 which is rare, or a competitive disadvantage, which is  
3 frequent.

4 Q About what has been the historical difference in  
5 price between barrels --

6 A The historical difference has ranged between three  
7 to four cents. Well, averaged between three and four cents.  
8 It's gone negative at times, just the recent past. At other  
9 times it's been as high as 20 cents, both of which are  
10 extreme. But between three and four cents. We're generally  
11 comfortable with that difference. We believe we can compete  
12 effectively with our block cheese producing competitors at  
13 that difference.

14 Q So if you can compete effectively with the price  
15 being three or four cents a pound, less for barrel cheese,  
16 how does that relate to your cost of production of barrel  
17 cheese versus block cheese?

18 A I can't speak directly because I don't have the  
19 numbers on the two styles of cheese, but we believe that the  
20 bottom line results are equivalent with a difference of  
21 three to four cents.

22 Q So you can get paid three cents less for barrels  
23 and be at the same place as getting three cents more for  
24 blocks.

25 A Yes. We've survived with that.

1           Q     Are there specific costs relating to packaging and  
2 things of that nature that are different between barrels and  
3 blocks?

4           A     Of course a 40 pound block, every 40 pounds has a  
5 package -- a cardboard box, very firm and wrapped. In  
6 barrel cheese it's 500 pounds in a unit. Sometimes a  
7 disposable fiber board barrel and sometimes it's a steel  
8 barrel that can be reused. In both cases I believe that the  
9 costs are less, but I can't document the amount.

10           MR. BESHORE: Thank you.

11           JUDGE HUNT: Any other questions?

12           Ms. Brenner? No?

13           I guess you can catch your plane then. Thank you,  
14 Mr. Christ.

15           We'll take a ten minute break until 3:00 o'clock.

16           I'm sorry -- Wait a minute.

17           Mr. Rosenbaum?

18           MR. ROSENBAUM: Your Honor, in our efforts to move  
19 things along I wanted to once again invoke the opportunity  
20 to have one witness introduce his testimony in written form  
21 and not have to read the whole document. It's the testimony  
22 of Mr. Lenahan. Therefore, I'll put it on the back table  
23 and people can pick up a copy and be in a position to Cross-  
24 Examine him when he takes the stand.

25           Let me just say the document does not have his

1 name on it. It's entitled, "Dairy Plant Product Loss  
2 Analysis Utilizing Effluent BOD".

3 JUDGE HUNT: All right. Off the record.

4 (Recess taken from 2:48 p.m. until 3:03 p.m.)

5 JUDGE HUNT: Back on the record.

6 Mr. Vetne has a clean copy of the exhibit that he  
7 was going to present. That's Exhibit 30 that he was going  
8 to get a clean copy of.

9 Mr. Vetne?

10 MR. VETNE: Your Honor, I am extraordinarily  
11 grateful to the Dairy Division and Market Administrator's  
12 staff for helping provide copies of the third page of  
13 Exhibit 30 which I have. And in addition, it has an  
14 attachment which is a bar graph version of the numbers in  
15 the third column of numbers at the bottom of the page.

16 There is no different information on here. The  
17 information that was on the exhibit is now legible and it's  
18 represented in bar graph form. I have already distributed  
19 copies around the room. There's more available.

20 I would like to ask that the legible copy with the  
21 bar graph be marked and received as Exhibit 30-A.

22 JUDGE HUNT: Does anyone have any objection to  
23 marking the clean copy as Exhibit 30-A?

24 (No audible response)

25 JUDGE HUNT: There being no objections, then we'll

1 accept it as 30-A.

2 (The document referred to was  
3 marked for identification as  
4 Exhibit No. 30-A and was  
5 received in evidence.)

6 MR. VETNE: Thank you, Your Honor.

7 JUDGE HUNT: Before we take the next witness and  
8 determine who the next witness will be, I want to go over  
9 again who definitely has plane reservations that they have  
10 to leave today, that they have to testify today? I do want  
11 to accommodate them.

12 (Discussion off the record of witnesses)

13 JUDGE HUNT: Let's take those who definitely have  
14 flights out today, and we'll start with Mr. Lenahan who  
15 would have been the next witness anyway.

16 Mr. Rosenbaum, I think he's your witness?

17 MR. ROSENBAUM: Yes, Your Honor.

18 Whereupon,

19 ROBERT LENAHAAN

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

22 JUDGE HUNT: Would you state and spell your name  
23 for the record, Mr. Lenahan?

24 THE WITNESS: My name is Robert Lenahan.

25 L-E-N-A-H-A-N.

1 DIRECT EXAMINATION

2 BY MR. ROSENBAUM:

3 Q Mr. Lenahan, did you prepare the document entitled  
4 "Dairy Plant Product Loss Analysis Utilizing Effluent BOD"?

5 A Yes, I did.

6 MR. ROSENBAUM: Your Honor, I would ask that that  
7 be marked as Exhibit 35. Copies are at the back of the room  
8 and copies have been given to the Reporter as well.

9 JUDGE HUNT: All right, it will be marked as 35.

10 (The document referred to was  
11 marked for identification as  
12 Exhibit No. 35.)

13 MR. ROSENBAUM: As I indicated, Your Honor, this  
14 was made available before the break, and therefore Mr.  
15 Lenahan is not intending to read the entire document. I  
16 will instead just ask a few questions to sort of summarize  
17 and then he'll be available for Cross-Examination.

18 BY MR. ROSENBAUM:

19 Q Mr. Lenahan, can you tell us what your current  
20 employment is?

21 A I currently work for EcoLab, Incorporated, the  
22 Food and Beverage Division. We are a vendor to the food and  
23 dairy industry as far as sanitation chemicals are concerned.

24 Q What's your title at that company?

25 A I am a senior, QMC is the actual title, Quality

1 Management Consultant.

2 Q And how long -- What's your degree in?

3 A I have a degree from Iowa State University in  
4 agricultural business.

5 Q How long have you had experience in the  
6 sanitation, food processing, and dairy industries?

7 A Twenty-one and a half years.

8 Q And how many of those have been with EcoLab?

9 A Ten years with EcoLab.

10 Q Have you actually had employment with a company in  
11 the dairy industry?

12 A I actually worked for Land O'Lakes Dairy  
13 Cooperatives.

14 Q I would simply like to ask you what I think are a  
15 few highlights of your written testimony which I think is  
16 very complete.

17 Am I correct that one of the things that comes out  
18 of, that's in the sewage of a plant like a cheese plant is  
19 called biological oxygen demand, also known as BOD?

20 A That is correct.

21 Q Just using your testimony, BOD is a measure of  
22 effluent strength in terms of the amount of dissolved oxygen  
23 utilized by microorganisms during the oxidation of organic  
24 components in the effluent, correct?

25 A That's correct.

1           Q     Your analysis is that with respect to a cheese  
2     plant or a powder plant, that the effluent BOD is virtually  
3     all the result of raw ingredient loss and finished product  
4     loss, is that correct?

5           A     That is correct.

6           Q     So one can compare the quantity of product going  
7     into the plant and measure the BOD coming out of that plant  
8     and thereby know how much raw ingredient loss and finished  
9     product loss is being encountered, is that correct?

10          A     That is correct.

11          Q     Indeed your company, as part of the services it  
12     provides, has collected data with respect to BOD for 51  
13     cheese plants, correct?

14          A     That's correct.

15          Q     And you've done that for other dairy product  
16     plants as well, fluid plants for example?

17          A     That's correct.

18          Q     But with respect to cheese plants, you're quite  
19     comfortable that whatever percentage BOD you get, that loss  
20     is really all coming from either the losses of the cheese  
21     itself, which would be the finished product, or losses of  
22     the raw ingredients going in, correct?

23          A     That's correct.

24          Q     Meaning essentially the milk or other milk-derived  
25     products, correct?

1           A     Correct.

2           Q     What you conclude on the last page is that these  
3     51 cheese plants have an average BOD loss of 2.35 percent,  
4     correct?

5           A     That is correct.

6           Q     So your bottom line conclusion is, and I quote, "I  
7     therefore conclude that the average cheese plant loses, as  
8     measured by pounds of BOD in its wastewater discharge, 2.35  
9     percent of the milk components that enter the plant as fluid  
10    milk," correct?

11          A     That is correct.

12          Q     And you feel quite comfortable in that conclusion,  
13    correct?

14          A     Yes, I do.

15          Q     And indeed, part of what you do on a day to day  
16    basis is help work with plants on questions surrounding  
17    those losses, correct?

18          A     That is correct.

19          Q     Your chart on the last page shows that while 2.35  
20    percent is the average, there are some plants that have  
21    achieved a lower loss, correct?

22          A     That is correct.

23          Q     Am I right that some of those plants achieve a  
24    lower loss because instead of discharging the BOD into the  
25    wastewater, they attempt to recover it for animal feed.

1           A     Some plants do in fact divert their high strength  
2     BOD streams to other non-POTW outlets, POTW meaning publicly  
3     owned treatment works facilities or sewage plants. They  
4     instead divert some of those high strength streams to  
5     perhaps animal feed in an effort to remove those poundage  
6     from BOD loading down at the treatment facility.

7           Q     But does a plant make any real money off of doing  
8     that generally?

9           A     Generally a plant does not make any money off of  
10    this. In fact it probably costs them some amount of money  
11    in order to do this.

12                   Plants often do this because they are a large  
13    contributor to a small municipality and they can no longer,  
14    the municipality can no longer afford to take all of the  
15    potential BOD that comes their way from a particular plant.  
16    They look for other outlets for their waste, rather than  
17    going down to the city for treatment.

18          Q     So those plants that are doing that, diverting the  
19    BOD as animal feed, would show a below average loss but in  
20    fact there's really no economic gain that they're obtaining  
21    from doing that.

22          A     That would be correct.

23          Q     In your experience, if a plant is working hard,  
24    doing a good job, following your advice, realistically, can  
25    they get that BOD below two percent?

1           A     I think if they arrive at two percent they would  
2     be doing a very good job.

3           Q     And that two percent is based upon the milk  
4     components that are arriving at the plant, correct?

5           A     That is correct, in a cheese operation.

6           Q     So you are not in that two percent figure  
7     accounting at all for whatever losses may have occurred from  
8     the farm getting that milk to the plant, correct?

9           A     No, that's correct.

10           MR. ROSENBAUM: Your Honor, at this point I would  
11     move Exhibit 35 into evidence.

12           JUDGE HUNT: Does anyone object to 35 being  
13     received into evidence?

14           Mr. Beshore?

15           MR. BESHORE: Can I Cross-Examine?

16           JUDGE HUNT: All right, we'll wait until after  
17     Cross-Examination.

18           MR. ROSENBAUM: At this point Mr. Lenahan is  
19     available for Cross-Examination.

20           JUDGE HUNT: All right.

21           Mr. Beshore, do you want to lead off?

22                         CROSS-EXAMINATION

23           BY MR. BESHORE:

24           Q     Mr. Lenahan, may I assume you've never been at a  
25     federal milk order hearing prior to this?

1           A     That's correct.

2           Q     What occasioned your attendance today?

3           A     I was asked -- We have a relationship with a  
4     number of the people in this room, with the dairy industry.  
5     Approximately 70 percent of our business is associated with  
6     dairy, and we are the largest supplier of dairy sanitation  
7     compounds and equipment in the United States. So we have a  
8     very good relationship with the dairy industry and we are  
9     interested in anything that happens in the dairy industry.

10                  The reason that I was called in today was kind of  
11     serendipitous. We have this database that I've been putting  
12     together for the last seven years -- not for this particular  
13     meeting, but as it turns out the information that I had  
14     gathered has a fairly decent effect on how this meeting is  
15     going as far as product loss is concerned, so I was asked to  
16     come today and testify based on my experiences for the last  
17     seven years doing this.

18           Q     The chart at the end of Exhibit 35, graph, I  
19     guess, this is a depiction of the BOD loss percentages of 51  
20     cheese plants? Am I correct?

21           A     That is correct.

22           Q     And each dot represents one of the plants.

23           A     Yes.

24           Q     Is the 2.35 percent a simple average or a weighted  
25     average?

1           A     It is a simple, arithmetic average.

2           Q     Would it be fair to hypothesize that the larger  
3 plants in your survey are some of your more efficient  
4 customers?

5           A     Actually the tendency is reversed sometimes.

6           Q     Large plants lose more?

7           A     It depends on what they're doing inside their  
8 facility. If they're doing more processing of whey, if  
9 they're doing demineralized whey. My opinion is the more  
10 they handle a product, the more chance there is for losing  
11 product.

12          Q     Of these cheese plants, how many are also whey  
13 processing plant?

14          A     As a percentage basis, probably about 80 percent  
15 handle their own whey there.

16          Q     The plants that you show to the far right that are  
17 eight, seven, five percent loss, they've got some problems  
18 in their operations there, would you agree?

19          A     They have some problems. But also keep in mind  
20 that this methodology is based on pounds of BOD. If you do  
21 not have good data, if you have infrequent sampling or  
22 things like that which give you an arbitrarily low number of  
23 pounds of BOD or an arbitrarily high number because of  
24 improper sampling, that would also skew that number, so it  
25 would require some investigation at a plant level to

1 determine what's really going on.

2           If you read the entire document, it explains why  
3 this might occur.

4       Q    Are you telling us that all of your observations  
5 are not equally reliable?

6       A    In what way?

7       Q    The eight percent is not as reliable a number as  
8 some of the other numbers on the graph. Is that what you're  
9 saying?

10      A    No, I'm saying if you treat all the plants, if you  
11 take their word or the numbers that are available from the  
12 local POTW as this is the amount of pounds of BOD that came  
13 out of the plant, this is the amount of pounds of milk that  
14 they received, you do the mathematics, that is the number  
15 that comes up.

16           The question is is the number of pounds of BOD  
17 correct. That could be based on infrequent or inaccurate  
18 sampling of the whey stream.

19      Q    A high number could only be wrong on the, could  
20 only be too high if the denominator's not good enough,  
21 they're not giving you their correct volumes of milk solids  
22 coming into the plant, correct?

23      A    I'm confident that they give me the correct amount  
24 of milk solids coming into the plant. That is easy to  
25 verify. As opposed to a sampling stream mechanism where

1     you're pulling samples out of the whey stream and analyzing  
2     it for potential BOD or for BOD.

3           Q     Do you work with your customers for target  
4     percentages after you sell them the right equipment and get  
5     them working the right way?

6           A     We indicate to them what other plants have  
7     achieved. Remember, the initiative for this originally was  
8     to help plants reduce their expense for sewer, because it  
9     has become a very major expense, in many cases over a  
10    million dollars a year, and it's going to continue to  
11    increase that way, so we were looking at ways to help them  
12    reduce that expense for a selfish reason. If they have  
13    money that they're not spending on sewer, they can spend it  
14    with us.

15          Q     Your equipment and your -- you sell equipment  
16    primarily?

17          A     That's one of the things that we do. We sell CIP  
18    equipment, clean in place equipment. Process controls.

19          Q     Your equipment will reduce losses and help them  
20    cut their sewer bill.

21          A     It will help them, yes. Help them do that.

22          Q     In a plant that's equipped with state of the art  
23    equipment from your company and that is well managed and  
24    efficiently operated, what loss level is achievable?

25          A     I still believe the two percent number is a valid

1 number for that.

2 Q In excess of 50 percent of 51 plants, I haven't  
3 counted the numbers exactly, but the evidence shows that is  
4 under two percent, a lot of them are under the 2.35, a lot  
5 of them are under two, and a bunch of them are under one.

6 A Again, it goes back to how do you treat your waste  
7 stream coming out of the plant. If you divert a lot of it  
8 to a non POTW outfall, which is animal feed, it doesn't go  
9 into the waste stream. So you can have less pounds coming  
10 out of the plant and you still have the same amount of raw  
11 ingredients coming in, it's going to give you a lower  
12 number.

13 MR. BESHORE: Thank you.

14 JUDGE HUNT: Mr. Galarneau?

15 BY MR. GALARNEAU:

16 Q Clay Galarneau, Michigan Milk.

17 Mr. Lenahan, referring back to the graph in your  
18 exhibit and the 2.3 percent loss, and then I heard you  
19 earlier testify that the more you handle the product the  
20 greater the loss?

21 A That would be my personal observation. As plants  
22 add additional equipment such as membrane systems and things  
23 like that for concentrating whey or for handling whey in a  
24 different manner, you have more equipment to clean, more  
25 membrane systems and things like that. It seems to me that

1 the more that you handle a product, whether it's raw milk or  
2 cheese or whey, the more potential that you have for lost  
3 product.

4 Q So this extra handling is coming to handle the  
5 whey side of the stream. Then do you have any shrinkage  
6 results on the protein or the butter fat versus the whey  
7 solid? There is a significant difference in the value of  
8 those three solids. Say you have 2.3 percent loss, it  
9 wouldn't necessarily be across all three products.

10 A No, you could not differentiate where that loss  
11 might be coming from except to say it's coming out of the  
12 plant as a whole. You would have to go inside the plant,  
13 observe what's going on inside the operation, and typically  
14 if you went back in the evaporator area you might find  
15 something back there which would explain a majority of where  
16 the product might be going. It may not. Every plant is  
17 unique because of how their operation is set up and how  
18 they're operated.

19 Q But it does seem, I'm drawing from your  
20 conclusions, though, that a greater portion of this shrink  
21 may be actually coming from the whey solid?

22 A That could be construed that way, yes.

23 Q Thank you.

24 JUDGE HUNT: Mr. Yale?

25 BY MR. YALE:

1           Q     Good afternoon. I represent dairy farmers in the  
2     West and the Mideast. Many of them, most of them are large  
3     dairy farmers. Does EcoLab do anything, provide any  
4     services, any equipment to dairy production operations where  
5     cows are milked, for clean in place in silos and the like?

6           A     Yes, we do have a division within our division  
7     that handles what we call farm business.

8           Q     Are you involved in that in any way?

9           A     No, I'm not.

10          Q     Would you agree that dairy farms have a major  
11     challenge in the area of environmental control as well?

12          A     As far as pollution runoff?

13          Q     Yes.

14          A     Yes, I believe they do.

15          Q     Is that a cost-free operation?

16          A     I don't know how to answer that. Based on  
17     specifics within a state or a region --

18          Q     I mean just to manage the animal waste and the  
19     like at a dairy farm, is that cost-free?

20          A     Oh, no. I'm sure there's a cost associated with  
21     it.

22          Q     In fact you're in business to provide cleaning  
23     services and other environmental control services to those  
24     type of operations, are you not?

25          A     Yes.

1           Q     Would you agree that those individuals who produce  
2     that milk need an income sufficient to cover the cost of  
3     their environmental cleanup?

4           A     I think they need sufficient income to cover their  
5     expenses, yes.

6           Q     Isn't it appropriate as federal policy and pricing  
7     to ensure that there's sufficient return to producers that  
8     they can afford the cost of those environmental controls?

9           A     I have no argument with that.

10          Q     I don't have any other questions. Thank you.

11                 JUDGE HUNT: Mr. Vetne?

12                 BY MR. VETNE:

13          Q     Mr. Lenahan, my name is John Vetne. I'm counsel  
14     for Kraft Foods.

15                 As I understand it in working with plants you  
16     measured incoming solids against solids in the stream. I  
17     want to ask you some questions to find out if, and if so  
18     what solids might be unaccounted for that don't come out in  
19     the waste treatment stream.

20                 First of all, some of these plants take whey and  
21     dry the whey to powdered form, am I correct?

22          A     Correct.

23          Q     When whey is dried, liquid whey removes a lot of  
24     water, some of the solids go up the smokestack into the air  
25     and serve as a weak fertilizer for the nearby fields.

1 That's not measured in the discharge stream, correct?

2 A That is correct.

3 Q I don't know if this happens, but if, well let me  
4 ask you. Commonly when either cheese or anything else is  
5 spilled on the floor, is the floor washed and the wash goes  
6 into the waste treatment system also?

7 A In theory they should dry pick that up and keep it  
8 out of the system, but in practice, most of the time they  
9 take a water hose and flush it down the drain.

10 Q And that would be part of the system that you're  
11 measuring?

12 A Correct.

13 Q If the ideal happens and they pick it up, it goes  
14 into the dumpster and also is not accounted for in the  
15 measurement that you make.

16 A That's correct.

17 Q Those are the two things that immediately came to  
18 my mind. Are there other types of losses that don't go down  
19 into the drain and are therefore not measured in the waste  
20 discharge, other than primarily the two that we mentioned?

21 A No.

22 Q It's either on the floor or up in the air, right?

23 A That's correct.

24 Q Thank you.

25 JUDGE HUNT: Any other questions of Mr. Lenahan?

1 (No audible response)

2 JUDGE HUNT: Ms. Brenner?

3 BY MS. BRENNER:

4 Q Mr. Lenahan, in dealing with these 51 cheese  
5 plants do you have any which of them correspond to which of  
6 these dots on your graph?

7 A I do.

8 Q And would you describe the ones that are, for  
9 instance, I think Mr. Beshore was correct that about half of  
10 them do fall below two percent. Are those ones that have  
11 infrequent sampling or some of the other things with the  
12 randomness you might have mentioned?

13 A Right.

14 Q This line looks pretty, it looks like something  
15 that's definitely related to -- It's very steady, and almost  
16 straight.

17 A And you're asking me exactly which --

18 Q If you know which these plants are that are below  
19 this two percent line, are they the ones that you would  
20 describe as not having been sampled regularly or --

21 A I would say that is not the sole reason they're  
22 below that line. There is also something called management  
23 practices, equipment, how a plant is operated, the attitude  
24 of the employees. There's a number of things that can  
25 contribute to the way I look at product loss including

1 equipment designs. There's a number of reasons why they  
2 might be above or below that average line, but to say what  
3 an individual plant does, what from that graph, I can't say.

4 We also have, when I do this analysis for a plant,  
5 we agree that we're going to keep information close to the  
6 vest because --

7 Q I wasn't asking which plants these are. I was  
8 asking if you were familiar with the characteristics of the  
9 plants in that section of the graph.

10 A I have visited all of those plants, in fact I've  
11 been to 257 plants over the last ten years. So I've seen a  
12 number of them. Not all of them are in the dairy industry.  
13 We also do this outside of the dairy industry like the  
14 brewery and soft drink industry, but the principles are the  
15 same. If you know the potential amount of BOD coming into  
16 the plant versus pounds going out you can still make this  
17 type of calculation.

18 Q Either in your testimony or in answer to a  
19 question you indicate there's no economic gain from reducing  
20 the BOD effluent, but isn't that one of the reasons that  
21 they're there?

22 A It's a cost avoidance, for lack of a better word.  
23 When I'm saying there's no economic gain, when they send us  
24 material out to animal feed typically it's for very small  
25 remuneration, perhaps maybe five cents a pound or less, or

1 maybe a gallon. And sometimes they actually pay people to  
2 come and pick this material up.

3 The point is if you're a large plant in a small  
4 city, you may not, the city may not have the capacity to  
5 handle any more production from your plant so you have to  
6 look for other ways to get it out of the system.

7 Q Are the sewer charges based on the BOD --

8 A Definitely. The range is from 1.5 cents to 71  
9 cents across the country for a pound of BOD. There's no  
10 real rhyme or reason as to why they're priced that way.  
11 Every county, every town seems to have their own mechanism  
12 for determining that.

13 Q Don't most plants with dryers these days have some  
14 kind of filter to try to keep the product out of the air?

15 A To keep particulate out of the air? Yes, most of  
16 them do.

17 MS. BRENNER: That's all I have. Thank you.

18 JUDGE HUNT: Mr. Rosenbaum?

19 REDIRECT EXAMINATION

20 BY MR. ROSENBAUM:

21 Q I just want to make sure the record's clear.

22 With respect to plants that are below two percent  
23 on this chart, did I understand you to say that was because  
24 many of these plants divert the BOD before it gets to the  
25 wastewater plant in terms of turning it into animal feed or

1 something like that, correct?

2 A Many of the plants that are below the average do  
3 things like divert high strength BOD streams to other  
4 outlets besides the sewer treatment plant.

5 Q But in your estimation, when I asked you a  
6 question of the economics, I want to make clear I was  
7 focusing on the economics of diverting BOD to animal feed as  
8 opposed to putting it in the wastewater plant. Your point  
9 was there's really no economic benefit in that diversion to  
10 the animal feed as opposed to putting it in the wastewater  
11 plant, correct?

12 A No. It's at best a neutral proposition.

13 Q But the reason you would divert to animal feed as  
14 opposed to putting it in the wastewater plant is, in many  
15 cases, is because you're in a small town and that wastewater  
16 plant just can't take any more BOD, right?

17 A That is correct.

18 Q Thank you.

19 JUDGE HUNT: Mr. Beshore?

20 RECROSS-EXAMINATION

21 BY MR. BESHORE:

22 Q Maybe I'm completing misunderstanding something  
23 here. But if I understood your comments in response I think  
24 to Ms. Brenner, there is frequently an amount paid for  
25 animal feed, five cents a pound or whatever it might be.

1           A     Occasionally, yes, there is.

2           Q     And as I understand it, there's always a charge  
3 when you put the stuff in the sewer, correct?

4           A     Yes.

5           Q     Wouldn't that be a plus?

6           A     Let me say that it is very infrequently that  
7 people get monies for diversion to animal feed. Most of the  
8 time plants actually have to pay to have this hauled off,  
9 and the person who receives it then processes it into animal  
10 feed or whatever they're going to do with it. But for the  
11 most part, there is very little economic benefit as far as  
12 cash in hand to the plant for sending this material to a  
13 feed source.

14          Q     Whether they get paid or not, they're avoiding the  
15 sewer charge, correct?

16          A     There's two things to look at. One is a  
17 regulatory issue. Perhaps the plant can't handle any more.  
18 Or it's an operational issue where there's monies involved,  
19 yes.

20          Q     So either way they're saving on that end. They  
21 may be getting paid something or they may not on the other  
22 end, correct?

23          A     As I indicated before, each plant is unique as to  
24 their circumstance based on their location and what they  
25 manufacture, and the current rate structure that's in place

1 as far as what they're paying for it for treatment.

2 JUDGE HUNT: Mr. Rosenbaum?

3 FURTHER REDIRECT EXAMINATION

4 BY MR. ROSENBAUM:

5 Q Just to clarify that, I think you said that the  
6 plant actually has to pay to have it hauled away to then be  
7 made into animal feed.

8 A In many cases they do have to pay someone to pick  
9 up a trailer load and haul it off for them.

10 Q So they are incurring a cost, correct?

11 A That is correct.

12 JUDGE HUNT: Ms. Brenner?

13 FURTHER RECROSS-EXAMINATION

14 BY MS. BRENNER:

15 Q I'm looking at these tables, and I'm not sure what  
16 page. Page three. I'm trying to figure out just what they  
17 mean.

18 I'm wondering -- You're going to explain, right?

19 A The methodology that's used to arrive at potential  
20 BOD is based off the USDA nutrient database. It states in  
21 per hundred gram units what this material is made up of. In  
22 this case I chose to look at milk, producer, fluid, 3.7  
23 percent butter fat. That indicates that that 100 grams of  
24 that particular material or ingredient contains 3.28 percent  
25 protein, or 3.28 grams, and 3.66 fat, and 4.65 carbohydrate.

1 There are coefficients that you can apply towards protein,  
2 fat and carbohydrate to arrive at a calculated BOD  
3 potential.

4 Protein is the most difficult item for a microbe  
5 to digest. It requires the most oxygen of the three. It  
6 requires actually more oxygen than the weight. That's why  
7 it has a factor of 1.03.

8 If you put a pound of protein into the system, it  
9 would require 1.03 pounds of oxygen to oxidize that  
10 material. Fat requires .89 pounds per pound of fat; and  
11 carbohydrate is .7 pounds of oxygen per pound of  
12 carbohydrate.

13 When you do the math for this particular example,  
14 it shows that this particular 3.7 percent butter fat milk is  
15 9.9 percent BOD by weight.

16 I also indicate that if you look at other breeds,  
17 such as Jersey, which have a higher protein fat and  
18 carbohydrate number than the previous example, you have 12.1  
19 percent BOD by weight just because of the additional fat,  
20 protein and carbohydrates.

21 Q In terms of actual losses, these numbers don't  
22 really represent any actual losses. They represent the  
23 potential --

24 A That's correct. To make it simple, look at it  
25 this way. We say that if you put a gallon of raw milk down

1 the drain, you've generated one pound of BOD. As you go  
2 through the process and remove that water and concentrate  
3 the fat to protein and the carbohydrate, and when you put a  
4 gallon of 40 percent solids down the drain you've got a much  
5 different number than if you just put raw milk down the  
6 drain.

7 Q But if you're making cheese and most of the solids  
8 are incurred, then what goes down the drain is likely to  
9 be --

10 A Mostly lactose and protein. Lactose would not  
11 show up as a solid. It's soluble in water, so it would show  
12 up as BOD.

13 Q Would that be the carbohydrate here?

14 A Yes.

15 MS. BRENNER: Thank you.

16 JUDGE HUNT: Mr. Yale?

17 BY MR. YALE:

18 Q In a situation, though, with an ultrafiltration  
19 process, you could have a situation where it's just water  
20 and a little bit of lactose that's part of your drainage,  
21 right? Does your system assume that all of the loss is 100  
22 percent milk with all the full components in a composite the  
23 way it comes in the door, and --

24 A We cannot differentiate between -- If you're  
25 looking just at pounds of BOD, you can't say that okay, this

1 100 pounds of BOD is all the result of lactose or all the  
2 result of protein loss or all the result of fat. It is  
3 based on the incoming ingredients, and you say that based on  
4 the incoming ingredients we have 1,000 pounds of available  
5 BOD, and we have 10 pounds of actual BOD coming out of the  
6 plant, you do the math, you've got one percent loss based on  
7 that methodology.

8 Q But you haven't done a methodology to determine  
9 that the loss as you mentioned in your statement, you lose  
10 it in gaskets and you lose it in handling and all these  
11 different phases, but at all those different phases there's  
12 different product that's actually going through the pipes or  
13 the pumps or the filters, right?

14 A Correct.

15 Q You haven't done a distribution to see how that  
16 product mixes in terms of its concentration, gone through  
17 those vessels in terms of potential contribution to a BOD,  
18 right?

19 A No.

20 Q Thank you.

21 JUDGE HUNT: Thank you very much, Mr. Lenahan.

22 MR. ROSENBAUM: Your Honor, I renew my motion to  
23 have Exhibit 35 accepted into evidence.

24 JUDGE HUNT: Any objections to 35?

25 (No audible response)

1 JUDGE HUNT: Exhibit 35 will be received in  
2 evidence.

3 (The document referred to,  
4 having been previously marked  
5 for identification as Exhibit  
6 No. 35 was received in  
7 evidence.)

8 JUDGE HUNT: Mr. Eastham?  
9 Whereupon,

10 THOMAS EASTHAM  
11 having been first duly sworn, was called as a witness herein  
12 and was examined and testified as follows:

13 DIRECT EXAMINATION

14 BY MR. ROSENBAUM:

15 Q Mr. Eastham, have you prepared a written statement  
16 today?

17 A I have.

18 Q I think that we have copies here, and anyone who  
19 wants one, I've got one available. I think we'll just have  
20 you read it, if you would.

21 A Thank you.

22 My name is Tom Eastham. I'm employed by Great  
23 Lakes Cheese Company, Inc. My current position is the plant  
24 manager for the Empire Cheese Plant in Cuba, New York. I've  
25 held this position since 1993.

1           I am responsible for all the day to day operations  
2   and participate in all short and long term planning at our  
3   manufacturing facilities.

4           I hold an Associate's Degree in Business from  
5   Jefferson Community College; I've been involved in the dairy  
6   industry since 1979.

7           During that time I had held positions in quality  
8   assurance, production, and management at cheese  
9   manufacturing facilities in Adams and Cuba, New York.

10          Great Lakes Cheese Company is a family and  
11   employee-owned company that manufactures cheese in the  
12   Northeast United States. Our manufacturing facilities are  
13   located in Adams and Cuba, New York. These plants are  
14   regulated by a federal order and employ over 250 people.

15          Great Lakes Cheese manufactures long hold and  
16   reduced fat cheddar at the Adams plant, and mozzarella and  
17   provolone at the Cuba plant.

18          My company is a member of the National Cheese  
19   Institute and the International Dairy Foods Association.  
20   I've read the testimony of their economists, Dr. Bob Yonkers  
21   and for those of which I am familiar, I endorse them.

22          I will not attempt to be as specific or cover all  
23   the areas of his testimony. I will, instead, focus my  
24   testimony on the areas that I believe are of particular  
25   importance.

1           First on the make allowances. To plants located  
2   in the Northeast U.S. the make allowance under the new  
3   product price formula system is critical from a competitive  
4   position. Like all similar manufacturers, we are required  
5   to pay dairy farmers as a minimum price everything my  
6   company receives for its cheese minus the make allowance.  
7   All movements in the price of cheese will result in a  
8   movement of the minimum price, an amount fully offset by the  
9   movement in the price of cheese. This leaves only the make  
10   allowance allowance for my company to recover all its costs.

11           Since this is the case, it is imperative that the  
12   U.S. Department of Agriculture include all costs in the make  
13   allowance. These costs should reflect the cost to receive  
14   raw milk, convert the milk to finished products, and sell  
15   these products in the market place.

16           My company would be opposed to any proposals that  
17   attempt to limit or delete costs used to calculate the make  
18   allowance. All costs including milk procurement, marketing,  
19   and capital costs need to be a part of this calculation.  
20   The rationale for this is basic. All these costs are part  
21   of the costs to operate a cheese manufacturing facility.

22           If these costs are not included in a make  
23   allowance we have no ability to recover them. It would soon  
24   become difficult or even impossible to generate returns that  
25   would allow a facility to remain profitable and in business.

1 Our options at that time would be to look to produce cheese  
2 outside the order system or to reduce our investment in the  
3 cheese manufacturing business.

4 On the yield factor, I'm aware of the proposals to  
5 increase the milk fat retention factor of .9 used to  
6 calculate the yield factor in the making of cheese. It is  
7 my understanding that the current yield factor results in  
8 approximately a ten percent yield per hundredweight of milk  
9 on typical milk. I'm opposed to any proposal to change the  
10 yield factor.

11 First, we pay for milk based on the measurement  
12 taken on the farm. As we know, every time milk is pumped,  
13 losses do occur. These losses need to continue to be taken  
14 into account.

15 Second, it's our experience that ten percent per  
16 hundredweight of milk yield is not obtainable in the  
17 Northeast except for a limited time of the year when the  
18 solids in the milk are at their peak. The factor as it  
19 exists is more than sufficient. Any effort to raise this  
20 would put our company at a competitive disadvantage.

21 Finally, on product prices, I believe that it's  
22 important for USDA to accurately determine what the price of  
23 cheese is. I understand that the survey used by USDA to  
24 determine the price of cheese includes 40 pound blocks and  
25 500 pound barrels.

1           Based on the market, the use of 640 pound blocks  
2   is playing an ever-increasing role. Technological advances  
3   in the manufacture of 640 pound blocks and market  
4   competition have resulted in an increase in demand for 640  
5   pound blocks. Many end users prefer the on-weight ratio of  
6   cheese chunk from a 640 pound block. I believe that price  
7   discovery is a good thing, and that the maximum possible  
8   amount of cheddar cheese should be represented when  
9   establishing average prices for the purposes of determining  
10   the minimum Class 3 prices. I would therefore endorse a  
11   proposal to add the 640 pound blocks to the USDA's survey.

12           MR. ROSENBAUM: Your Honor, at this time the  
13   witness is available for Cross-Examination.

14           JUDGE HUNT: Mr. Beshore?

15                           CROSS-EXAMINATION

16           BY MR. BESHORE:

17           Q    Good afternoon, Mr. Eastham.

18                   I represent, among others, the Association of  
19   Dairy Cooperatives in the Northeast which includes Dairy Lee  
20   and is probably the suppliers to your plants up there in New  
21   York.

22                   When you are relating yield to the milk supply in  
23   the Northeast, in the comments in your statement relating to  
24   yield factor, I take it you're talking about how many pounds  
25   of cheddar cheese you get from an average hundredweight of

1 milk that you purchase at Cuba, New York.

2 A Right. Typical milk. Actually, when you say at  
3 Cuba, I'm probably trying to talk about cheddar cheese which  
4 is manufactured at the Adams plant. I think that's what the  
5 survey is based on, the make allowance is based on.

6 Q What type of cheese do you manufacture at Cuba?

7 A Mozzarella and provolone.

8 Q At Adams, what kinds of cheddar do you make there?  
9 Is it blocks or barrels or --

10 A We make 40 pound blocks and 640 pound blocks.

11 Q So it's all block cheese?

12 A Yes.

13 Q So you were talking about the yield at Adams for  
14 block cheese.

15 A Right.

16 Q I take it when you speak of a 10 percent yield you  
17 mean getting 10 pounds of cheese per hundredweight of milk.

18 A Yes.

19 Q If the .90 factor in these rather complex formulas  
20 relates to something different, you --

21 A When I'm talking about the typical milk, I guess  
22 what I'm talking about, and I think there's been some  
23 testimony about those numbers, an average is like 367 fat  
24 with a 3.2 true, or actually not true, but total protein.  
25 And our experience is we wouldn't yield what the formula has

1 for a yield factor, which I believe is somewhat a little bit  
2 over ten percent. Our experience at our facility, we would  
3 not yield that amount of cheese per hundredweight of milk.

4 Q Because your, the protein in the milk that you're  
5 acquiring --

6 A I guess what I'm trying to do is take it to a  
7 typical milk. Even with that typical milk we would not  
8 yield the ten percent that the formula is achieving using  
9 the 367 with a 3.2 protein.

10 Q Okay. The .90 figure, what I was getting at, do  
11 you know how much of the butter fat you take in is retained  
12 in your block cheddars?

13 A Retained in the block cheddars?

14 Q Yes.

15 A Not exactly, but I have an idea.

16 Q What would that be?

17 A Roughly around the .9 to maybe a little bit  
18 higher. We have pretty efficient equipment. Even with that  
19 little bit higher retention, again I would tell you that we  
20 don't achieve that ten percent yield of the formula, what  
21 the typical milk is based on.

22 Q Okay.

23 When you talk about 640 pound blocks, you use a  
24 phrase that I haven't heard before, end users prefer the on  
25 weight ratio of cheese. What does that mean?

1           A     I think if you look at the chunking business, more  
2     and more of that business is going away from random weight  
3     chunks to exact weight chunks.  It's more efficient for a  
4     640 that generally speaking you can hit the on weight ratios  
5     for an exact weight.  In other words it doesn't become  
6     rejected as you're sending it down the line for being out of  
7     spec for weight.

8           Q     So --

9           A     So if you're trying to chunk an eight ounce chunk  
10    with a 640, you're going to be more accurate, more on weight  
11    percentages.

12          Q     Than if you're chunking what?

13          A     Than if you're chunking say a 40 pounder.

14          Q     So you're supplying your cheese to cut and wrap  
15    operations.

16          A     Some of it, yes.

17          Q     Thank you very much.

18                 JUDGE HUNT:  Mr. Yale?

19                 BY MR. YALE:

20          Q     Good afternoon.

21          A     Hi.

22          Q     I'm Ben Yale and I represent dairy producers in  
23    the West and the Mideast, and I've got some questions.

24                 First of all, did your firm participate in the  
25    NCI?

1           A     We did not.

2           Q     Do you report your prices to the NASS survey?

3           A     We make long hold cheddar and therefore we do not.

4           Q     Is longhorn cheddar, isn't that a higher value  
5 product than just the straight block cheddar that's  
6 referenced in the NASS survey?

7           A     I guess I don't know what everybody's pricing is.  
8 I don't know if I could testify that -- I mean it is a value  
9 added product, if that answers the question.

10          Q     And it consistently sells at a price higher than  
11 just straight cheddar 40 pound blocks.

12          A     It's a value added product.

13          Q     And it costs money to improve it above just a  
14 straight cheddar, right?

15          A     Absolutely.

16          Q     Is it your understanding at this hearing that the  
17 make allowances are intended to compensate you for those  
18 costs?

19          A     On the long hold?

20          Q     Yes.

21          A     I don't know. I believe my understanding of this  
22 hearing is the make allowance on the cheeses currently used  
23 in the survey.

24          Q     Do you see the NASS survey numbers?

25          A     Yes.

1           Q     Do you use those in any way? Do you use those  
2 numbers in any kind of accounting or anything? Any price  
3 comparisons or anything?

4           A     I don't. It may be done at some other location or  
5 in accounting. I personally don't.

6           Q     Do you do the pricing of your product?

7           A     No.

8           Q     Do you know if those people use those numbers?

9           A     I do not.

10          Q     Based on your experience with the cheese  
11 operation, are your products priced off of the CME? Do you  
12 use like the CME plus or anything in setting your prices?  
13 Or minus? I'm not trying to set you in a trap and in a  
14 range, but do you use the CME as the benchmark?

15          A     I guess from my company's standpoint any of our  
16 pricing would be proprietary.

17          Q     You indicate in here that there's loss from farm  
18 to the plant, right?

19          A     Yes.

20          Q     Do you measure that loss?

21          A     We do actually a couple or three different times a  
22 year weight trucks as they arrive at the plant. And against  
23 the tickets.

24          Q     By based on the question that Mr. Beshore asked, I  
25 get the impression you receive some milk from some

1 cooperatives?

2 A That would be correct.

3 Q And is that price based upon the farm weights and  
4 tests?

5 A It is.

6 Q Are those on the cooperative's trucks or on your  
7 trucks?

8 A the cooperative's trucks.

9 Q Do you have any trucks of your own?

10 A We do not.

11 Q Does your pricing for that milk on those  
12 cooperatives reflect the fact that it's farm weights and  
13 tests as opposed to scale weights and tests?

14 A Our contract is farm weights and tests. I don't  
15 think there's any difference. I think that's generally the  
16 way the contracts are done in our part of the world.

17 Q Have you ever sought assistance from the Federal  
18 Milk Market Administrator's office to measure farm tanks to  
19 ensure, and their dip sticks, that they were accurate?

20 A Again, I think if we have an issue, we have no  
21 control over the farm. We might bring that to the attention  
22 of the cooperative and whether they seek the help of,  
23 whether the market administrator or whether they do that  
24 themselves, I guess that would be up to them.

25 Q Do you do that very often?

1           A     No, I wouldn't say we do it as a general practice.  
2     Again, in order to -- We'd have to monitor that on an  
3     everyday basis. And that's not the case.

4           Q     So isn't that a reflection that the amount of loss  
5     is not that significant?

6           A     I think any loss is significant. Those costs come  
7     from somewhere.

8           Q     Can you quantify them?

9           A     I cannot.

10          Q     I get the impression by I think it's a second page  
11     of your statement in the middle paragraph, the milk that you  
12     receive is pooled on the federal order?

13          A     That's my understanding.

14          Q     Under that system, the producers that deliver milk  
15     to your plant -- and by the way, do you have any independent  
16     producers or is it all cooperative?

17          A     All cooperative.

18          Q     So the milk that comes from those cooperative  
19     plants --

20          A     Cooperative farms.

21          Q     Cooperative farms. I'm sorry, thank you. That  
22     milk you pay a Class 3 price to the federal order or to the  
23     cooperative, is that correct? Plus maybe a premium, but I  
24     don't want to get into that. I'm just saying you pay a  
25     Class 3 price.

1           A     You're accurate.

2           Q     The cooperative for that milk that's delivered to  
3     you pays its producers more than that Class 3 price, doesn't  
4     it?

5           A     I would suspect -- I guess it would just be  
6     speculation. I really don't know what they pay their  
7     farmers.

8           Q     They receive additional money from the federal  
9     order pool for the Class 1 sales, don't they?

10          A     If that's how that system works, then I would say  
11     they must.

12          Q     In other words, the reality is that your plant  
13     does not really pay for the full value for the milk that the  
14     producers receive under the federal order program, isn't  
15     that correct?

16          A     No, I guess I would disagree with that. Again, I  
17     don't know what the end price is or the farm price is, but I  
18     believe every time that it's not in line the cooperative  
19     certainly comes back to seek to put it back into line.

20          Q     If you left the federal order system, would you be  
21     able to obtain the extra blend money from the Class 1  
22     system?

23          A     Again, I'm not familiar. I just listed kind of  
24     what I saw are our options.

25          Q     What would be the impact if you left the federal

1 order system?

2 A I think it's more likely we would probably  
3 reassess whether we want to be in the cheese manufacturing  
4 business. I really don't know all the implications of --  
5 I'm not an economist, I don't spend a lot of my time on the  
6 federal order system. Those are the two options I think  
7 we'd have available to us as I understand it.

8 Q You indicate you've held the position of current  
9 plant manager since 1993?

10 A That's correct.

11 Q And I'm not looking for exact amounts, but at  
12 least in the last seven years can you generally say that  
13 your operations have been profitable?

14 A I think in the last seven years certainly we've  
15 managed to maintain sufficient profits to continue in  
16 business.

17 Q And was it profitable prior to 1998?

18 A Prior to 1998?

19 Q Yes.

20 A We just talked 1993 until now.

21 Q I understand, so 1993 to 1998, that about five  
22 year period. Same situation? Same answer?

23 A I would say same answer, sure.

24 Q Thank you.

25 JUDGE HUNT: Mr. Vetne?

1 BY MR. VETNE:

2 Q Mr. Eastham, I'm John Vetne, I represent Kraft  
3 Foods.

4 A Hi, John.

5 Q I just have a few questions. I won't quantify the  
6 number any better than that.

7 Does Great Lakes Cheese operate any plants outside  
8 of New York?

9 A We do.

10 Q In what states?

11 A Ohio and Wisconsin.

12 Q Do you have any familiarity with those plants?

13 A They aren't manufacturing plants so, I mean I'm  
14 familiar with what the operations are, but I don't have any  
15 specific --

16 Q Do those plants receive cheese and cut and wrap?

17 A Yes.

18 Q Do they receive cheese manufactured in New York?

19 A Yes.

20 Q Do you know whether Great Lakes Cheese purchases  
21 for cutting and wrapping or resale cheese from other cheese  
22 manufacturers?

23 A We do.

24 Q And do you know whether that includes cheese that  
25 is manufactured on the West Coast?

1           A     It does.

2           Q     And this comes into the cut and wrap operations in  
3     Ohio and Wisconsin?

4           A     Yes.

5           Q     And it is distributed from those cut and wrap  
6     operations through the consumer chain to consumers in the  
7     East Coasts?

8           A     Yes.

9           Q     Thank you.

10                JUDGE HUNT:  Anyone else?

11                Ms. Warlick?

12                BY MS. WARLICK:

13           Q     Hi, Mr. Eastham.

14                Would you agree with the previous witness that  
15     there is no price difference per pound between the 40 and  
16     640 pound blocks?

17           A     I guess I didn't hear the previous witness on  
18     that, but I certainly, it's our experience that there is  
19     little or no difference in the manufacturing cost of a 40 or  
20     a 640.

21                JUDGE HUNT:  Ms. Brenner?

22                BY MS. BRENNER:

23           Q     Mr. Eastham, what do you do with the whey that  
24     results from your cheese processing?

25           A     The salt whey?  Or the whey from --

1 Q The whey --

2 A We dry whole whey.

3 Q You dry whole whey. What do you do with the salt  
4 whey?

5 A The cream is removed from the salt whey and the  
6 balance, and the fat not recovered from that process is  
7 taken out to farms and fed to animals.

8 Q How much salt whey as a percentage of the  
9 incoming --

10 A I guess I really couldn't quantify that.

11 Q Not even --

12 A It's certainly a small amount, comparatively  
13 speaking.

14 Q Under one percent of your --

15 A I would say it's probably more than one percent.  
16 Again, I don't have those numbers, and I'm just kind of  
17 guessing.

18 Q How much of the butter fat that's received in your  
19 plant do you generally account for in either cheese or whey  
20 or the whey cream from the salt whey that you recover?

21 A From all portions?

22 Q Uh huh.

23 A Which plant, I guess --

24 Q The cheddar plant.

25 A I'm not really familiar with theirs. But I mean I

1 would, based on being there many years ago, this is seven  
2 years ago, I would say probably total fat four or five  
3 percent at the end of the day.

4 Q That you don't account for?

5 A Right.

6 Q That would include from when it comes into the  
7 plant? Or when it comes from the farm?

8 A That's all the way through the system.

9 Q From the farm.

10 A I only know what -- I guess I'm talking from the  
11 vat in. We take those measurements at the vat as our  
12 beginning point.

13 Q Okay. Thank you.

14 JUDGE HUNT: Mr. Beshore?

15 BY MR. BESHORE:

16 Q Mr. Eastham, I'm a little puzzled by the comments  
17 regarding costs or price of 40s versus 640s. Something  
18 tells me if you have 16 separately wrapped 40 pound blocks  
19 versus one 640 pound block of the same cheddar cheese that  
20 more goes into making 16 separate units of 40 pounds each,  
21 wrapping them and whatever you do with them, than the one  
22 640 pound unit.

23 A It's our experience at our plant, we have a fairly  
24 technologically advanced system on the 40 pound side, and we  
25 find we can do that very competitively and at the same time

1     there's a lot of capital expense involved in the equipment  
2     and the boxes in the 640s.

3           Q     So your efficient packaging of the 40s costs about  
4     as much as the newer, more expensive capital equipment for  
5     packaging the 640 --

6           A     Equipment as well as the boxes for the 640s.  
7     Yeah.

8           MR. BESHORE:   Thank you.

9           JUDGE HUNT:   Anyone else?

10          (No audible response)

11          JUDGE HUNT:   Thank you very much, Mr. Eastham.

12          THE WITNESS:   Thank you.

13          I think Mr. Gallaway, is it, that's got a flight  
14     out today?

15          (Pause)

16          MR. ROSENBAUM:   We still have to make copies of  
17     his testimony.

18          JUDGE HUNT:   Ms. Ledman, is she here?

19          (Pause)

20          JUDGE HUNT:   Mr. Williams?

21          MR. ROSENBAUM:   Mr. Williams is ready.

22          JUDGE HUNT:   Good afternoon, sir.

23     Whereupon,

24                               JEFFRY WILLIAMS

25     having been first duly sworn, was called as a witness herein

1 and was examined and testified as follows:

2 JUDGE HUNT: Please state and spell your name for  
3 the record.

4 THE WITNESS: My name is Jeffry O. Williams.  
5 J-E-F-F-R-Y, middle initial O, W-I-L-L-I-A-M-S.

6 DIRECT EXAMINATION

7 BY MR. ROSENBAUM:

8 Q Mr. Williams, do you have a prepared, written  
9 statement for today?

10 A Yes, I do.

11 Q Could you please read that into the record?

12 A Yes.

13 Again, my name is Jeffry O. Williams. I am  
14 currently employed by Glambia Foods, Inc. formerly known as  
15 Avermore West, Inc. My position there is Executive Vice  
16 President.

17 My responsibilities in that position include  
18 Director of Procurement, Logistics, and Business  
19 Development.

20 As Director of Procurement I am responsible for  
21 the purchase of nearly \$300 million worth of milk per annum.  
22 Aside from my duties at Glambia Foods, I have served as  
23 President of Idaho Milk Processors Association for two  
24 years, and have been a board member of that organization  
25 since 1995.

1           The following testimony is submitted on behalf of  
2   Glambia Foods, Inc., a dairy food company headquartered in  
3   Twin Falls, Idaho.

4           Glambia Foods operates two cheese plants in the  
5   western federal milk marketing order. We are the largest  
6   milk buyer in Idaho, processing 6.6 million pounds, which is  
7   over one-third of the state's daily production of milk per  
8   day into 500 pound barrels of American style cheese and 40  
9   pound blocks of American style cheese.

10          Approximately 70 percent of the milk we process  
11   goes through our barrel cheese operation, and the other 30  
12   percent of the milk we process goes through our block cheese  
13   operation.

14          We purchase 4.6 million pounds of milk per day  
15   from 180 independent dairy farmers, and the remaining two  
16   million pounds of milk per day from cooperatives that market  
17   their members' milk in Idaho.

18          We employ 425 people in our Idaho operation.

19          My company is a member of National Cheese  
20   Institute and the International Dairy Foods Association. I  
21   have read the testimony of those organizations submitted by  
22   their economist, Dr. Robert Yonkers, and I agree with the  
23   analysis that Dr. Yonkers presented, and I'll not attempt to  
24   cover all the points he has made. Instead I'll focus my  
25   testimony on a few points that I believe are particularly

1 important for our business and generically important for all  
2 cheesemakers operating within the federal order system.

3 Point number one concerning make allowances. Over  
4 90 percent of the milk produced in Idaho goes into the  
5 manufacture of cheese products. Therefore the price of  
6 Class 3 milk is an extremely important issue for the Idaho  
7 dairy industry.

8 The Idaho milk market is extremely competitive  
9 with half a dozen major milk buyers operating in our milk  
10 procurement area.

11 As a result, we have been forced to pay over order  
12 premiums well above the federal order class three price to  
13 remain competitive.

14 More specifically, through April of this year, our  
15 milk price has been 34 cents per hundredweight more  
16 expensive relative to the Class 3 price as compared to the  
17 price we paid relative to the BFP in 1998 and 1999.

18 Since over 85 percent of our cheese sales revenue  
19 goes to the dairy farmer to pay for his milk, it's  
20 imperative that the federal order Class 3 milk price  
21 parallels California's 4B milk price.

22 I thought this argument was the thrust of the  
23 USDA's present Class 3 make allowance of 17.02 cents per  
24 pound coupled with the use of the NASS survey for 40 pound  
25 blocks of cheddar cheese, and 500 pound barrels of cheddar

1 cheese. These are the products we make, and these are the  
2 products that we compete head on with California cheddar  
3 plants in the market place.

4 From the period of January 1995 through August  
5 1998 the federal order Class 3 price averaged 64 cents per  
6 hundredweight higher than the California 4B price.

7 Assuming a cheddar cheese yield factor of 9.5  
8 percent for base milk constituents, this price difference  
9 effectively gave California cheddar cheese manufacturers  
10 nearly a seven cents per pound of cheese advantage.

11 This huge advantage coupled with the looming  
12 threat of supports going away for butter and non-fat dry  
13 milk caused California milk processors to gravitate toward  
14 making more cheese. Motivated by this distinct competitive  
15 advantage, how much more cheese did California make?

16 In 1995 California and Idaho each manufactured  
17 approximately 345 million pounds of American style cheese.  
18 Last year California cheese plants manufactured 597 million  
19 pounds of American style cheese -- 92 million pounds more  
20 than Idaho cheese plants. That is a 69 percent increase  
21 during the period stretching from 1995 to 1999.

22 What was the increase in cheese production over a  
23 similar period of time by other historically strong American  
24 style cheese manufacturing plants, i.e. Wisconsin and  
25 Minnesota operating within the federal order system?

1 Wisconsin was down one percent and Minnesota was up five  
2 percent.

3           It's my opinion that California's growth in  
4 American style cheese production is due in large part to  
5 this huge gap between the federal order minimum price and  
6 its own 4B price.

7           California's huge advantage has slowly diminished  
8 in recent years. During the 20 month period beginning in  
9 September 1998 when the NASS survey was introduced into the  
10 pricing mechanism for Class 3 milk, the gap between the  
11 federal order Class 3 price and California 4B price has  
12 narrowed to an average of just eight cents per  
13 hundredweight. However, that gap has widened again to 27  
14 cents per hundredweight over the past four months of year  
15 2000 under USDA's final rule utilizing the full 17.02 cents  
16 per pound make allowance.

17           While a negative gap between Class 3 price and  
18 California's 4B price of 27 cents per hundredweight is  
19 certainly better than a negative gap of 64 cents per  
20 hundredweight, in the commodity cheese business that we  
21 operate in, that 27 cents per hundredweight is huge money.

22           Again, using a cheddar cheese yield factor of 9.5  
23 percent, that 27 cents per hundredweight equates to 2.8  
24 cents per pound of cheese which amounts to \$6.7 million per  
25 annum for our Idaho-based business.

1           As a result of a trend toward a more level playing  
2 field vis-a-vis California milk pricing, we invested over  
3 \$33 million into our barrel cheese factory in an effort to  
4 upgrade our technology and our throughput to gain additional  
5 cost efficiencies. Had the disparate prices between Class 3  
6 and 4B continued in the 60 to 70 cent per hundredweight  
7 range, it is doubtful my company would have made that  
8 investment in Idaho. And should the disparity between Class  
9 3 and 4B rear its ugly head again, as many of the proposals  
10 advocate it should, there will be no incentive to build  
11 largescale cheese operations anywhere within the bounds of  
12 the federal order pricing system.

13           It is disheartening to see the number of proposals  
14 included in the notice of hearing that suggest decreases in  
15 the federal order make allowances.

16           As the largest milk producing state and soon to be  
17 the largest cheese producing state, the makeup of  
18 California's 4B milk price to include the make allowance and  
19 the yield calculations cannot be ignored.

20           We operate in a single national market for milk  
21 used for manufactured dairy products and it defies logic for  
22 the federal order program to operate as if that were not the  
23 case.

24           I cannot emphasize enough how important the make  
25 allowance is under the new product pricing formula system

1 that went into effect on January 1 of this year. This  
2 system is designed to require a manufacturer like Glambia  
3 Foods to pay to dairy farmers as the minimum milk price  
4 everything my company receives for its cheese minus the make  
5 allowance. If the price of the cheese goes up, then so does  
6 the minimum price in an amount that fully offsets the  
7 increase in the cheese price.

8 My company is therefore very dependent on the make  
9 allowance to cover all of its costs. I therefore strongly  
10 urge that the Department of Agriculture include in the make  
11 allowance all the costs that a manufacturer must incur in  
12 taking raw milk and converting it into a finished product  
13 sold in the marketplace.

14 I understand there are some proposals that would  
15 exclude from the make allowance several specific costs  
16 including procurement costs, marketing costs, and the cost  
17 of capital. I am completely opposed to those proposals.  
18 The reason is simple. These are costs my company must incur  
19 as part of its cheese manufacturing operations. These are  
20 not optional costs. If they are not included in the make  
21 allowance, my company will have no way to get paid for these  
22 costs.

23 How can my company continue to be competitive and  
24 continue to invest in manufacturing assets if these costs  
25 are not covered?

1           The truth is we could not, and we would have to  
2   either shift production outside the federal order system,  
3   i.e. California, or discontinue our investment in the cheese  
4   business.

5           Point number two, the NCI make allowance survey.  
6   As described in Dr. Yonkers' testimony, NCI has recently  
7   completed a survey to determined weighted average make  
8   allowances for cheese and whey. My company participated in  
9   the cheese survey by submitting data for the 12 month period  
10  covering all of 1999 for both our 40 pound cheddar block  
11  cheese plant as well as our 500 pound cheddar barrel cheese  
12  plant.

13           Obviously for competitive reasons I'm not at  
14  liberty to divulge what our specific manufacturing costs  
15  were, however, I can confirm that from the perspective of my  
16  company the survey was taken with great seriousness and  
17  attention, and I am confident we succeeded in providing  
18  accurate figures.

19           Point number 3, the NASS survey. In addition to  
20  the introduction of the make allowance and yield factors in  
21  the final rule, the utilization of the NASS survey for both  
22  40 pound block cheddar cheese and 500 pound barrel cheddar  
23  cheese has helped to level the playing field between cheese  
24  manufacturing plants operating within the federal order  
25  system and cheese manufacturing plants operating in

1 California. The reason the NASS survey works is due to the  
2 amount of other states -- meaning Western cheese  
3 manufacturers -- reporting their cheese sales volumes and  
4 prices.

5 With the other states making up nearly 80 percent  
6 of the reported blocks and nearly 60 percent of the reported  
7 barrels, it is evident what an important role this survey  
8 plays in creating a surface pricing mechanism to clear the  
9 market of excess product.

10 Although we do not have much history yet, it's  
11 interesting to see that since introducing the NASS data  
12 for 500 pound barrels into the Class 3 pricing formula, we  
13 have not seen the huge market distortions which in the past  
14 created spreads up to 20 cents per pound on the Chicago  
15 Mercantile Exchange between the price of blocks and the  
16 price of barrels.

17 Year to date the widest spread between blocks and  
18 barrels on the CME has been only five cents per pound and  
19 that lasted only one day. That is just one of the reasons  
20 we would strongly urge the rejection of any proposal to drop  
21 the price of 500 pound barrel cheese from the Class 3  
22 formula.

23 The other compelling reason to keep barrel cheese  
24 in the formula is the fact that barrel cheese represents  
25 over 60 percent of the NASS survey volume.

1           To improve upon the NASS survey we support IDFA's  
2   proposal to introduce 640 pound block cheese into the Class  
3   3 pricing formula. Although we do not currently make 640  
4   pound blocks, our customers' demand for this product is  
5   increasing to the point where we have had some very serious  
6   discussions about adding this product to our portfolio.  
7   Obviously we would be more inclined to do so if the  
8   wholesale price of 640 pound blocks were figured into the  
9   cost of milk we would be purchasing to manufacture that  
10   product.

11           Along with IDFA, my company strongly opposes any  
12   proposal to utilize the CME instead of the NASS survey. As  
13   Dr. Yonkers testified, the CME data represents an extremely  
14   small percentage of all U.S. cheddar cheese production, and  
15   furthermore, the CME is not national in scope.

16           In conclusion, Glambia Foods urges the Department  
17   of Agriculture to allow the current system a chance to prove  
18   that all the years of hard work and analysis that created it  
19   was beneficial to all participants in the dairy industry. I  
20   hardly think the four months the final rule has been in  
21   place has given anyone the proper amount of data to pass  
22   judgment on its effectiveness in setting minimum class  
23   prices.

24           It is my contention that if milk prices today were  
25   where they were eight to 12 months ago, this hearing would

1 not be taking place.

2 Thank you for the opportunity to record my  
3 testimony. I will now stand for questions.

4 Q Mr. Williams, just so we make the record clear  
5 here, I think, in case there's any ambiguity, to point out  
6 the NASS survey data first became available in September of  
7 1998, but it was first included in studying the actual  
8 prices January 1st of this year.

9 A Yes, that's correct.

10 MR. ROSENBAUM: He's available for Cross-  
11 Examination.

12 JUDGE HUNT: Mr. Beshore?

13 CROSS-EXAMINATION

14 BY MR. BESHORE:

15 Q Thank you. Mr. Glambia --

16 A Mr. Williams. I wish I was Mr. Glambia.

17 (Laughter)

18 Q Sorry, I can't provide that opportunity for you.  
19 Mr. Williams, I'm sorry.

20 Page two of your testimony, there's a 34 cent per  
21 hundredweight figure and I'm not quite sure that I  
22 understand it. In the first full paragraph you say through  
23 April this year our milk price has been 34 cents per  
24 hundredweight more expensive relative to the Class 3 price  
25 as compared to the price we paid relative to the BFP. Are

1     you paying 34 cents a hundredweight premiums now?

2           A     Yes, we are.

3           Q     And you were paying class price last year?

4           A     We were paying, actually we're paying 34 cents  
5     more of a premium this year than we were last year. We paid  
6     over Class 3 prices in '98 and '99.

7           Q     Are those protein premiums?

8           A     No, those aren't protein premiums.

9           Q     Simply volume premiums?

10          A     They're just per hundredweight premiums.

11          Q     Regardless of milk components?

12          A     The components are valued equally, so regardless  
13     of whether a producer, what his butter fat is or what his  
14     protein is, he gets paid the same amount per pound of those  
15     components. So this is just a per hundredweight premium.

16          Q     Are you paying quality premiums?

17          A     Yes, we are.

18          Q     Volume premiums?

19          A     No volume premiums. That's somewhat reflected in  
20     the producer's haul rate.

21          Q     The 9.5 percent cheese yield factor that's  
22     mentioned at the top of page three of your statement, are  
23     you saying you produced 9.5 pounds of cheese per  
24     hundredweight of milk?

25          A     We use, for -- Our cheese yield formula that we

1 use is 90 percent fat recovery, 78 percent recovery. It's a  
2 modified VanSlyke formula. So roughly, when you plug in 3-  
3 35, 3-2 milk components you're going to roughly get 9.5  
4 pounds of cheese per hundred pounds of milk.

5 Q Is that barrel cheese?

6 A That's typically barrel cheese, yes, because of  
7 the moisture is different than block.

8 Q So that's 9.5 pounds of what, 35 percent moisture?

9 A We use 36 percent moisture. The exact calculation  
10 is 9.446 pounds, but I use 9.5 for rounding purposes.

11 Q What yield are you getting when you're making  
12 cheddar blocks?

13 A We use the same calculation, or the same formula  
14 when we price our milk, but our moistures would be a little  
15 bit higher on blocks.

16 Q So you'd have more pounds of cheese.

17 A Yes, you would have a percentage more, yes.

18 Q Are you paying for milk on a cheese yield formula,  
19 did I understand you to say?

20 A Yes, we are. Not all of our milk, but a good  
21 portion of it we do pay off a cheese yield pricing formula.

22 Q So if you're paying on a cheese yield formula are  
23 you paying on top of that a flat volume premium, or a flat  
24 34 cents? Or is that on different volumes of milk perhaps?

25 A That's on our producer pay price, would be, is

1 reflected in that 34 cents over the Class 3 price relative  
2 to last year's overage of the BFP.

3 Q So your cheese yield formula generates a price  
4 this year that's higher than the price last year relative to  
5 the minimum federal order price.

6 A That's correct.

7 Q Are you a participant in the NASS survey?

8 A Yes, we are.

9 Q Thank you.

10 JUDGE HUNT: Mr. Coughlin?

11 BY MR. COUGHLIN:

12 Q Mr. Williams, I want to be sure I don't call you  
13 by a name of a person I don't think exists. Is there a Mr.  
14 Glambia?

15 A Not that I'm aware of.

16 Q Ed Coughlin. I represent the National Milk  
17 Producers Federation.

18 I'd like to turn to page seven of your testimony  
19 where you're talking about the inclusion of 640 pound  
20 blocks. It's in that second paragraph on that page. About  
21 in the middle of the testimony you talk about if USDA was to  
22 include a NASS survey of 640 pound blocks, you make a  
23 statement there, obviously we would be more inclined to  
24 produce 60 [sic] pound blocks, and I'm paraphrasing there,  
25 if the wholesale price of 640 pound blocks were figured into

1 the cost of the milk we would be purchasing to manufacture  
2 that product.

3 What's your basis for making that statement?

4 A I guess the basis for making that statement is the  
5 same basis that we're happy to see 500 pound barrels  
6 included in the NASS survey because that's a product that we  
7 make. Therefore the value of that product is directly tied  
8 to the value of the milk that we would be purchasing.

9 So analogous to that would be if 640 pound blocks,  
10 if the value in the marketplace of 640 pound blocks was tied  
11 to the milk that we'd be buying to manufacture those 640  
12 pound blocks, then I'm assuming that the spread would be  
13 there summarily to a 500 pound barrel of cheese versus the  
14 milk you would purchase to manufacture that 500 pound  
15 barrel.

16 Q It seems to me that the decision as to whether or  
17 not you make 640s or not would be one based on economics,  
18 and the economics would -- in other words, to make that  
19 decision, this seems to indicate to me that in relationship  
20 to the milk price you would be receiving a greater return if  
21 you made 640 pound blocks, if the 640s were included in the  
22 survey.

23 A No, that's not what -- It is an economic decision,  
24 certainly, and I think economics are involved here when  
25 you're talking about the price of the milk that you're going

1 to purchase to make those 640 pound blocks, needs to be tied  
2 to the value of those 640 pound blocks in the marketplace,  
3 just as it is with 40 pound blocks and 500 pound barrels.

4 Q What does the make allowance need to be tied to?  
5 What you make when you make cheese is the make allowance. I  
6 think you've testified to that.

7 A Yes.

8 Q So by making the statement here, inclusion of the  
9 640 pound blocks in the survey, you'd be more inclined to  
10 make 640 pound blocks, you'd have to -- doing that means to  
11 me that you feel that you could make a greater profit, so if  
12 you do that it means that the make allowance then for 640  
13 pound blocks you would anticipate would be more favorable.

14 A I don't have the economics in front of me, I've  
15 not looked at the economics of making 640 pound blocks. All  
16 I'm saying is that if 640 pound blocks were included in the  
17 survey, and there was a make allowance attached to that  
18 similar to what we have with blocks, 40 pound blocks now and  
19 500 pound barrels now, there might be an incentive there to  
20 make 640 pound blocks.

21 We were making 500 pound barrels of cheese for a  
22 long time, similarly to say the Land O'Lakes testimony  
23 earlier, and we were making that cheese and subject to the  
24 whims of the 40 pound block market, and that was a very  
25 difficult position to be in, particularly when blocks were

1 trading at 20 cents ahead of barrels. We were stuck with  
2 procuring milk at a block price but selling barrels at a  
3 price that had no relation to the price of milk that we were  
4 buying.

5 I'm just saying if that same situation could occur  
6 now conceivably with 640 pound blocks, there would be no  
7 incentive to manufacture 640 pound blocks in that scenario.

8 Q Are you anticipating that USDA would have a  
9 separate make allowance for 640 pound blocks?

10 A No, I wouldn't. I'd anticipate that if there was  
11 a cost difference to make a 640 pound block versus a 40  
12 pound block, then there would probably be an adjustment to  
13 that 640 pound block and then the make allowance would be  
14 the same for all the cheese.

15 Q What kind of cost difference do you experience  
16 between your 500 pound barrels and your 40 pound blocks?

17 A In our operation it's difficult to compare because  
18 our barrel cheese operation is running more than double the  
19 amount of milk and therefore it's much more efficient than  
20 say our block operation. So it's difficult to compare  
21 apples to apples in that case, and I don't have any specific  
22 numbers on that.

23 Q Thank you.

24 JUDGE HUNT: Mr. Yale?

25 BY MR. YALE:

1 Q Good afternoon, Mr. Williams.

2 A Good afternoon.

3 Q I represent producers in the West including Idaho  
4 Dairymen's Association.

5 Mr. Williams, you indicated that you participated  
6 in the NCI make study. Do you also report your sales to  
7 NASS?

8 A Yes, we do.

9 Q One of the things that kind of makes Idaho look  
10 more like the Upper Midwest than the West or the rest of the  
11 country is it has a very low utilization. Class 1  
12 utilization. And does your company continue to have its  
13 milk pooled on the federal order or are you now outside of  
14 the federal order pool?

15 A We still participate in the federal order pool.

16 Q On all your milk?

17 A Not on all our milk, no.

18 Q You understand the price that you pay, that this  
19 make allowance has no bearing on the milk that you don't put  
20 in the pool. Do you understand that?

21 A Well, I wouldn't agree with that because the milk  
22 that we don't put in the pool still has to be competitively  
23 priced in the marketplace otherwise it won't be going  
24 through our plant, it will go through somebody else's.

25 Q I understand, but you get to set that price

1     however low, how high you want to in order to attract the  
2     milk, but you don't have to concern yourself about a federal  
3     order minimum price, right?

4             A     That's correct.

5             Q     You indicate -- I'm trying to state this as  
6     clearly as possible. After about a week you start to get a  
7     mush brain here, so I'm having -- not you, me -- trying to  
8     get this thing through.

9                     I think you indicated there's a competitive  
10    difficulty, and that is if you don't pool all your milk on  
11    the federal order pool and you've got a competitor that  
12    does, they can take that blend, which includes some Class 1  
13    proceeds, and potentially pay more than what you do, and  
14    you're going to have match that federal order blend price at  
15    least, if not more, in order to attract milk. Is that  
16    correct?

17            A     We would have to pay a competitive price, yes.  
18    Whether that's above the federal order, below the federal  
19    order, or the federal order price.

20            Q     Whatever you can negotiate with your producers and  
21    they're willing to deliver the milk.

22            A     Yes, that's correct.

23            Q     I want to walk this through, but if you have a  
24    situation in some of the other federal orders, there's a  
25    much higher Class 1 utilization which means that there's

1 more of the Class 1 blend money goes into the money  
2 available to producers. I'm sure you're aware, like the  
3 Southwest and the Central states, areas to the east and  
4 south of you.

5 That has a situation where your competitors are  
6 attracting milk with less of their own money. Isn't that  
7 true?

8 A What do you mean by less of their own money?

9 Q They're only paying the Class 3 price and the  
10 federal order blend is paying an additional amount of money  
11 to those producers which attracts them to the market. Does  
12 that make sense to you?

13 A Yes.

14 Q If you have a situation where you increase the  
15 make allowance you effectively reduce the Class 3 price in  
16 the federal order, right?

17 A Yes.

18 Q That would mean that those plants and those orders  
19 would pay less money, but they still have the benefit of  
20 that Class 1 blend to make up some of the difference, and  
21 also the potential to get Class 1 premiums to make up the  
22 rest of the difference. Won't that put you at a competitive  
23 disadvantage since you don't really get to participate as  
24 fully in the federal order blend in procuring your milk?

25 A In that particular scenario that you just painted,

1 yes, that would be true.

2 Q You mention California, which I've always found  
3 incongruous when we come to a federal order hearing and talk  
4 about California. We can't do anything about it, it seems  
5 like, but --

6 A We're trying to.

7 Q -- except to respond to it. But one of the  
8 questions I have is, don't we take the risk that if we try  
9 to reach California by the federal order program that  
10 California has full opportunity to do what they want to in  
11 their system to retain or regain or even maximize  
12 competitive advantage against you and other plants east of  
13 there?

14 A In what way?

15 Q They could change their regulations, their pricing  
16 formulas. Like you suggested that they did, they shifted  
17 from the powder to the cheese.

18 A Sure, I suppose they could do that.

19 Q I want to turn over on page six of your testimony,  
20 you suggest that since there have been reporting the NASS  
21 data for 500 pound barrels for Class 3 that there's been  
22 less spread between the barrels and the blocks. And do I  
23 understand you to suggest that the plants who sell 500 pound  
24 barrels and/or blocks are using the NASS data in setting  
25 their prices?

1 A Setting what prices? Their selling price?

2 Q Their selling price.

3 A No.

4 Q Are they using that information to come up with a  
5 selling price?

6 A I can't speak for other companies, only for our  
7 own. Our cheese is sold off of the CME price.

8 Q That's not uncommon, is it?

9 A I don't believe so, no.

10 Q One of the criticisms that's heard over the CME  
11 versus the NASS is that to a degree the NASS is a lower  
12 price and is more reflective of the price in the West. Is  
13 that a fair statement?

14 A Yes.

15 Q So the problem isn't so much with the CME as what  
16 location we use to price the CME and at what location  
17 adjustment, isn't that really the issue?

18 A I think that's part of the issue. The other part  
19 is the potential to manipulate the CME price.

20 Q You may not have been here, but earlier in the  
21 week NASS indicated there's only 29 firms that report the  
22 prices to the NASS cheddar cheese and they can, there's no  
23 offset balance there where in the CME everything is open.  
24 Wouldn't that be less manipulation?

25 A I don't think so. On the NASS survey you actually

1 have to have the cheese sales to influence the price on the  
2 NASS survey, whereas with the CME -- potentially anyone with  
3 deep enough pockets can influence the price on the CME  
4 whether they have cheese sales or not.

5 Q But there would be somebody out there that would  
6 have to respond to them, and if there's product that could  
7 move in that direction they'll start to buy product and  
8 match the CME, won't they?

9 A You'd assume so, but there's been newspaper  
10 articles of people talking about influencing the price of  
11 milk on the CME.

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

14 JUDGE HUNT: Mr. Galarneau?

15 BY MR. GALARNEAU:

16 Q Good afternoon, Mr. Williams. My name is Clay  
17 Galarneau with Michigan Milk Producers.

18 On page two of your testimony at the bottom of the  
19 page you make reference to a period from January 1995 to  
20 August of 1998, the federal order Class 3 price averaged 64  
21 cents per hundredweight higher than California 4B?

22 A Yes.

23 Q Then as we go on to page three, toward the bottom,  
24 you recognize that this gap is now only 27 cents?

25 A Yes, for the first four months of this year.

1 Q Can we assume that the farmers are now receiving  
2 37 cents less for their Class 3 milk?

3 A Which farmers are you talking about?

4 Q The ones receiving Class 3 value.

5 A So you're talking about the farmers in California  
6 or the farmers in the federal order system?

7 Q The farmers in the federal order system.

8 A I hadn't thought of it that way, but I suppose you  
9 could make that assumption.

10 MR. GALARNEAU: Thank you.

11 JUDGE HUNT: Ms. Brenner?

12 BY MS. BRENNER:

13 Q Mr. Williams, I'm interested in, you said that the  
14 only source of revenue for a cheese plant is the make  
15 allowance, and anything that you get for your cheese  
16 otherwise is paid out to producers.

17 I was wondering about, the premium you're paying  
18 now is 34 cents more than the premium you were paying a year  
19 ago?

20 A That's correct.

21 Q Which is the amount that's over the order Class 3  
22 price. So we're not sure exactly how much it is, except  
23 it's more than 34 cents.

24 A Yes.

25 Q At the same time your price is, the order price is

1 27 cents more than the California price for the last four  
2 months.

3 A Yes.

4 Q I realize according to your testimony that  
5 California cheese production has increased significantly,  
6 and you do indicate it was a lot more than Wisconsin and  
7 Minnesota, but according to the numbers you've got here,  
8 Idaho's cheese production also increased by, not as much as  
9 California's but about 46 percent over that same time  
10 period.

11 A That's correct.

12 Q Other things you've said indicate that the other  
13 cheese manufacturers in Idaho are also paying a competitive  
14 rate with you, or a rate competitive with yours to their  
15 producers. I was just wondering how you can afford to do  
16 this if the make allowance is just barely enough to --

17 A In our particular situation we have manufacturing  
18 other than cheese. We do have extensive whey processing  
19 manufacturing, so --

20 Q Your whey processing allows you to be more  
21 competitive?

22 A Yes.

23 Q What do you do with the whey?

24 A We fractionate it into whey protein concentrate,  
25 whey protein isolate, and lactose.

1 Q Is the whey cream used in those products, too?

2 A No, the whey cream is not used in the whey  
3 products. The whey cream is either, well in our case we  
4 work it back into the cheese for certain customers.

5 Q How much of your total milk receipts ends up in  
6 this item called salt whey?

7 A I couldn't tell you. I'm familiar with the term  
8 salt whey, but I couldn't tell you how many pounds we  
9 generate of that.

10 MS. BRENNER: I think that's all I have. Thanks.

11 JUDGE HUNT: Anyone else?

12 (No audible response)

13 JUDGE HUNT: Thank you very much, Mr. Williams.

14 We'll take a 15 minute break now.

15 (Recess taken at 4:40 p.m.)

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1 Vice President of Operations for Saputo Cheese USA. My  
2 responsibilities in that position include management of and  
3 milk procurement for all of the company's U.S. manufacturing  
4 facilities.

5 I serve on the Board of Directors of the National  
6 Cheese Institute, the American Dairy Products Institute, and  
7 the Wisconsin Cheesemakers Association. I'm a member of the  
8 Wisconsin Dairy 20/20 Council, the Wisconsin Dairy Products  
9 Association, the Institute of Food Technologists, and the  
10 American and Wisconsin Institutes of CPAs.

11 The University of Wisconsin, Milwaukee awarded my  
12 undergraduate degree in 1974.

13 My involvement in the dairy industry began as an  
14 auditor and a consultant for dairy and dairy-related  
15 companies. I've been directly employed in the industry for  
16 the past 20 years. For a majority of that time I've had  
17 bottom line responsibility for entities of various sizes and  
18 structures from local and family owned to international and  
19 publicly traded.

20 Prior to joining Saputo I was President of Avemore  
21 Cheese of Monroe, Wisconsin. The purchase of milk,  
22 including the management of the relationship with farmers  
23 and farmer organizations is one of the critical success  
24 factors for any dairy manufacturing company in the United  
25 States.

1           My company, Saputo, has 17 manufacturing  
2 facilities across the United States employing approximately  
3 2,000 people. With sales here in excess of \$1 billion we're  
4 among the three largest manufacturers of U.S. Italian  
5 cheese. Besides traditional Italian varieties --  
6 mozzarella, provolone, ricotta, parmesan and romano -- we  
7 also make a wide range of other cheeses. They include, for  
8 example, string, stick, swiss, lorraine, bleu, gorgonzola,  
9 aziago, fontanella, and fetta.

10           Our product line is not exclusive to cheese and  
11 comprises such items as sweetened condensed milk, egg nog,  
12 powdered and condensed whole and skim milk and a variety of  
13 whey products as well as other specialty items.

14           We buy from three to four billion pounds of milk  
15 annually, primarily from farmer-owned cooperative  
16 organizations. With the exception of plants we operate in  
17 California, the vast majority of milk we buy is encompassed  
18 within the federal order system and extends, at least to  
19 some degree, to all classes of milk.

20           I've read a number of papers in advance of the  
21 hearings including the testimony of Dr. Robert Yonkers  
22 representing the International Dairy Foods Association and  
23 the National Cheese Institute, one of the many organizations  
24 we are members of. I agree with the analysis that Dr.  
25 Yonkers has presented, and I'll not attempt to cover all the

1 points he's made. I've attached a summary of his main  
2 points to my testimony.

3 Instead, I'll focus my testimony on a few topics  
4 that I believe are particularly important.

5 Before I begin, I'd like to commend USDA for their  
6 efforts on confronting such a difficult and contentious  
7 issue. The policies established here will undoubtedly  
8 impact an extraordinary number of people's lives. Needless  
9 to say, you've undertaken an enormous responsibility.

10 In my opinion, the final rule, while far from  
11 perfect, demonstrated that USDA was listening and  
12 represented a quantum leap forward from the previous system.

13 That being said, I'd like to address two broad  
14 areas of concern which may well be impacted by these  
15 hearings.

16 First, allow the market to work. It's hard to  
17 imagine, given the intricacy of the provisions of the final  
18 rule, that they in fact pale in comparison to the complexity  
19 of considerations faced each day by the industry  
20 stakeholders. Because circumstances are so volatile,  
21 proposals directed at refining such things as make  
22 allowances and yield factors to the Nth degree are  
23 pointless. Even had the expertise existed to identify the  
24 most appropriate set of factors for today, they would no  
25 doubt become obsolete in a matter of months.

1           The most salient thing to consider is that the  
2     price threshold established should be one that allows the  
3     market to work. The market will correct for a regulated  
4     price that's too low. Excess profits lead to over-order  
5     premiums from companies or individuals seeking to share in  
6     the opportunity.

7           Prices are established by the ebbs and flows in  
8     the marketplace. At Saputo in no case do we pay less than  
9     the regulated price for milk. In fact we pay above that  
10    price in all regions that we operate, and in some cases  
11    considerably above.

12          Pay prices are inevitably determined by local  
13    competitive conditions. When prices are set too high they  
14    preempt the market and lead to anomalies or aberrations in  
15    the flow of commerce. Until now they have contributed to  
16    the shift of investment in facilities from one region of the  
17    country to another.

18          We firmly believe the proposal that gives the  
19    market the best chance to work is the one submitted by the  
20    International Dairy Foods Association.

21          Second, consider fairness. As I mentioned  
22    previously, we purchase the bulk of our milk from  
23    cooperative associations. Many of these associations  
24    operate their own manufacturing facilities and compete with  
25    us head to head in the marketplace while at the same time

1 controlling the bulk of the milk supply. Unlike proprietary  
2 plants, they're exempt from complying with many requirements  
3 compelled by the federal order system. For example, they  
4 alone have the right to reblend or pay less than the  
5 regulated price for milk.

6           Increasing this advantage by mandating prices  
7 significantly higher than the market could otherwise sustain  
8 might lead to the ultimate extinction of proprietary dairy  
9 businesses. Enabling cooperatives to control the milk  
10 supply with this kind of advantage could lead to abuse.  
11 Proprietary plants could be compelled to pay higher than  
12 competitive premiums, and rather than passing these premiums  
13 on to producers they may in fact be used to subsidize below  
14 market finished product prices in order to captured market  
15 share from proprietary companies.

16           These points as well as many others are taken into  
17 consideration in the detailed proposal submitted by the  
18 IDFA. We wholeheartedly endorse their submission.

19           MR. ROSENBAUM: Your Honor, at this time Mr. Dryer  
20 is available for Cross-Examination.

21           JUDGE HUNT: Mr. Marshall?

22           MR. MARSHALL: Thank you, Your Honor.

23                           CROSS-EXAMINATION

24           BY MR. MARSHALL:

25           Q     Mr. Dryer, just one question. Seriously.

1           A comment on the bottom of your third page with  
2   respect to, I'll just read it, "When prices are set too high  
3   they preempt the market, lead to anomalies, aberrations.  
4   Until now they have contributed to the shift of investment  
5   in facilities from one region of the country to another."

6           Could you just expand on that a bit and let us  
7   know what you meant by that?

8           A    I'm referring there to the fact that in the past  
9   where prices within the federal order system, regulated  
10  prices, were significantly higher than they were in  
11  unregulated areas such as California, that I think that  
12  contributed to the amount of expansion that took place in  
13  that region.

14           MR. MARSHALL: Thank you very much.

15           JUDGE HUNT: Anyone else?

16           (No audible response)

17           JUDGE HUNT: All right. Thank you very much, Mr.  
18  Dryer.

19           Ms. Ledman? We'll take you now.

20  Whereupon,

21                           MARY KEOUGH LEDMAN

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

24           JUDGE HUNT: State and spell your name, Ms.  
25  Ledman.

1 THE WITNESS: My name is Mary Keough Ledman.

2 M-A-R-Y, K-E-O-U-G-H, L-E-D-M-A-N.

3 MS. YOVIENE: Your Honor, my name is Wendy

4 Yoviene, I'm here on behalf of Suiza Foods Corporation. I

5 will be tendering Ms. Ledman as an expert witness in the

6 areas of dairy price forecasting and dairy policy analysis,

7 so I'm going to ask her a few questions about her background

8 to qualify her.

9 JUDGE HUNT: Certainly.

10 DIRECT EXAMINATION

11 BY MS. YOVIENE:

12 Q Ms. Ledman, could you please tell His Honor about  
13 your background including when you first were introduced to  
14 the dairy industry, your education, and your professional  
15 background since your college education?

16 A I was raised on a dairy farm in Southern  
17 Wisconsin, a 50 cow, typical Wisconsin dairy. I helped on  
18 the family farm, and through the participation in Future  
19 Farmers of America I worked on dairy farms in Germany, Japan  
20 and New Zealand.

21 I then received a Master's Degree in Agricultural  
22 Economics from Texas A&M. I wrote my Master's thesis on  
23 alternatives to the Minnesota/Wisconsin price series.

24 I also received a Fulbright Fellowship and  
25 attended a graduate program in Germany and studied the

1 European community's agricultural policy, their milk quota  
2 system.

3 I further gained additional work experience, my  
4 professional career includes working for the Order 30,  
5 federal milk market order office in Glenellen, Illinois as a  
6 payroll auditor. I also worked at the Foreign Agricultural  
7 Service in their dairy division. And I worked for the  
8 National Agricultural Statistical Service.

9 My private sector experience includes being  
10 Manager of Dairy Economics for Kraft Foods and Director of  
11 Materials Planning for Stella Foods.

12 I began my own consulting business in 1995, and I  
13 specialize in dairy product price forecasting and policy  
14 analysis.

15 JUDGE HUNT: Thank you, Ms. Ledman.

16 MS. YOVIERNE: Thank you, Ms. Ledman.

17 BY MS. YOVIERNE:

18 Q I have here before me a document that appears to  
19 be your curriculum vitae. I'm going to walk it up to you,  
20 ask you to review it, and please let us know if this is an  
21 accurate depiction of your educational background and your  
22 work experience, and then Your Honor, I will be ask that it  
23 be marked as an exhibit and received into the record after  
24 she confirms it's accurate.

25 (Pause)

1           A     Yes, that's my vitae.

2                   JUDGE HUNT:  We'll mark that as the proposed  
3     Exhibit 36 then.

4                                   (The document referred to was  
5                                   marked for identification as  
6                                   Exhibit No. 36.)

7           JUDGE HUNT:  Are copies available?

8           MS. YOVIENE:  Yes, copies are being passed out.

9           JUDGE HUNT:  Are you going to ask her questions  
10    about that?

11           MS. YOVIENE:  No, sir.  I believe she has just  
12    talked about her background and it's all reflected in the  
13    curriculum vitae.

14           JUDGE HUNT:  Okay.  That's marked as Exhibit 36  
15    then.

16           MS. YOVIENE:  At this time I would also request  
17    that Ms. Ledman be qualified as an expert, and that her  
18    testimony be treated as that of an expert in dairy price  
19    forecasting and policy analysis.

20           JUDGE HUNT:  Does anyone question her credentials?  
21           Mr. Beshore?

22           MR. BESHORE:  I certainly do not question her  
23    credentials.  The only question I would have is whether that  
24    is intended to place upon her testimony some greater weight  
25    than that of persons of qualification and expertise who have

1 testified previously but have not been favored with a formal  
2 tender of the nature that Ms. Ledman's counsel is making.

3 JUDGE HUNT: I think all the witnesses who have  
4 testified have great stature, or at least appear to me have  
5 stature either through education or through their  
6 experience. So I don't think it's necessary that the  
7 testimony of one person outweighs another just in and of  
8 itself. It depends on what they have to offer.

9 MS. YOVIENE: Is the motion granted, Your Honor?

10 JUDGE HUNT: Yes.

11 MS. YOVIENE: Thank you, Your Honor.

12 One last bit of housekeeping before Ms. Ledman is  
13 ready to testify.

14 During her Direct testimony she's going to be  
15 referring to a couple of documents, and I wanted to have  
16 them pre-marked.

17 JUDGE HUNT: The first one is what?

18 MS. YOVIENE: The first one will be --

19 JUDGE HUNT: Or do you want to have them all  
20 grouped together as just this one exhibit?

21 MS. YOVIENE: Probably --

22 JUDGE HUNT: If you prefer them as separate, we  
23 can do that.

24 MS. YOVIENE: -- the way she's going to be doing  
25 her testimony, it's probably better to separate them.

1 JUDGE HUNT: Which one do you want pre-marked?

2 MS. YOVINE: The first one will be the comparison  
3 of Monthly Average NASS Grade AA Butter Prices and CME Grade  
4 AA Butter Prices.

5 JUDGE HUNT: We'll mark that as proposed Exhibit  
6 37. That's the Comparison of Monthly Average NASS, okay.

7 (The document referred to was  
8 marked for identification as  
9 Exhibit No. 37.)

10 MS. YOVINE: Thank you.

11 The next one will be a letter by Paul Christ on  
12 behalf of Land O'Lakes, it's on Land O'Lakes letterhead  
13 dated February 25th.

14 JUDGE HUNT: We'll mark the Christ letter as  
15 proposed Exhibit 38.

16 (The document referred to was  
17 marked for identification as  
18 Exhibit No. 38.)

19 MS. YOVINE: The next document is on IDFA  
20 letterhead. It's a letter by Constance Tipton dated  
21 February 29.

22 JUDGE HUNT: That letter will be marked as 39,

23 (The document referred to was  
24 marked for identification as  
25 Exhibit No. 39.)

1 MS. YOVINE: The next document is entitled Impact  
2 Analysis of Proposals 3 and 8 at Test.

3 JUDGE HUNT: I'll mark that as 40.

4 (The document referred to was  
5 marked for identification as  
6 Exhibit No. 40.)

7 MS. YOVINE: Thank you, Your Honor.

8 BY MS. YOVINE:

9 Q Ms. Ledman, if you'd please proceed with your  
10 testimony.

11 A Thank you. I am testifying on behalf of Suiza in  
12 support of testimony provided yesterday by Ernest Yates. In  
13 particular, my testimony is intended to support proposal  
14 number three and oppose the limited scope of proposal number  
15 eight.

16 The final rule implemented on January 1, 2000  
17 resulted in higher butter fat values in Class 2, 3, and 4  
18 products due to the use of Grade AA butter prices instead of  
19 Grade A butter prices in the end product formulas.  
20 Historically the Grade A butter price has served as a  
21 cornerstone for pricing milk fat or cream. It has long been  
22 an industry practice to buy raw material cream at the Grade  
23 A butter price times a multiplier, and then to sell the  
24 finished product based upon the Grade AA butter price.

25 USDA recognized the role of Grade A butter price

1 in 1998 when the Chicago Mercantile Exchange discontinued  
2 trading Grade A butter. USDA then announced an equivalent  
3 price series and stated that establishing an equivalent  
4 Grade A price was essential to continuing operation of the  
5 federal order program.

6 To obtain an equivalent Grade A price series in  
7 1998 USDA tracked the historical price difference between  
8 Grade AA and Grade A butter trading on the Chicago  
9 Mercantile Exchange. The historical average was  
10 approximately nine cents. USDA then incorporated the CME  
11 Grade AA butter price minus nine cents into the butter fat  
12 formula.

13 As part of the final rule, USDA replaced the CME  
14 Grade AA butter price minus nine cents with the Grade AA  
15 butter price surveyed by USDA's National Agricultural  
16 Statistical Service. In light of the federal orders  
17 program's long history of attempting to set minimum prices  
18 that make economic sense, I believe the failure to adjust  
19 the NASS Grade AA butter price to reflect a Grade A butter  
20 price equivalent was an oversight.

21 Unfortunately, as a result of this oversight the  
22 present system establishes minimum prices for butter fat  
23 that may not be at market clearing levels because bulk fluid  
24 cream is sold into an unregulated market.

25 Presently Class 1 processors purchasing raw milk

1 for fluid needs must account to the pool on the butter fat  
2 portion of their milk at a butter fat value that is based  
3 off of a Grade AA butter price instead of a Grade A butter  
4 price or its equivalent.

5 Periodically during the year there are supply and  
6 demand situations when Class 2, 3, and 4 processors that  
7 purchase bulk cream are simply unwilling to pay more than  
8 the manufacturing value for that cream. Thus the Class 1  
9 processors pool obligation on the butter fat portion of raw  
10 milk during this period can exceed the revenue that can be  
11 extracted from the marketplace.

12 Following the approach employed by USDA in 1998 I  
13 have compared the monthly average NASS Grade AA butter  
14 prices and the CME grade AA butter prices from October 1998  
15 through April 2000. During this 19 month period the two  
16 price series were virtually the same. This is illustrated  
17 on Exhibit 37 noted as Comparison of Monthly Average NASS  
18 Grade AA Butter Prices and CME AA Butter Prices.

19 However, when the last quarter of 1998 data is  
20 removed, because USDA reports a monthly average NASS butter  
21 price for that period that was not available at the time the  
22 class price would have been announced. Therefore, I believe  
23 that the January 1999 to April 2000 price difference between  
24 the CME Grade AA butter price and the NASS Grade AA butter  
25 price which is 1.63 cents, would be more representative of

1     what the difference between those two price series is likely  
2     to be.

3             Therefore, it is my opinion that a Grade A butter  
4     price equivalent would be the NASS Grade AA price minus  
5     approximately two cents.

6             In the interest of industry consensus, however,  
7     Suiza's proposal adopted the three cent recommendation. It  
8     is my understanding that other industry experts, including  
9     those representing both producers and processors such as  
10    Paul Christ for Land O'Lakes, Chris Newburn for the American  
11    Butter Institute, and the Milk Industry Foundation and the  
12    International Ice Cream Association, have also come to  
13    similar conclusions. See Exhibit 23, Exhibit 38 and Exhibit  
14    39.

15            The question that seems to remain is to which of  
16    the minimum price formulas should the butter fat price  
17    adjustment be applied? As an economist, I cannot justify  
18    proposal eight. Proposal eight limits the proposed  
19    adjustment to the Class 4 butter fat price. Doing so would  
20    create disorderly marketing. In particular, proposal eight  
21    would set up signals that interfere with normal market  
22    forces. In my opinion, at least in the short term, Class 1  
23    processors with bulk cream to sell will buy for the Class 4  
24    customers to the exclusion of Class 2 and 3 customers. This  
25    may work well for those that are fortunate enough to secure

1 Class 4 customers, but in the short term it will place other  
2 Class 1 processors selling cream to Class 2 and 3 processors  
3 at an economic disadvantage.

4 In addition, it is my opinion proposal eight will  
5 create problems over the long term as well. To the extent  
6 that Class 1 processors will prefer Class 4 customers to  
7 Class 2 and 3 customers, the Class 2 and 3 processors will  
8 be forced to pay even higher prices to draw bulk cream away  
9 from Class 4 facilities.

10 This could have unintended business consequences  
11 for Class 2 and 3 processors. Moreover, during a tight  
12 butter market as experienced in 1998 and 1999, cream costs  
13 could reach high enough levels for these processors to  
14 employ butter substitutes. None of these results will be  
15 good for the industry.

16 Moreover, proposal eight would disrupt the  
17 essential price relationship between Class 2 and Class 4.  
18 USDA determined in the final rule that a 70 cent per  
19 hundredweight differential between Class 2 and Class 4 was  
20 appropriate before product substitution began. During the  
21 first two months of this year proposal eight would have  
22 increased the 70 cent per hundredweight differential between  
23 Class 2 and Class 4 prices to 93 cents per hundredweight,  
24 thus providing Class 2 processors with the incentive to seek  
25 other alternatives.

1           The request to correct Class 2, 3 and 4 butter fat  
2 formulas to reflect the Grade A butter price instead of the  
3 Grade AA butter price is simply a request to correct an  
4 error or oversight made during the rulemaking process.  
5 There is no indication that basing the butter fat price off  
6 of the Grade AA butter price was based on a reasoned  
7 decisionmaking supported by evidence, and certainly there is  
8 no evidence in the record that this result was ever  
9 intended. In fact there was no discussion on the issue  
10 during the informal rulemaking.

11           Accordingly, correcting this oversight will do no  
12 more than return the butter fat values to the level they  
13 should have been all along.

14           In conclusion, the failure to adjust the NASS  
15 Grade AA butter price to reflect the Grade A butter price  
16 was an oversight and is inconsistent with the core  
17 principles of the federal milk market order system.  
18 Moreover, basing the butter fat value off of Grade A product  
19 values in lieu of Grade AA for Class 2, 3, and 4 as opposed  
20 to just Class 4 would be disruptive to the milk market order  
21 system and would facilitate disorderly marketing.

22           Further, the price enhancement associated with the  
23 implementation of Option 1A Class 1 differentials in tandem  
24 with the use of the higher of the Class 3 or 4 price to act  
25 as the Class 1 mover, provides USDA with the flexibility to

1 make this essential adjustment to the butter fat price  
2 calculation in Classes 2, 3, and 4.

3 Accordingly, I urge you to adopt the proposal  
4 number three.

5 Thank you.

6 Q Thank you, Ms. Ledman. Before I make you  
7 available for Cross-Examination I would like to ask you just  
8 a few questions.

9 Can you tell me if Grade A butter is obsolete?

10 A No. I do not think that Grade A butter is  
11 obsolete. There is Grade A butter and Grade B butter  
12 produced in the United States.

13 I've talked with butter manufacturers who have  
14 given me anywhere, estimates from three to seven percent of  
15 butter production is that or Grade B or Grade A.

16 U.S. butter production in 1999 totaled  
17 approximately 1.2 billion pounds of butter. Roughly  
18 speaking then, approximately five percent of that or about  
19 55 million pounds could be Grade A or Grade B. Keeping in  
20 mind that Grade A and Grade B butter is made from whey  
21 cream.

22 The industry long accepted the Minnesota/Wisconsin  
23 milk price based upon Grade B milk produced in Minnesota and  
24 Wisconsin that did not reflect any more than two to three  
25 percent of total U.S. milk production.

1           So there is Grade A and Grade B butter. It's  
2 approximately five percent of U.S. production. And we have  
3 set minimum prices within the federal order systems based  
4 upon milk that represented less than that of total U.S.  
5 production.

6           Q     Have you performed an impact analysis in regard to  
7 comparing proposal three to proposal eight?

8           A     Yes, I did prepare an impact analysis of proposals  
9 three and eight.

10          Q     That is marked as proposed Exhibit 40?

11          A     That is correct.

12          Q     What was the purpose of your analysis and what did  
13 you conclude, and how does it compare to the analysis that  
14 USDA undertook?

15          A     I took a different approach than USDA. USDA did a  
16 fine job in analyzing the proposals using a supply/demand  
17 model, a dynamic model. Their indication was that the  
18 impact of lowering the butter price by six cents per pound  
19 in the calculations for Class 1, 2, 3, and 4 butter fat  
20 would just reduce the blend price by .006 cents per pound.

21                I approached this from a worst case scenario.  
22 That is what would have happened to Class 2, 3 and 4 prices  
23 had the NASS minus six cents be in the formulas for January  
24 and February?

25                If you take a look at Exhibit 40, just to be clear

1 here what I did is i used the average NASS monthly prices  
2 for January and February for all of the class prices. And  
3 just to be clear, what I mean is I did not calculate a  
4 separate two week average for the advance price for Class 1.  
5 And the skim advance for Class 2.

6 What I was trying to do was try to isolate the  
7 impact of proposal number three of lowering the fat price  
8 six cents, the NASS price six cents per pound.

9 That compared to proposal eight which lowers the  
10 fat value six cents per pound for just Class 4. I did this  
11 at test. That is, I received the data from the, as the  
12 pounds of skim, the second page of Exhibit 40 is the pounds  
13 of skim and fat that were actually in the federal order  
14 system January and February. That would show you that Class  
15 1 milk, the summary table accounted for 1.98 percent fat;  
16 Class 2, 7.38 percent fat; Class 3, 3.82 percent fat; Class  
17 4, 6.67; and the average fat content in federal order milk  
18 during January and February, the average of those two months  
19 was 3.76.

20 In summary, proposal eight would have had the  
21 impact of lowering the blend by 4.3 cents, whereas proposal  
22 three that lowers the fat on Class 2, 3, and 4 would have  
23 resulted in 10.6 cent reduction of the regulated milk price.

24 Q When you say it would have had an impact of  
25 lowering the blend, you mean that it would have had an

1 impact on the regulated price as opposed to the all milk  
2 price?

3 A Correct.

4 Q That's your measure.

5 If you had to characterize the difference between  
6 proposal number three and proposal number eight, how would  
7 you do that?

8 A There are two key differences between proposal  
9 three and eight, the first of which is that proposal three  
10 attempts to replicate a Grade A butter fat value by minusing  
11 six cents off of the NASS AA butter price. It's a market-  
12 oriented approach. Rather than proposal eight seems to be  
13 more of a results-oriented approach of just subtracting six  
14 cents arbitrarily from a butter fat value.

15 Further, proposal eight applies the lower butter  
16 fat value just on Class 4, whereas proposal three recognizes  
17 that bulk surplus cream is used in Class 2, 3 and 4 as well.

18 Q All right. Would you say that, I guess the last  
19 question I have right now before I make you available for  
20 Cross-Examination, will the adoption of proposal number  
21 eight, as opposed to proposal number three, help your  
22 clients, your fluid milk clients?

23 A No. Proposal eight will just cause disruptive  
24 market conditions.

25 Q Great.

1           MS. YOVIERNE: One more thing before I make her  
2     available for Cross-Examination. At this time I would  
3     respectfully request that the pre-marked exhibits be  
4     received into the record as exhibits.

5           JUDGE HUNT: Does anyone object to Exhibits 36  
6     through 40 being made part of the record in this proceeding?

7           Mr. Beshore?

8           MR. BESHORE: I object to Exhibit 39 being used  
9     to, as it was referred to in the testimony, for the truth of  
10    the matters asserted in it. I don't ever recall a proposal  
11    letter being offered in support of the proposal in substance  
12    in these things, and I don't think this is a good time to  
13    start.

14          JUDGE HUNT: Does anyone else have any objection  
15    to any of the exhibits?

16          MR. YALE: Ben Yale, the proponents for one and  
17    others, we would join in that objection.

18          JUDGE HUNT: To 39?

19          MR. YALE: Yes.

20          MS. YOVIERNE: If I may make a comment?

21          JUDGE HUNT: Yes.

22          MS. YOVIERNE: The letter by Constance Tipton can  
23    be used as an admission of a party. Suiza is in support of  
24    proposal number three and IDFA is in support of proposal  
25    number four.

1 JUDGE HUNT: On 39, I will sustain the objection.

2 As I earlier ruled, offering a letter is a means of in  
3 effect offering testimony and the ground rule is here to  
4 have testimony to be considered, they have to be subject to  
5 Cross-Examination. This is a statement by a person who's  
6 not present, so for that reason I'm going to deny the  
7 admission of Exhibit 39.

8 Mr. Vetne?

9 MR. VETNE: I think the objection to the receipt  
10 of Exhibit 39 was taken, and hopefully tentatively ruled  
11 upon, as an objection to use of 39 for any purpose  
12 whatsoever. Let me suggest first of all that even as to the  
13 truth of its content, if the witness on examination, and  
14 maybe we ought to hear the Cross first, as an expert can  
15 verify the accuracy of the analytical assumptions in the  
16 letter in her own testimony, the objection of not being able  
17 to Cross somebody --

18 JUDGE HUNT: She's got to give it as her own  
19 testimony then.

20 MR. VETNE: The assumptions and calculations and  
21 analysis therein. She didn't write the letter, obviously.

22 Secondly, for a more limited purpose, it is a  
23 letter that she included as part of her analytical package.  
24 She has been qualified as an analytical expert, and one of  
25 the things that she said she did was to analyze the proposal

1     advocated by a party other than the one she represents on  
2     the stand and comment on it. It would be useless to make an  
3     analysis unless you have something on the record from which  
4     to make the analysis.

5             Thirdly, it is still, I believe, admissible, even  
6     if for no other purpose, not necessarily for the truth of  
7     the factual assertions made therein with which counsel may  
8     object. But for the truth of the fact that this was the  
9     analysis and presentation actually made to the Secretary.

10            Regardless of whether --

11            JUDGE HUNT: Just that there's a letter written  
12     from this person to the Secretary, if you want to admit it  
13     for that reason, I'll allow it. But not for the truth of  
14     what it allegedly contains.

15            MR. BESHORE: For that purpose it has absolutely  
16     no pertinence to the proceeding.

17            JUDGE HUNT: I'm saying I'll allow it for that  
18     limited purpose, as a letter to the Secretary. I'll allow  
19     it.

20            MR. BESHORE: I object to it on that purpose  
21     because it's completely irrelevant. Who cares? Of what  
22     relevance to this record is it if somebody --

23            JUDGE HUNT: I'm saying I'll allow it on that  
24     condition. Otherwise it will accompany the record as a  
25     letter, as a rejected exhibit.

1           MR. VETNE: Frequently evidence is received for  
2 one purpose and not another. In this case there was a  
3 proposal submitted. The letter is a document that's part of  
4 this rulemaking that people had notice of. And in preparing  
5 for this hearing one of the things that people would do was  
6 to look at the analysis of a proponent and prepare an  
7 analysis responsive to, whether in support of or against or  
8 in between, responsive to that analysis. You don't get the  
9 responsive analysis as effectively if you just ignore what  
10 it's responding to.

11           MS. YOVIENE: Your Honor, on the point of, I would  
12 respectfully request that it at least be admitted for the  
13 point of other people thinking along the same lines as Ms.  
14 Ledman, as Mr. Vetne explained. If you decide not to admit  
15 it as support for the truth of the matter of the statements  
16 therein, that's another story. But I would like to quote  
17 from Federal Rule of Evidence --

18           JUDGE HUNT: I have ruled that I will allow it as  
19 a letter that was submitted to the Secretary. Just for that  
20 purpose. If you object to that it will --

21           MS. YOVIENE: That's fine, thank you.

22           JUDGE HUNT: It will be admitted for that purpose.

23           And no objections to the other proposed exhibits?

24           (No audible response)

25           JUDGE HUNT: All right, then 36 through 40 will be

1 received in evidence.

2 (The documents referred to,  
3 having been previously marked  
4 for identification as Exhibit  
5 Nos. 36 through 40 were  
6 received in evidence.)

7 MS. YOVIENE: Thank you, Your Honor.

8 I'll now make Ms. Ledman available for Cross-  
9 Examination.

10 JUDGE HUNT: Mr. Beshore?

11 CROSS-EXAMINATION

12 BY MR. BESHORE:

13 Q Hello, Mary.

14 I'd first like to ask, you make what I think is an  
15 absolutely correct observation at the top of page two that  
16 it's long been an industry practice to buy raw material  
17 cream at a Grade A butter price times a multiplier and sell  
18 the finished product based upon the Grade AA price.

19 That applies in particular to butter, does it not?

20 A It applies to butter as well as other items such  
21 as ice cream and cream cheese. I've seen pricing formulas  
22 to customers that also use the AA milk pricing formula.

23 Q Are you testifying that it has historically been  
24 an industry practice to buy cream and sell creamers, for  
25 instance, Class 2 products, creamers at a finished product

1 based on the double, the Grade A butter price?

2 A I have no direct knowledge of creamers.

3 Q Cottage cheese? Is that sold on the Grade A  
4 butter price? Lowfat cottage cheese?

5 A I am here to testify about my role as a consultant  
6 to some companies, pricing formulas to customers that I've  
7 seen, have been primarily on the ice cream and cream cheese  
8 side.

9 Q So that comment has no pertinence to any other  
10 products in Class 2 or 3 other than cream cheese and ice  
11 cream. that's your testimony.

12 A Cream cheese which is a Class 3 product, and ice  
13 cream which is a Class 2 product.

14 Q Proposal 40, the impact analysis which you've  
15 done. That attempts to -- That only analyzes the impact of  
16 proposal eight and no other proposals advanced at this  
17 hearing by Land O'Lakes or the National Milk Producers  
18 Federation or other proponents of proposal eight, isn't that  
19 correct?

20 A Let me just try to make that a little bit clearer.  
21 What I did is I took the proposal number eight as written in  
22 the hearing notice and which only changed the Class 4  
23 formula by altering the butter fat, replacing the NASS AA  
24 butter price by the butter fat value minus six cents. I did  
25 not change the non-fat or any of the make allowances that

1 have since been talked about during, since Monday. This was  
2 just isolating the butter fat value change of proposal three  
3 and proposal eight.

4 Q And no other proposals.

5 A Correct.

6 Q In making your analysis in proposal three versus  
7 proposal eight, are you, is this aggregate average volumes  
8 for January and February? Did I understand it that way?

9 A Yes, it is.

10 Q At one point in your testimony you said there was  
11 an effect of proposal eight to enhance the differential  
12 between Class 2 and 4 to 90 plus cents I think versus 70  
13 cents. Does that appear on your numbers here in your  
14 analysis of proposal eight?

15 A No, it doesn't. In fact it's an unfair, it would  
16 be an unfair analysis by me to infer that the price  
17 difference between Class 4 and Class 2 would be -- if I  
18 could just direct you to proposal eight and look at the  
19 third column from the left, with as a Class 4 price of  
20 \$13.12 versus the Class 2 price of \$14.83. That would infer  
21 that the difference would be a \$1.71 difference. That would  
22 be an unfair comparison between what the price enhancement  
23 would be by using proposal eight.

24 The reason why that jumps from 93 cents -- 93  
25 cents is at a 3.5 percent butter fat level. And this

1 analysis is at test. And as the following page indicates,  
2 the test level of Class 2 milk was 7.38 percent while the  
3 Class 4 percent was 6.67. So that's why these values are  
4 inflated. I didn't want to infer that the price difference  
5 between Class 2 and Class 4 would grow to \$1.71.

6 Q I guess what puzzled me in particular, and still  
7 puzzles me, is that on proposal eight the columns to the  
8 left, you show the prices that it was based on. For  
9 instance, Class 4 skim, 7.71, Class 2 skim, 8.41, a 70 cent  
10 differential. Isn't that correct?

11 A Correct.

12 Q And of course the butter fat values are changing,  
13 so that the butter fat values are different in Class 4 than  
14 they are in Class 2. That's the proposal, correct?  
15 Different by six cents a pound I guess. Is that the  
16 difference?

17 A I'm sorry.

18 Q There's only a 70 cent difference in the Class 4  
19 and Class 2 skim values which is the 70 cent differential.  
20 Correct? That's what you show on Exhibit 40, proposal  
21 eight, the actual --

22 A Yes.

23 Q Okay, proposal eight skim, 7.71, proposal eight  
24 skim, 8.41. Okay. There's a six plus cent difference in  
25 the proposal eight butter fat value, Class 2 versus Class 4,

1 correct?

2 A Correct.

3 Q That, you're showing what the proposal would do.

4 A Correct.

5 Q In what way has proposal eight increased, changed,  
6 modified in any way the Class 2 differential?

7 A It's enhanced the difference between the Class 4  
8 price at 3-5 test and the Class 2 price.

9 Q By changing the butter fat value.

10 A That is true, by changing the butter fat value.

11 Q But there's no difference whatsoever in the  
12 differential, isn't that correct?

13 The difference in Class 2 and Class 4 milk just  
14 depends on how much butter fat you have in it because the  
15 butter fat prices change, isn't that correct?

16 A Yes.

17 Q So if you're looking at -- the expansion of the  
18 differentials has been thrown up in the hearing, and I take  
19 it in your testimony also, as a threat for seeking  
20 alternatives. That's what you say. "Provides Class 2  
21 processors with the incentive to seek other alternatives"  
22 and I take that to mean alternative ingredients, correct?

23 A No, not just alternative ingredients.

24 Q Alternative what?

25 A Milk procurement activities.

1 Q Alternative sources of supply.

2 A Alternative milk procurement activities such as  
3 Class 2 plants can be stand-alone plants, they can be  
4 pooled, they could have a patron milk supply and not be,  
5 they could be an unregulated plant. This would send a  
6 signal to Class 2 users to do something differently,  
7 especially if it's for the long term.

8 Q Proposal eight makes no change whatsoever to the  
9 cost of milk for Class 2 customers, isn't that correct?

10 A Proposal number eight changes the important  
11 relationship between Class 4 and Class 2.

12 Q It makes no change in the cost of milk to Class 2  
13 processors under the federal order system, correct?

14 (Pause)

15 JUDGE HUNT: Can you answer that?

16 THE WITNESS: It changes the relationship, and  
17 this is a federal order system where you cannot just dissect  
18 one piece and say that it has no impact on another piece.

19 BY MR. BESHORE:

20 Q I was just asking for an answer to the question.  
21 Whether -- That's not the answer.

22 The question is, would the cost of milk be the  
23 same for Class 2 processors after proposal eight and before  
24 proposal eight's adoption, if it were to be adopted. I  
25 think that's a simple yes or no question.

1 JUDGE HUNT: Can you answer it yes or no?

2 THE WITNESS: No.

3 BY MR. BESHORE:

4 Q The answer is no.

5 A No.

6 Q So your testimony is that it would change. The  
7 minimum federal order value would change if proposal eight  
8 is adopted for Class 2 processors.

9 MS. YOVIENE: Objection. That question was asked  
10 and answered.

11 JUDGE HUNT: She said no.

12 THE WITNESS: I will answer the question no.

13 BY MR. BESHORE:

14 Q What change is there in the Class 2 skim value  
15 after proposal eight's adopted from before its adoption?

16 A There is a change in the relationship of the skim.  
17 Of the skim price.

18 Q What change in the absolute price is there?

19 A I believe that there's a change relative to the  
20 skim value.

21 Q You've said there's been a change, but your Table  
22 40 says the net effect of proposal eight on federal order  
23 Class 2 value at test is 0.0000, and the net effect of  
24 proposal eight on federal order blend value at test is  
25 0.0000.

1           A     My table also shows that the relationship between  
2     Class 2 and 4 is greatly enhanced.

3           Q     Okay. Now is it your testimony that there would  
4     be an economic, that proposal eight would make it  
5     economically viable for Class 2 processors to substitute  
6     non-fat dry milk for fresh skim milk if proposal eight is  
7     adopted?

8           A     That actually depends upon what the market  
9     conditions are at that time.

10          Q     What the non-fat solids would cost.

11          A     Correct.

12          Q     The same thing would apply to butter or butter fat  
13     in Class 2, wouldn't it?

14          A     If they were to substitute, yes. Market  
15     conditions.

16          Q     It depends on what the price of butter is,  
17     correct?

18          A     Yes.

19          Q     And whether proposal eight or proposal three is  
20     adopted, or neither of them are adopted, whether non-fat  
21     solids replace fresh solids or butter replaces fresh butter  
22     fat in Class 2 depends on the same market conditions, what  
23     the price of the butter is or what the price of the powder  
24     is, isn't that correct?

25          A     In general I'm going to agree with you on that

1 one.

2 Q Thank you.

3 JUDGE HUNT: Mr. Yale?

4 BY MR. YALE:

5 Q Good afternoon.

6 A Good afternoon, Ben.

7 Q I won't ask you the names of the cows that you  
8 milked in Germany.

9 A Thank you.

10 Q You in your impact analysis, there was, as I  
11 understand it, ten cents a hundredweight. Is that safe to  
12 say that on an annual basis that we're talking approximately  
13 \$100 million?

14 A No. this ten cents per hundredweight, first of  
15 all it represents milk at 3.76 percent butter fat. The  
16 annual average is more like 3.67 cents. This is really  
17 viewed as a worst case scenario, and this would be the  
18 impact on the minimum regulated blend price. I believe that  
19 there are, the market conditions would really make this be  
20 minimal.

21 Q What do you mean by market conditions make it be  
22 minimal?

23 A I'm sorry, I didn't make that very clear. I  
24 believe that premiums in the marketplace would mask this ten  
25 cent difference. The ten cent difference would be masked by

1 two ways. One, there are competitive premiums that exist in  
2 the marketplace, and number two, it's at 3.76 percent butter  
3 fat and the national average is 3.67. I think USDA's  
4 analysis of more dynamic supply/demand analysis is more  
5 appropriate for the long term impact.

6 And further, USDA's analysis includes the minus  
7 six cents on Class 1 as well, and we have not included that  
8 in our analysis here.

9 Q Your changes are only to Classes 2, 3, and 4?

10 A That is correct.

11 Q I was a little confused by your testimony. What  
12 would be the end formula? Is it NASS minus three? Is it  
13 NASS minus two? Is it NASS minus 1.6? Is it NASS minus  
14 six? What is the number?

15 A It would be NASS minus six.

16 Q So what was the relevance of the three cents and  
17 the two cents and the 1.6 cents that was in your testimony?  
18 And maybe it's my mush brain at this hour, but the question  
19 just kind of went over.

20 A It is confusing.

21 If you look at the data, the actual data would  
22 indicate that there's zero difference between the NASS and  
23 the CME. But all of us sitting here recognize the  
24 volatility that the industry has experienced since that NASS  
25 data was being collected.

1           So if you look at a more stable time period, that  
2    difference is 1.6 cents. I think many people in here would  
3    like to see minus nine cents. But the reality of it is,  
4    people have come here already recognizing that politically  
5    it would be more possible to get six cents, and that's where  
6    people have come to terms here.

7           Q    So in other words, so I understand your testimony,  
8    you're saying that first of all you have to adjust the NASS  
9    to the CME by a discount of one to three cents, and then on  
10   top of that your six cent reduction would take you down to  
11   the theoretical Grade A butter price, is that --

12          A    Correct.

13          Q    You indicate there's about five percent of the  
14   butter is Grade A and Grade B? Is that about right?

15          A    That's my understanding, yes.

16          Q    And the direction of its percentage as a part of  
17   the dairy industry, in what direction is that going?

18          A    I think it will be relatively stable, although I  
19   could paint a scenario, because it's made from whey cream  
20   and that cheese production continues to increase, you'll  
21   always have whey cream butter.

22          Q    You indicate the department has used other  
23   analysis of smaller amounts such as the Grade B milk, but  
24   when the decision to use Grade B milk in the Upper Midwest  
25   was first established, its percentage at least in that

1 market was in excess of 50 percent, was it not?

2 A In 1960, yes.

3 Q And part of the reason we're having this hearing  
4 today is because they abandoned the use of manufacturing  
5 grade milk because it was, in fact, too thin, wasn't it?

6 A The real reason -- the real reason why we  
7 abandoned using the MW price is not because there's not  
8 Grade B milk. Still in Minnesota and Wisconsin seven to  
9 eight percent of the milk in those two states is Grade B.

10 What happened is that processors changed the way  
11 they paid for Grade B milk. Back in 1960 they sent out two  
12 checks. They sent one out on the 15th of the month for milk  
13 delivered during the first two weeks of the month. Then,  
14 for example, by May 1st they would have sent out the check  
15 for the second two weeks of the month.

16 Today Grade B milk checks and the timeliness of  
17 those milk checks are exactly the same as their Grade A  
18 payroll which I think the federal order requires payment for  
19 the month of May by approximately June 12th to 14th.

20 So what was happening was that NASS was setting a  
21 milk price on June 5th for milk purchased in May, but yet  
22 that Grade B milk check hadn't gone out until June 15th.

23 Q But isn't it also it reached a point there was so  
24 little milk that maybe, instead of Grade B setting the Grade  
25 A price the Grade B price might be responding to the Grade A

1 price?

2 A The Grade B price, in my opinion, was responding  
3 to the price announced on the 5th of the month. It's so  
4 well published in Minnesota and Wisconsin that it would come  
5 out on the 15th of the month but yet the processors wouldn't  
6 set their price for that until the 15th. So it was actually  
7 leading what processors would pay for Grade B milk.

8 Q But there was, nonetheless, some reporting in some  
9 series in which information was collected on an actual  
10 market price for Grade B milk correct?

11 A Correct.

12 Q And there is no collection now of a market price  
13 for Grade B or Grade A milk -- Grade B or Grade A butter to  
14 the same degree.

15 A No, there is not a reporting of Grade A butter.

16 Q You were talking about this last year or so has  
17 been unstable. Would you identify what might be considered  
18 a normal year? If we wanted to look at a normal year? It  
19 sounds like Ohio weather, but a normal year?

20 A The industry is usually quick to point out that  
21 1997 was a normal year, but I'm thinking that milk  
22 production growth in California in 1997 was very stagnant  
23 and I don't think that would be considered a normal year.

24 So it's very difficult to depict what a normal  
25 year is in our industry.

1           Q     Again, you just mentioned something about the MNW,  
2     I guess more recently the BFP, how they -- It didn't seem to  
3     be doing the job anymore. The plants were almost responding  
4     to what was being announced rather than the announcement  
5     responding to the plant payments, right? Was that kind of  
6     the --

7           A     It's my opinion that the announced BFP leads what  
8     plants paid for milk during the previous month.

9           Q     And 1998, 1999 that seemed to really show some  
10    abnormality in the BFP and how it's --

11          A     My personal opinion is that the biggest problem  
12    with the BFP in 1999 was the fact that we had, that the NASS  
13    cheese price lagged the current market conditions in  
14    Minnesota and Wisconsin, so that we had a couple of months  
15    with very, for example January 1999 if my memory serves me  
16    right, was 1627 for BFP followed by a February of 1027.  
17    That rebounded in March approximately to 1121. That was  
18    largely due to the relationship of the product formula  
19    updater to the competitive pay price series. That  
20    adversarial relationship no longer exists by going to a  
21    total product formula pricing.

22          Q     Are there any sales of grade butter that are  
23    indexed at a Grade A price or is the butter still marked off  
24    of a Grade AA but with a discount? There is no Grade A  
25    index or Grade B index to sale --

1           A     There's not a reported Grade A price.

2                     MR. YALE: I have no other questions.

3                     Thank you, Your Honor

4                     JUDGE HUNT: Anyone else have questions of Ms.

5     Ledman?

6                     Ms. Brenner?

7                     BY MS. BRENNER:

8           Q     You stated that the failure to adjust the NASS  
9     Grade AA butter price by USDA was an oversight. As an  
10    expert in the industry and a consultant to the industry,  
11    were you familiar with the committee, the BFP replacement  
12    committee report when it came out?

13          A     Yes.

14          Q     The preliminary report on BFP.

15          A     Uh huh.

16          Q     Didn't that have the AA price in it?

17          A     I believe it did.

18          Q     What about the proposed rule?

19          A     Yes.

20          Q     And the final decision?

21          A     Yes, but I think it was really an industry -- not  
22    just a USDA oversight, but probably an industry oversight as  
23    well. There were bigger fishes to fry with 1A versus 1B and  
24    that directed really the entire industry's attention. I  
25    think as well as at USDA.

1           I think that the inclusion of anhydrous milk fat  
2   in Class 3 is another example of that unintended oversight.

3           Q    I'm not going to argue you with you on anhydrous  
4   milk fat.

5                   (Laughter)

6           Q    I've seen a couple of copies of the equivalent  
7   price announcement that we put out when the CME I guess  
8   discontinued trading in Grade A butter.

9                   I'm getting the impression that the use of the  
10   phrase "essential to the continuing operation of the federal  
11   order program" has been taken to mean that we absolutely  
12   needed to use a Grade a butter price as opposed to any other  
13   kind of butter price to operate the program.

14                  Do you think that might have had more to do with  
15   the fact that it was embedded in each of the orders? The  
16   reference to the Grade A price? And that in the middle of  
17   the federal order reform process we might have had to go to  
18   a hearing to move from Grade A to Grade AA butter.

19           A    I believe that it's embedded within the federal  
20   order -- the concept of a minimum price, and that the Grade  
21   A, the use of a Grade A or Grade A equivalent in the butter  
22   fat differential, which had been debated about 20 years ago  
23   or so, really on the same premise that fluid handlers could  
24   not cover their cost of selling surplus cream. I think that  
25   was fought 20 years ago and I think that when the CME

1 discontinued the Grade A butter price that USDA consciously  
2 looked at the replacement of the A market as trying to find  
3 an equivalent to it. If not, then why couldn't they just  
4 say well, we're going to go to the AA?

5 Q It might have been a little hard at that point to  
6 say it was equivalent to. But 20 years ago, wouldn't there  
7 have been a higher proportion of Grade A butter to Grade AA  
8 than there was in 1998?

9 A There may have been, but I still believe the  
10 industry practice of pricing milk fat was tied to an  
11 ingredient basis than a finished product basis.

12 Q And you said that Grade A and Grade B butter are  
13 both made from whey cream.

14 A That's my understanding. And largely sold into  
15 bakeries for use. There is some Grade A butter used in food  
16 service, and I personally bought Grade A butter at Dick's  
17 Grocery Store in Monroe, Wisconsin a year ago and was  
18 surprised that it was Grade A.

19 Q You didn't intend to buy Grade A butter.

20 (Laughter)

21 A It was a very good price and I was just surprised  
22 when I read the label, quite honestly.

23 MS. BRENNER: Thank you.

24 JUDGE HUNT: Mr. Vetne?

25

1 BY MR. VETNE:

2 Q I'm John Vetne, I'm representing Kraft in this  
3 proceeding.

4 Mr. Beshore asked you a question which caused me  
5 some semantic confusion, and I apologize to you if nobody  
6 else shared that confusion but I need to clarify it for  
7 myself.

8 The question was to the effect that proposal  
9 number eight doesn't change Class 2 handlers' costs under  
10 the federal order system. Do you recall that question?

11 A Yes, I do.

12 Q Let me divvy up that question to explain my  
13 confusion. Maybe I can suggest two meanings for it. And  
14 maybe the answer is different for the meaning of either.

15 With respect to the segregated components of Class  
16 2 skim and Class 2 butter fat. What you show on Exhibit 40  
17 is it doesn't change the minimum regulated price for Class 2  
18 skim or Class 2 butter fat. And that would be a yes answer,  
19 is that correct?

20 A Yes.

21 Q But for a Class 2 handler operating under the  
22 federal order system, is it your opinion that it might  
23 change that Class 2 handler's real life competitive costs,  
24 not represented by the Class 2 price?

25 A Yes.

1           Q     And those real life competitive costs include a  
2     new competitive relationship attracting milk to butter that  
3     might not be there before. Is that correct?

4           A     Correct.

5           Q     And in your analytical opinion when making a  
6     regulatory decision the department should consider real life  
7     competitive consequences of its regulated decision, would  
8     you agree with that?

9           A     Yes, I would.

10          Q     I guess it's along the same line of question,  
11     something about disorderly consequences that you refer to in  
12     your testimony.

13                 Under the current system which a lot of folks  
14     think is broken, mistakenly so, at least Class 2, Class 3  
15     and Class 4 handlers are equally disadvantaged in the same  
16     say with respect to the butter fat price, correct?

17          A     Correct.

18          Q     And would you agree with me that fixing what may  
19     be broken, mistakenly or not, for one class, would actually  
20     be worse than keeping things as they are?

21          A     Yes.

22          Q     Turn with me please to page three of your  
23     testimony. In the middle of the page you refer to  
24     differences between the Grade A butter price -- the NASS AA  
25     and the CME AA, do you see that?

1 A Yes.

2 Q And was CME AA 1.63 cents higher than the NASS AA?

3 A Yes, that's correct.

4 Q And that's where the two cents or three cents  
5 comes from?

6 A Yes.

7 Q So in the next line, my opinion that -- and you  
8 looked to the CME as, strike that.

9 In the next line you stated that, "It's my opinion  
10 that a Grade A butter price equivalent to the NASS AA butter  
11 price would be two cents less."

12 So if in the previous sentence you're referring to  
13 two AA prices, shouldn't the middle line there beginning  
14 with "It is my opinion", shouldn't that also be a AA  
15 reference? You don't want to subtract just two cents from  
16 the Grade AA price, right? You want to subtract six or  
17 maybe seven.

18 (Pause)

19 A The proposal is to subtract six cents from the  
20 NASS.

21 Q But the words on your paper here say you should  
22 subtract two cents from the NASS. I don't want anybody  
23 quoting that part of your testimony if you didn't intend to  
24 say subtract just two cents.

25 A Actually, in my opinion it would be the NASS'

1 1.63, rather than CME minus nine, it would be more like the  
2 NASS minus seven, but for industry consensus it's NASS minus  
3 six.

4 Q Would your opinion be correctly expressed then if  
5 the sentence beginning, "Therefore, it is my opinion", if  
6 one modification is made to that sentence, if you throw  
7 another A the first time you put a capital A there, so  
8 you're comparing two AA values, that would be a correct  
9 reflection of your opinion.

10 A Yes.

11 Q Thank you for that.

12 The 70 cent differential that's now in the order,  
13 and you've been questioned about that, my recollection is,  
14 and I'll ask you if it's yours, because it certainly is Mr.  
15 Beshore's, that that was put in there as sort of a threshold  
16 of difference between the Class 4 skim price and the Class 2  
17 skim price, within which Class 2 handlers would not have an  
18 incentive to use powder as a substitute for producer skim  
19 milk.

20 A Yes.

21 Q And since the fat was the same, that was the only  
22 difference in the 3-5 price or, and it would be the only  
23 difference, it will only be the skim portion that will be  
24 affected by the average Class 2 milk that is what, seven  
25 percent butter fat? Roughly.

1           A     Roughly. A little bit more than that.

2           Q     It's only the skim portion that would differ under  
3     the existing system or pre-existing system.

4           A     Yes.

5           Q     With respect to product alternatives or other  
6     alternatives, an economic decision affecting the fat side is  
7     now involved that wasn't there before. Have you ever heard  
8     of whole milk powder?

9           A     Yes, I have.

10          Q     Can powder be made with various quantities of fat  
11     in the powder?

12          A     Yes, it can.

13          Q     Including whatever started out at 3-5 or 3-7 or  
14     four or five?

15          A     Yes, it can.

16          Q     When a fat, a powder that includes fat is made,  
17     you don't have to remove any more water than you'd remove  
18     from powder originally, correct?

19          A     Correct.

20          Q     If you were advising a Class 2 processor, would  
21     you advise the processor that if this new competitive  
22     relationship came to be, to look at fat/skim powder mixes as  
23     an alternative for at least some of producer milk in making  
24     Class 2 products.

25          A     Yes.

1           Q     In fact you can have fat powder to virtually any  
2     specification you want, can't you?

3           A     Yes.

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

5                 JUDGE HUNT: Mr. Galarneau?

6                 BY MR. GALARNEAU:

7           Q     Clay Galarneau with Michigan Milk Producers. Good  
8     evening.

9           A     Hi, Clay.

10          Q     Mary, on page two of your testimony you make  
11     reference to the historical price difference between Grade A  
12     and Grade AA butter trading at the CME averaging this nine  
13     cent difference.

14          A     Yes.

15          Q     Do you have any knowledge as to how much history  
16     they may have looked at?

17          A     I think it was recent history. I'm thinking two  
18     to three years.

19          Q     I'm thinking more about like 1994 and sooner.  
20     Before that, and maybe you can remember this as well, butter  
21     was often priced at support and maybe the Grade A price  
22     would average about a penny over support -- I'm sorry, the  
23     Grade AA price about a penny over support and the Grade A  
24     price at maybe a penny or two under support.

25          A     I believe the difference prior to 1994 if that's

1 the time period -- I trust your start date there -- was  
2 probably more like four to five cents, and yes, Grade A and  
3 I believe the support price at 65 cents was for both Grade A  
4 and AA butter.

5 Q It is now.

6 A Okay.

7 Q Before 1994 it wasn't. And we had a long period,  
8 or several periods, and I think if you used a different  
9 recollection of history you would have saw that that  
10 difference was not nine cents.

11 So I take it you agree with that?

12 A Only if I had the data in front of me to verify.

13 Q Mary, do you have knowledge of marketing  
14 conditions of cream products in California?

15 A I was waiting for that one, Clay.

16 (Laughter)

17 Q Then you have the answer?

18 A Yes, I do have knowledge of -- I do forecasting  
19 for California class prices as well.

20 Q And you are familiar then with the class price  
21 differences between cream that goes to ice cream and yogurt  
22 as opposed to cheese and non-fat?

23 A Yes, I do.

24 Q That difference now is what, 3.7 to 3.93 cents?

25 A What I find interesting is that California also

1 has a 70 cent differential between Class 2 and Class 3  
2 products and also Class 4 products.

3 Q Excuse me. That wasn't the question I asked.

4 A But they apply that 70 cents differently between  
5 the fat and the skim.

6 Q Can you answer the question that I asked, please?

7 A Their fat premium is 3.7 cents off of the two  
8 prior months' average butter, 4A butter fat value.

9 Q Are you aware, in your opinion does that cause  
10 disorderly marketing in California?

11 A Yes it does with the California bi-monthly prices,  
12 but there are opportunities to move federal order cream into  
13 California at times, and there's opportunities to move  
14 California cream into the federal orders.

15 Q But you introduced a new variable, as opposed to a  
16 timing difference as opposed to the price difference.

17 A I think the timing, I think that's important,  
18 especially when you average out two months in which the  
19 butter price may be \$1.25 in one month and it shoots to  
20 \$1.75 the next, that averaging had a large degree in keeping  
21 it for two months, has a large degree of the market  
22 volatility of moving cream in and out of California.

23 Q What I'm trying to determine though is are you  
24 aware of disorderly marketing conditions because the butter  
25 fat price going to Class 2 and 3 products is this 3.9 cents

1 difference, not as opposed to any timing differences that  
2 may result? Can you separate the two?

3 A Repeat it one more time.

4 Q The Class 2 and 3 prices for butter fat in  
5 California are set at 3.7 and 3.9 cents higher than the  
6 Class 4A and 4B prices, and I'm concerned, or trying to  
7 understand if there are disorderly marketing conditions that  
8 result from that fact alone. And you introduced what you  
9 believe was knowledge that yes, timing differences caused  
10 problems. Well, all things being equal, if timing  
11 differences were eliminated with several months of similar  
12 butter fat prices in the country, then do you think that 3.9  
13 cents alone would cause disorderly marketing?

14 A I believe that it does create disorderly marketing  
15 in a national market for cream. Yes, I do.

16 Q Thank you.

17 JUDGE HUNT: Anyone else?

18 (No audible response)

19 JUDGE HUNT: Ms. Yoviene, do you have anything  
20 else?

21 MS. YOVIENE: No, I'm finished with the witness.  
22 Thank you, Your Honor.

23 JUDGE HUNT: Thank you very much, Ms. Ledman.

24 We'll take a very short break until we take Mr.  
25 Gallaway.

1 (Recess taken from 6:27 to 6:39 p.m.)

2 JUDGE HUNT: On the record.

3 Mr. Rosenbaum indicated that Mr. Blaise is going  
4 to testify in lieu of Mr. Gallaway, who will testify  
5 tomorrow. Is that correct?

6 MR. ROSENBAUM: That's correct, Your Honor.  
7 Whereupon,

8 DAN BLAISE  
9 having been first duly sworn, was called as a witness herein  
10 and was examined and testified as follows:

11 JUDGE HUNT: State and spell your name, Mr.  
12 Blaise.

13 THE WITNESS: Dan Blaise, B-L-A-I-S-E.

14 DIRECT EXAMINATION

15 BY MR. ROSENBAUM:

16 Q Mr. Blaise, do you have a prepared statement?

17 A Yes, I do.

18 Q Why don't you start to read that statement. I  
19 think I'm going to have a couple of questions after you read  
20 the first paragraph, but why don't you go ahead and start.

21 A This testimony is being submitted by Wells Dairy,  
22 Inc. Based in Lamars, Iowa, Wells Dairy has become the  
23 largest family-owned dairy processor in the United States  
24 operating four processing plants in Iowa and in Nebraska.  
25 We are a manufacturer of frozen dairy desserts, cultured

1 dairy products, and bottled fluid milk. We purchase raw  
2 milk directly from dairy producers and also from several  
3 large dairy cooperatives who are regulated under the federal  
4 orders. We also purchase large quantities of butter fat and  
5 skim solids for our ice cream plants.

6 All of our raw milk purchases and most of our  
7 dairy ingredient purchases are directly affected by federal  
8 order Class 2 prices.

9 Q Let me just interrupt you there for a second, Mr.  
10 Blaise. You talk about the company being the largest  
11 family-owned dairy processor in the United States. People  
12 here in the East might not be as familiar with your company.

13 Am I right that Wells Dairy is one of the largest  
14 ice cream manufacturers in the country?

15 A Yes.

16 Q Certainly in the top ten, maybe even closer to the  
17 top than that.

18 A Yeah.

19 Q And I've actually had the privilege to be in your  
20 ice cream plant in Lamars, Iowa. Is that perhaps the  
21 largest single freestanding ice cream plant in the country?

22 A Yes, that's correct.

23 Q Why don't you continue with your testimony, if you  
24 would.

25 A We are proposing that the NASS AA butter survey

1 price be reduced by six cents and the product price formulas  
2 applicable to all classes of milk. We also want to state  
3 that any changes in the Class 4 skim milk price formula that  
4 results in an increase in the Class 4 price, that a  
5 corresponding decrease in the Class 2 differential occur.

6           The NASS AA butter survey price needs to be  
7 reduced by six cents in the product price formulas for all  
8 classes of milk. USDA historically used the Chicago  
9 Mercantile's Exchange Grade A butter price in determining  
10 the minimum butter fat value for federal order pricing.  
11 When the CME eliminated the trading of the Grade A butter  
12 market, the USDA used the CME Grade AA market price less  
13 nine cents.

14           This nine cents represented the historical  
15 difference between the Grade A and AA market price.

16           Currently the final rule uses the NASS Grade AA  
17 butter prices in determining the butter fat value for  
18 federal order pricing. There is no adjustment in the price  
19 formula to represent the historical difference between AA  
20 and A butter. This resulted in a higher value for butter  
21 fat under the final rule.

22           Wells Dairy proposes that the NASS survey butter  
23 price be reduced by six cents to reflect the historical  
24 relationship that existed between the butter price and  
25 butter fat value. This change to the butter fat value

1 should be applied to all classes of milk including Class 1  
2 and 2. If this price reduction is to occur on Class 4  
3 products only it will raise our costs on purchasing butter  
4 fat for our ice cream production.

5           Currently when we purchase cream we compete  
6 against butter churns. We normally pay a slightly higher  
7 multiplier than the butter churns to accommodate the  
8 seasonality of the ice cream business. If cream sellers are  
9 given an overly large price discount for selling their  
10 excess butter fat to butter churns than to ice cream plants,  
11 we will be forced to pay unduly high multipliers to obtain  
12 that cream. Thus we will see a significant price increase  
13 for butter fat.

14           If this does occur we will look at any and all  
15 alternatives. This could include buying more cream from  
16 California, or using cream substitutes such as butter,  
17 anhydrous milk fat, and/or frozen cream.

18           In summary, more federal order cream would end up  
19 in the manufacturing of butter and anhydrous milk fat, and  
20 the producers will have a lower blend price.

21           Any increase in the Class 4 skim milk price should  
22 be reflected in an equal and opposite decrease in the 70  
23 cent Class 2 differential. In the manufacturing of a  
24 majority of the Class 2 products, the substitution of wet  
25 skim solids by dry skim solids occurs when the prices

1 dictate.

2 Wells Dairy every month analyzes the cost of dry  
3 skim solids versus wet skim solids and uses the cheaper of  
4 the two. So the relationship between the wholesale powder  
5 price and the Class 2 skim solids price is very important.  
6 USDA in the final rule has determined that 70 cents  
7 differential best represents that difference.

8 To increase the Class 4 skim price and not change  
9 the Class 2 differential will put more milk into Class 4 and  
10 more powder used in Class 2 manufacturing. When this  
11 happens the dairy producers are the losers because more milk  
12 goes into the lower Class 4 price.

13 In summary, Wells Dairy wants the NASS survey  
14 butter price to be reduced by six cents per pound and that  
15 this reduction be applied to all classes of milk. Also with  
16 any increase in the Class 4 skim price, an equal reduction  
17 in the Class 2 differential must occur.

18 If these items do not occur there will be a  
19 replacement of Class 2 milk by Class 4 manufactured products  
20 and the dairy producers will certainly lose the right to  
21 obtain the higher price that Class 2 commands.

22 MR. ROSENBAUM: Mr. Blaise is available for Cross-  
23 Examination.

24 JUDGE HUNT: Thank you.

25 Mr. Beshore?

1 CROSS-EXAMINATION

2 BY MR. BESHORE:

3 Q Dan, when Wells analyzes whether it's going to use  
4 wet ingredients or dry ingredients in its ice cream, how  
5 much more does it cost you to reconstitute the dry  
6 ingredients to make your fresh ice cream?

7 A I typically like to use six cents per pound. That  
8 tends to cover things pretty good. What I'll do is take the  
9 powder price plus the six in comparison to wet.

10 Q So to see whether it's viable or not, the powder  
11 price has got to be six cents per pound less than the price  
12 of wet solids in Class 2.

13 A Right.

14 Q How about with butter? Do you ever reconstitute  
15 butter for butter fat in ice cream?

16 A We have in the past.

17 Q What's the reconstitution cost that you use to  
18 figure out if that's economical?

19 A I'm not sure. I wasn't employed with Wells at the  
20 time that they did it and I haven't seen any of those  
21 figures.

22 Q So you don't look at that one on a monthly basis?

23 A Yeah. I wouldn't personally. My supervisor would  
24 look at it. But yes, Wells does take a look at the price  
25 relationship on butter fat monthly at least.

1 Q Do you know what additional reconstitution costs  
2 your boss looks at when he evaluates that?

3 A It would be based upon what we would estimate at  
4 our manufacturing facility would be our direct cost for  
5 reconstituting that. There isn't an index or something that  
6 we look up or any published figures. It's just real life.

7 Q It was about six cents per pound for skim solids.

8 A Right. And I do not know as far as butter if that  
9 would be the same ratio or not.

10 Q Has Wells ever used anhydrous milk fat in its ice  
11 cream?

12 A Yes, they have.

13 Q What reconstitution cost do you use for anhydrous  
14 milk fat?

15 A I don't know. Same as butter. It's a  
16 substitution, and like I said before, I don't know what the  
17 conversion cost is.

18 Q Do you know which one costs more or less?

19 A Probably, I would say butter would cost more, and  
20 then anhydrous fat would be cheaper.

21 Q By the way, is the price of anhydrous milk fat  
22 recorded anywhere that you know of? Can you go to Dairy  
23 Market News and check out the current market price for  
24 anhydrous milk fat?

25 A I haven't seen that. I'm assuming that it would

1 be on there, yes.

2 Q Have you ever used whole milk powder to make ice  
3 cream?

4 A I haven't, no.

5 Q Do you know if Wells ever has?

6 A I do not know.

7 Q What proposals are you talking about in Roman  
8 numeral III when you talk about increasing the Class 4 skim  
9 milk price?

10 A The actual proposal number?

11 Q Yeah, or what topic are you talking about there?

12 A Basically the stance that we're taking with the  
13 testimony that I've just presented is that in any proposal,  
14 as far as when we talked about, and I'm sure, Marvin, that  
15 we'll talk about cream here in a minute too, but on the  
16 Class 2 skim solid side, we are basically saying that if any  
17 proposal that comes from this hearing would increase that  
18 Class 2 differential or the price of the Class 2 wet solids  
19 where it would be more advantageous for us to use powder,  
20 that we will do so.

21 Q But in the, I'm trying to figure out under what  
22 circumstances you're requesting the differential be reduced.  
23 What do you think would be done in this hearing that  
24 would --

25 A If the Class 4 skim price would be increased, then

1 I think a corresponding decrease should happen in the Class  
2 2 differential. And that way we'd maintain the same  
3 relationship.

4 Q Okay. That's all I've got.

5 JUDGE HUNT: Mr. Yale?

6 BY MR. YALE:

7 Q If I understand it, you purchase a lot of your  
8 milk for ice cream.

9 A Yes.

10 Q Do you sell any of your cream?

11 A Occasionally we have to. We don't like to. But  
12 there are certain circumstances where we would have to, but  
13 it's very, very minimal.

14 Q Is the cream, the excess that you have, is that  
15 treated as Class 2 because it goes into your ice cream?

16 A Right.

17 Q All your bottled milk is sold in flow jugs and  
18 cardboard today? Is that pretty much how you market your  
19 fluid milk?

20 A Yes. We are exploring some other alternatives,  
21 but as of the present time, yes.

22 Q It's probably been some time ago that you got away  
23 from cases and bottles and returns?

24 A Oh, yeah.

25 Q Would it be -- When I first started in this many

1 years ago, one of the first hearings I went to they still  
2 had some plants talking about the cost of moving returned  
3 bottles as a cost for differentials. That would be pretty  
4 stupid today, wouldn't it? To include the cost of returned  
5 bottles in a federal order hearing in 2000 --

6 A If we were discussing that now --

7 Q Yes.

8 A -- I guarantee you I would have been asleep a long  
9 time ago.

10 Q But isn't that really the situation, some of us  
11 have been asleep already without talking about that.

12 (Laughter)

13 Q But isn't that really the situation with trying to  
14 go back to a price for Grade A butter that just doesn't  
15 exist anymore? Isn't it just as obsolete as the bottles and  
16 the cases?

17 A I don't think so. You were one of the people that  
18 examined Mary Ledman before me, and there's still Grade A  
19 and B butter out there, and there probably always will be.

20 Q There's still a few bottles out there, too.

21 A I guess so. But I'm thinking the percentage of  
22 bottles may be even less than --

23 MR. YALE: I have no other questions.

24 JUDGE HUNT: Mr. Rosenbaum?

25

1 REDIRECT EXAMINATION

2 BY MR. ROSENBAUM:

3 Q Mr. Blaise, tell me about the opportunity to buy  
4 more cream from California.

5 A That's an alternative we would look at. We have a  
6 majority of our surplus cream already comes from them. We  
7 have developed relationships which I feel are very strong  
8 relationships, that if we did have a situation that would  
9 occur, the difference between California's cream pricing and  
10 something that would happen with the Class 4/Class 2  
11 relationship under the federal orders, we certainly would  
12 look to expand that relationship.

13 Q Expand meaning increase the purchases.

14 A Correct.

15 MR. ROSENBAUM: Thank you.

16 JUDGE HUNT: Mr. Vetne?

17 RECROSS-EXAMINATION

18 BY MR. VETNE:

19 Q Did you mean to say that a majority of your  
20 supplemental cream comes from California?

21 A I'm saying surplus, supplemental.

22 Q It's supplemental needs for you, it's surplus to  
23 California, is that right? It's not your surplus. You need  
24 it.

25 A Yeah.

1           Q     And you receive those at Wells Dairy ice cream  
2     manufacturing plants that are non-pool plants under the  
3     federal order system, correct?

4           A     Correct.

5           Q     So you don't account to any federal order producer  
6     when you buy milk which you find economically beneficial  
7     from California. It's not part of your pooled receipts.

8           A     Right.

9                 MR. VETNE: Thank you.

10                JUDGE HUNT: Mr. Schad?

11                BY MR. SCHAD:

12           Q     I just have one question. Other people have come  
13     in front before and talked about maintaining the 70 cent  
14     differential between the Class 2 and Class 4, so if there  
15     was any change in the price of skim solids in Class 4, any  
16     decrease in the --

17           A     Increase in the price of the Class 4 skim solids,  
18     a decrease in the differential.

19           Q     Right. Are you aware that the position of  
20     National Milk Producers is to increase the make allowance in  
21     Class 4 which would decrease the Class 4 skim price?

22           A     Uh huh.

23           Q     If that came about, would you be also in favor of  
24     increasing the differential to capture the 70 cent spread?

25           A     As long as that relationship stayed there, and to

1 be quite honest with you on this, you can do whatever you  
2 want to with that differential. What I'm going to look at  
3 and the bottom line is that if those wet skim solids cost me  
4 more than what I can do for powder, regardless of whatever  
5 kind of formula they want to put out here, I'm going to go  
6 with the cheaper of the two. That's the bottom line.

7 Q Sure. Thank you.

8 JUDGE HUNT: Any other questions?

9 Mr. Rosenbaum?

10 FURTHER REDIRECT EXAMINATION

11 BY MR. ROSENBAUM:

12 Q MR. Blaise, I don't think I ever asked you to  
13 identify your position with the company. It's in your  
14 written document, but because you read it, we should have  
15 that in the record.

16 A I'm Assistant Dairy Procurement Manager.

17 MR. ROSENBAUM: Thank you.

18 JUDGE HUNT: Ms. Brenner?

19 FURTHER RECROSS-EXAMINATION

20 BY MS. BRENNER:

21 Q Hi, Mr. Blaise.

22 Some of us on the East Coast do know about Wells  
23 Dairy because we have little Blue Bunny Ice Cream trucks  
24 running around our neighborhoods.

25 I'm really getting intrigued about anhydrous milk

1 fat. I've spent 30 years in milk marketing and I've never  
2 seen any, and actually I don't think I've ever seen it on a  
3 handler report. Could you describe it?

4 A It comes in solid form. It's 55 gallon drums.  
5 You have to heat it up to get it into the process to be able  
6 to use it into ice cream.

7 I'm not really an expert on anhydrous milk fat. I  
8 would say that, and in my testimony I said we would explore  
9 other alternatives such as that. I know that Wells in the  
10 past has used those products. We certainly, if forced, we  
11 don't want to but if we're forced we certainly will go back  
12 to doing some of that.

13 Q Do you know anyone who makes it?

14 A No, I don't. But you could talk to some of the  
15 cooperatives. I'm sure the cooperatives do some of that,  
16 but I have not contacted a supplier yet. That would be part  
17 of the exploration process if it was warranted.

18 MS. BRENNER: Thank you.

19 JUDGE HUNT: Any other questions?

20 (No audible response)

21 JUDGE HUNT: Thank you very much, Mr. Blaise.

22 Mr. Olsen, do you want to call Mr. Venkatachalam?

23 MR. OLSEN: Yes, sir.

24

25

1 Whereupon,

2 C. K. VENKATACHALAM

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

5 JUDGE HUNT: Would you state and spell your name  
6 for the record, sir?

7 THE WITNESS: My name is C. K. Venkatachalam.  
8 It's a pretty long name and I've shorted it to be, you can  
9 address me as Venkat. You can imagine the problem I have  
10 over the telephone conveying my name to people, so Venkat is  
11 the way I have been known for the last 20 years.

12 But officially it is C. K. Venkatachalam.

13 JUDGE HUNT: Does the Reporter have a copy of your  
14 testimony to get the spelling of your name? You do? Great.

15 MR. OLSEN: Your Honor, we're passing out his  
16 testimony.

17 I'm going to ask Venkat to read his testimony and  
18 then have it offered into evidence when he's finished doing  
19 that, Your Honor.

20 JUDGE HUNT: That would be 41.

21 (The document referred to was  
22 marked for identification as  
23 Exhibit No. 41.)

24 Mr. OLSEN: Thank you, and I'd also like to have  
25 Venkat qualified as an expert in the areas in which he's

1 going to be testifying relating to whey and non-fat dry milk  
2 production. I'll let him get through his introduction and  
3 background and then ask you to consider that, since it's not  
4 entirely clear to me now whether we're doing that or not.

5 DIRECT EXAMINATION

6 BY MR. OLSEN:

7 Q With that said, Venkat, why don't you go ahead and  
8 begin with your introduction and background, please.

9 A I am the Director of Whey Products Technical  
10 Service for Leprino Foods Company, headquarters in Denver,  
11 Colorado. My business address is 1830 West 38th Avenue,  
12 Denver, Colorado 80211-2200.

13 I hold a Bachelor's Degree in Chemical Engineering  
14 and have 38 years of industrial experience.

15 Early in my career I worked with multinational  
16 companies such as Exxon, Unilever and Cadbury's. My past 21  
17 years work has been in the dairy industry and I have been  
18 with Leprino Foods for the past six years.

19 My background includes designing, installing and  
20 commissioning pre-heaters, evaporators, high temperature,  
21 short time equipment, flash coolers for milk, whey, whey  
22 protein concentrate and cheese products. We are working  
23 with GEA Wiegand, a design engineering firm specializing in  
24 dairy evaporation equipment.

25 I worked with GEA for 15 years and during that

1 time I was responsible for planning, project engineering,  
2 design, installation and startup of 50-plus evaporator  
3 systems. That is in excess of 50 units. I have also  
4 performed cost/benefit analysis for evaporation reverse  
5 osmosis system and helped several customers optimize their  
6 equipment purchases.

7 In my current position with Leprino I am  
8 responsible for analyzing whey operations with a view to  
9 improving efficiencies while maintaining or improving the  
10 finished product quality. I also specify major pieces of  
11 equipment such as separators, clarifiers, membrane system,  
12 HDSD units, evaporators, units, dryers, powder handling, and  
13 powder packaging system and commissioning them to process  
14 the intended products.

15 MR. OLSEN: Very quickly, Your Honor, I'd now  
16 offer Venkat as an expert in the areas as he's identified  
17 them and ask that his testimony be considered as such.

18 JUDGE HUNT: I'll accept his testimony, and in  
19 doing so, Mr. Beshore, that does not diminish the testimony  
20 of other people who have testified here.

21 (Laughter)

22 BY MR. OLSEN:

23 Q Go ahead, Mr. Venkat.

24 A The purpose of my presentation today is to provide  
25 technical information regarding the differences in

1 manufacturing processes between whey powder and non-fat dry  
2 milk, focusing primarily on energy utilization and equipment  
3 requirement.

4 Sue Taylor is testifying tomorrow on behalf of  
5 Leprino on the policy issues under consideration at this  
6 hearing. One issue that I understand Sue will discuss in  
7 her testimony is the need for a higher whey make allowance  
8 in the Class 3 price formula. I am told that when  
9 establishing the current Class 3 price formula USDA assumed  
10 the manufacturing costs for whey and non-fat dry milk are  
11 the same. For the reasons discussed below, this is an  
12 erroneous assumption.

13 There are a few similarities between whey powder  
14 and non-fat dry milk. Before elaborating on the  
15 differences, let me point out the similarities.

16 Milk for both these products is processed first  
17 through clarifiers for fines removal; separators for  
18 skimming fat to an acceptable level; and is legally  
19 pasteurized in an HDSD system. At this point in time the  
20 similarities stop.

21 There are significant differences between whey and  
22 non-fat dry milk. Let me start with the process itself.

23 In addition to the processes required in the  
24 production of non-fat dry milk, whey powder production  
25 requires additional separation and pasteurization, a

1 crystallization process, and a two-stage dryer. In addition  
2 to the initial pass through the clarifier, separators, and  
3 pasteurizer that occur prior to the cheese production, the  
4 whey stream coming off cheese vats must pass through a  
5 clarifier and be separated and pasteurized a second time.

6           To produce sweet whey powder the pasteurized whey  
7 is evaporated to about 52 to 55 percent total solids, is  
8 then flash cooled to about 85-95 degrees fahrenheit to form  
9 nuclei for fine lactose crystals. This product is then  
10 cooled in jacketed, agitated, crystallizers to about 45  
11 degrees F under controlled cooling conditions.

12           The resulting slurry is then spray-dried in a two-  
13 stage dryer to produce a free flowing, non-caking powder.  
14 The powder is packed in poly-lined kraft paper bags which  
15 are heat sealed.

16           There are significant differences between whey and  
17 non-fat dry milk with respect to initial solids content.  
18 dilute whey has a total solids content of 6.3 percent.  
19 That's an average. Typically it ranges from 6.1 to 6.5.  
20 For 100 pounds of whey powder we need to remove about 1,440  
21 pounds of water. Expressed another way, we need to remove  
22 14.4 pounds of water per pound of whey powder. About 94  
23 percent of this water is removed during evaporation, while  
24 the balance of six percent is removed during drying.

25           As you can see, evaporation is the single most

1 energy intensive operation in the powder manufacturing  
2 process.

3 Skim used to produce non-fat dry milk has a total  
4 solids content of 9.25 percent on an average. It ranges  
5 from 9 to 9.5. Pasteurized non-fat milk is evaporated to  
6 about 54 percent solids and is spray dried in a hot  
7 condition. Unlike whey, there is no crystallization  
8 involved.

9 This condensed product is spray dried in a single  
10 stage dryer to produce non-fat dry milk and is packed in  
11 heat-sealed poly-lined kraft bags. For 100 pounds of non-  
12 fat dry milk we need to remove about 1,048 pounds of water,  
13 or expressed similar to whey, we need to remove 10.5 pounds  
14 of water per pound of non-fat dry milk. That basically  
15 arises from the initial differences in the solid content of  
16 the dilute feed to the system.

17 Thus the main differences between whey powder and  
18 non-fat dry milk production can be summarized as follows.

19 Pounds of water removed per pound of powder for  
20 whey, it is 14.4, and for non-fat dry milk it is 10.5.

21 Energy to crystallize, item number B, is needed  
22 for whey powder and there is no crystallization in non-fat  
23 dry milk so it's not needed.

24 Capital equipment. Extra clarifiers, separator,  
25 pasteurizer, larger evaporator, crystallization and

1 refrigeration equipment and a double stage dryer are needed  
2 for whey powder.

3 For non-fat dry milk a smaller evaporator and a  
4 single stage dryer will do the job.

5 Item D. These are the equipment I have listed  
6 under Item C. They need to be run and there is power and  
7 energy to be consumed. And I made a qualitative statement  
8 here saying that it is needed for whey and it's not needed  
9 for non-fat dry milk.

10 As a result of these differences it costs more to  
11 produce whey powder compared to non-fat dry milk. Although  
12 it obviously requires more labor and management to operate  
13 and maintain the additional equipment and processes  
14 associated with whey production I will focus on the energy  
15 and equipment costs which are within my area of expertise.

16 Energy costs to produce whey powder are higher  
17 than energy costs to produce non-fat dry milk by 0.774 cents  
18 per pound, and the details I will read out as I have  
19 enumerated down below.

20 The following assumptions are used to calculate  
21 the energy costs associated with producing whey powder and  
22 non-fat dry milk.

23 Number one, dilute whey and skim contain average  
24 total solids of 6.3 percent and 9.25 percent respectively.

25 Assuming no losses, product yields at 97 percent

1 moisture, would be 6.49 pounds of whey and 9.54 pounds of  
2 non-fat dry milk per hundred pounds of dilute feed.  
3 Actually that isn't 97 percent moisture it's 97 percent  
4 solids. It's three percent moisture. It's an error in the  
5 testimony. Sorry about that. It can't be 97 percent  
6 moisture.

7 (Laughter)

8 Steam costs, our averages work out to \$4.25 per  
9 thousand pounds of steam. Electricity cost is about six  
10 cents per kilowatt hour.

11 We also have examples on my previous experience in  
12 design engineering equipment. We can evaporate about eight  
13 pounds of water per pound of steam used. And the additional  
14 power consumption for whey based on the additional equipment  
15 involved, four 50 horsepower units which are the separators  
16 and clarifiers, that is about 200 horsepower; six 15  
17 horsepower crystallizers which add up to 90; and about ten  
18 15 horsepower additional pumps amounting to about 150.  
19 These are the installed capacity. Typically these equipment  
20 run around 75 percent load, which makes it 330 horsepower  
21 consumption or conversion into kilowatt hours it would be  
22 247.

23 My written testimony includes a table that details  
24 the calculations. If I may walk through this table, it is  
25 not confusing to me but I'm sure for people who read it for

1 the first time, it needs some explanation.

2           There are four columns. If we restrict ourselves  
3 to column one and three, and actually column three and four  
4 are translating pics into per pound of powder so it becomes  
5 easier, so I will go through the details of column one and  
6 three as we go along and it will become pretty easy then.

7           Composition for dilute whey, if there is 100  
8 pounds there is 6.3 pounds of solids and water is 93.7  
9 pounds. For skim milk it is 9.25 pounds of solids and 90.75  
10 pounds of water. Both equalling 100 pounds of starting  
11 material.

12           Evaporation to 54 percent total solids, the amount  
13 of water you need to remove starting from 100 pounds of  
14 dilute whey is 88.33 pounds. Now the same amount for skim  
15 milk to produce 54 percent solids would need water removal  
16 of 82.870 pounds.

17           At a water removal efficiency of eight pounds of  
18 water per pound of steam used, our steam consumption then  
19 becomes 88.33 divided by eight, that makes it 11. I've  
20 rounded the figures to reasonable numbers. So 11.00. And  
21 the same number for skim milk is 82.87 divided by eight,  
22 works out to 10.4.

23           The cost of steam, as I have enumerated above, is  
24 \$4.25 per thousand pounds. Therefore the steam cost for  
25 dilute whey is 11 pounds divided by 1,000 times 4.25, that

1 will be 0.047 dollars. And the same way for skim milk it  
2 will work out 0.044 dollars.

3 Because we produce more amount of skim milk per  
4 100 pounds of feed stock, which is given about that we make  
5 6.49 pounds of whey powder per hundredweight of dilute whey,  
6 and 9.54 pounds per hundredweight of skim, our cost of steam  
7 per pound of finished powder, which is in column two and  
8 four, now works out to 0.723 cents and 0.462 cents which is  
9 nothing but the dollars 0.047 multiplied by 100 to make it  
10 cents, and divided by 6.49 and that number will be 0.723.  
11 Similar figure for the skim milk of 0.462.

12 Now as I explained before, we need to crystallize  
13 condensed whey before we can dry it to produce a non-caking  
14 free-flowing powder. The cost of refrigeration in kilowatt  
15 hours per hundred pounds of dilute whey is 0.2 in terms of  
16 kilowatt hours. At six cents a kilowatt hour, the  
17 refrigeration cost for dilute whey, 100 pounds of dilute  
18 whey, is 0.012 dollars.

19 And this divided by 6.49 will work out to 0.185  
20 cents per pound of finished powder.

21 The same conversion doesn't exist for skim because  
22 there is no crystallization.

23 Then we go to the next step which is drying to 97  
24 percent solids.

25 Water removed per 100 pounds of dilute whey is

1 5.17 pounds. And we need in the dryer 11,000 BTUs. Dryers  
2 are typically gas heated, they are not steam heated. So we  
3 need to convert them into therm calculations. The therm is  
4 100,000 BTU unit based on which you buy natural gas.

5 So the cost of a therm is about 28 cents, or 0.28  
6 cents. And for 11,000 BTUs our cost works out to 0.031  
7 dollars which is column one under dilute whey for drying.

8 Now this divided by 6.49 pounds of powder per 100  
9 pounds of dilute feed will work out to 0.474 cents per pound  
10 of dry whey.

11 Similar numbers for skim milk. We start with more  
12 amount of water to be removed in the dryer per 100 pounds of  
13 feed stock. That starts with 7.59. We need more amount of  
14 energy to dry all the water, which is 15,340 BTUs. And the  
15 cost of gas per therm is 0.28, or 28 cents, and that  
16 translates to dryer gas cost of 0.043 dollars per 100 pounds  
17 of skim feed.

18 Translated that as dry powder, since we make 9.54  
19 pounds per 100 weight of skim, it translates as 0.45 cents  
20 per pound of dry powder.

21 So to recapitulate, per pound of dry powder, our  
22 drying cost is similar, it's about .474 and about .45.  
23 Additional power required to run the units, I have given you  
24 in my basis that we consume about 247 kilowatt hours. This  
25 is based on connective costs of equipment multiplied by a 75

1 percent factor which is typically ratio of actual  
2 consumption to the installed power. And multiplied by .748  
3 which is conversion from horsepower to kilowatt hours.

4 So that works out to 247 at six cents a kilowatt  
5 hour, it works out to \$14.82 per -- it's not per thousand  
6 pounds.

7 Actually this, I must qualify this piece of  
8 information. This 14.82 pounds is really meant for a plant  
9 handling about two million pounds of milk. A plant that  
10 handles two million pounds of milk will produce about 40.9  
11 million pounds of whey powder. If you divide 14.82 dollars  
12 by 49.9 million pounds of whey powder you'll get a  
13 conversion factor of 0.304 cents per pound of finished  
14 powder, and we have nothing to be added to skim milk.

15 If we add up the dollars or the cents per pound of  
16 finished powder we can add up column two, 1.686 cents per  
17 pound of finished product for whey, and 0.912 cents per  
18 pound of skim milk powder.

19 So I have summarized down below the difference  
20 between the two numbers column wise. The calculations of  
21 the additional energy costs to produce finished whey powder  
22 relative to non-fat dry milk in the above table can be  
23 summarized.

24 The differential in evaporation steam is .261  
25 which is nothing but the difference between .723 in the

1 previous page, and .462. And if you go to the next column,  
2 it is .185 minus zero. And if you go to the next item,  
3 dryer gas, is .474 minus .450. And additional power is  
4 .0304 minus zero, is .304 making at total of .774. These  
5 are cents per pound.

6           There are also additional equipment costs  
7 associated with producing equal value volumes of dry whey.  
8 The additional equipment required to produce whey powder  
9 requires additional capital. This additional capital  
10 impacts the business in two ways -- additional interest  
11 costs and additional depreciation.

12           Additional equipment required for a whey plant  
13 relative to a butter powder plant, assuming both plants  
14 receive two million pounds of raw milk per day, are as  
15 follows. We need about two additional clarifiers which are  
16 about .7 million dollars; two separators which are .7  
17 million dollars. These are installed costs. Additional  
18 evaporator, larger evaporator with additional building and  
19 services we estimate at 1.8 million. Six crystallizers with  
20 controls and cooling water piping, 1.2 million. And an  
21 additional fluid bed which is what I call as a two-stage  
22 dryer that you need for all whey compared to skim milk, and  
23 that is 1.2 million.

24           The total adds up to \$5.6 million for a two  
25 million pound milk input plant.

1           Operating 350 days each year, this plant could  
2     produce roughly 40.9 million pounds of whey powder annually.  
3     Spreading the 5.6 million of additional capital cost over  
4     this 40.9 million pounds of whey powder, using an eight  
5     percent cost of capital, the additional cost of capital in a  
6     whey powder operation is 1.1 cents per pound of whey powder.  
7     This is additional cost.

8           Amortized over 20 years annual depreciation for  
9     the additional equipment is approximately .685 cents per  
10    pound of whey powder.

11           In summary, the incremental whey energy and  
12    equipment costs associated with producing whey powder as  
13    compared to producing non-fat dry milk is 2.559 cents, made  
14    up of 0.774 for energy, 1.1 for capital, and 0.685 for  
15    depreciation, adding up to 2.559.

16           As I stated earlier, the additional equipment in  
17    whey operations requires other costs such as extra labor to  
18    run the equipment, additional maintenance, as increased  
19    overhead costs. My testimony only covers the additional  
20    energy and equipment costs in whey processing. However,  
21    these other operating costs should not be overlooked.

22           Q     Thank you, Venkat.

23           MR. OLSEN: Venkat is now available for Cross-  
24    Examination.

25           JUDGE HUNT: Mr. Yale?

1 CROSS-EXAMINATION

2 BY MR. YALE:

3 Q Good evening.

4 A Good evening.

5 Q Was this study prepared for this hearing? Or was  
6 it used for any other purposes?

7 A No, just for this hearing.

8 Q Is this the kind of, have you ever put together a  
9 packet similar to this to seek capital for the building of  
10 such a plant?

11 A Yeah. We are expanding our facilities quite a bit  
12 and I am all the while involved in putting, specifying,  
13 installing and cost estimating, this kind of --

14 Q Did you bring any of those cost numbers with you  
15 today?

16 A No. I do not have them with me.

17 Q Are those the same kind of numbers that you  
18 present for cost analysis for building of this new plant, or  
19 expansion?

20 A Yeah. We have costs of separators. If we are  
21 talking of additional equipment, we have costs of  
22 separators, we know how much it costs to install them and to  
23 connect them up. The same way we know what it costs to add  
24 additional evaporation equipment in building costs. And the  
25 utilities associated with those.

1           Q     So I understand your number, let's say that all  
2     the other evidence indicated there's a make of \$1.40, for  
3     example, not \$1.40 -- 14 cents per pound of whey powder.  
4     For non-fat dry milk. You would say based on your testimony  
5     that it should be then 16.59 for the whey, by adding just  
6     this 2.559, is that right?

7           A     Yeah. That's correct.

8           Q     I notice in here you speak in terms of kilowatt  
9     hours. Isn't it true that large bulk power is primarily  
10    purchased in terms of demand and you'd be speaking more in  
11    terms of KW rather than KWH?

12          A     No. We have been using the factor of kilowatt  
13    hours which is actual consumption. Most of our equipment we  
14    use, again, I had to base this largely on our operations  
15    today. We use our ratio of actual consumption which is  
16    kilowatt hours to the demand which is kilowatts is not that  
17    different. Basically because we use primarily a lot of  
18    variable frequency drives. When you start out equipment  
19    there's no peak loads that go through the system, so they  
20    are kind of mostly soft start. The peaks versus the average  
21    consumption is not a very high number. So we don't get  
22    penalized on very high peak demands.

23               And there again, I must be careful. I am not the  
24    specialist who can talk that, but I know for a fact that our  
25    cost estimates are primarily based on consumption of

1 kilowatt hours.

2 Q Have you run a cost analysis of the -- Let me ask  
3 you this.

4 Do you actually operate a plant such as this?

5 A A whey plant? Yes. We have two of those.

6 Q Do you do a cost analysis of the operation of  
7 those plants on a regular basis?

8 A Yes, we do.

9 Q Did you bring any of that information with you?

10 A No, I haven't. I'm afraid not.

11 Q There was an NCI study, you may have heard about,  
12 a National Cheese Institute study that was done on various  
13 operations. Was any of that information presented on the  
14 production of dry whey to them? Your actual costs? Did you  
15 participate in that, do you know?

16 A I cannot answer that question. This is the first  
17 time I am participating in an open forum like this, so I am  
18 a technical man.

19 I assume that other people in my company would  
20 have participated but I am not privy to that information.

21 Q Do you yourself have ready access to that  
22 information of actual costs to operate the dry whey powder  
23 operation?

24 A Yes, I do.

25 Q Did you compare those results to these results?

1           A     These results are based on my data that I have  
2     back in the office. We have probably quarterly data that we  
3     sit and analyze and we have multifactory facilities so that  
4     we use for comparing plant to plant. We use the data.

5           Q     This would be categorized as a theoretical plant?  
6     This is kind of theory. Not an actual plant, but one you've  
7     kind of planned out in theory?

8           A     No, because we do have plants operating around  
9     two, two and a half million pounds a day producing whey  
10    powder.

11          Q     But these aren't the actual costs from those  
12    plants?

13          A     These differential costs -- Well, the operating  
14    costs or the actual costs, but the investments are what I  
15    anticipate it to be today if I had to put in a non-fat dry  
16    milk or a whey plant.

17          Q     Is it your understanding that as a result of this  
18    hearing that your company would be reimbursed in full for  
19    these costs?

20          A     I cannot comment on that at all because I do not  
21    know.

22          Q     Do you know what explanation was given to you for  
23    preparing, the purpose for preparing this testimony?

24          A     I was asked to come here as a technical specialist  
25    to explain the differences between the manufacturing process

1 for non-fat dry milk and whey powder. That's all I was  
2 given.

3 Q And you did a fine job. It's a nice piece of  
4 work, and I appreciate that.

5 I do have a question, though, it's kind of a  
6 specialty, right? I mean there aren't too many people that  
7 get involve in building dry whey powder plants, right?

8 (Laughter)

9 Q If I representing a producer, wanted to have  
10 somebody of equal expertise to be able to review this and  
11 challenge that, where would one find someone other than in a  
12 plant like yours?

13 A I'm sure other companies have dry whey producing  
14 plants. I'm sure they must be part of associations where  
15 the data should be available. These are all assumptions on  
16 my part because I don't get involved in that at all.

17 Q But those would be other operations that would be  
18 purchasing milk from producers as well, would they not? In  
19 a similar situation as your boss, right?

20 A Yeah.

21 Q So there really is no independent source of data  
22 available to producers to analyze this data, is that  
23 correct?

24 A There may be consultants available in the market  
25 who do this for a living. Such as people, if you go for

1 designing a plant, they can give you information on what the  
2 equipment costs and operating costs should be.

3 Q There are several techniques to develop dry whey,  
4 are there not? Aren't there some other alternative  
5 processes besides the one that you just described? Maybe  
6 some modifications of this process?

7 A If you want to produce -- each one of the unit  
8 operations you can do alternate methods. Evaporation you  
9 can do something else, drying, you have to do a two-stage  
10 drying for sweet whey powder. That's because you need to  
11 crystallize a component called lactose and that's the only  
12 way you can make non-caking powder.

13 Q But instead of evaporation isn't there the  
14 possibility of using some reverse osmosis or ultra-  
15 filtration?

16 A Yes. Well, not necessarily ultra-filtration, but  
17 reverse osmosis is another way of removing water.

18 Now we have investigated both, and my testimony  
19 still stands basically because the cost of reverse osmosis,  
20 operational costs including the replacement costs for  
21 membranes, almost works out to be even with evaporation. So  
22 it's applicable, my analysis is applicable for both.

23 The only time you put in reverse osmosis is if you  
24 are constrained for space. Evaporators are very large, very  
25 big pieces of equipment, and if you have a real constraint

1 on space and you put in reverse osmosis. But reverse  
2 osmosis takes it only up to a certain solid. In whey you  
3 take 63 to maybe 10, 11, but you still need the evaporation.

4 These combinations, in our overall costing we have  
5 found that they don't make much of a difference. That's why  
6 we don't go for reverse osmosis at all, we go for  
7 evaporation.

8 Q I notice in here you talk about non-fat dry milk  
9 and the dry whey, is there another product in the non-fat  
10 dry milk besides the solids not fat? In the solids not fat  
11 isn't there some dry buttermilk? Or you don't have any dry  
12 buttermilk out of your operation.

13 A I don't have any experience at all on dry  
14 buttermilk so I would be incompetent to comment on that.

15 Q Is the product that goes into your operation  
16 totally skim? I mean you don't use any of the fat in any of  
17 this drying?

18 A Not in the drying, but they may be using it in the  
19 cheese operation. Again, I'm not privy to that, I am only  
20 on the liquid part of the operations.

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

22 JUDGE HUNT: Anyone else?

23 Mr. Marshall?

24 MR. MARSHALL: Thank you, Your Honor.

25 BY MR. MARSHALL:

1           Q     I need a little bit of clarification about your  
2 points of comparison here. First let me begin by saying I  
3 really appreciate your testimony.

4                     The top of page two you talk about something  
5 called a two stage dryer and I think you might have ad  
6 libbed some comments about the difference. But could you  
7 explain whether you would make non-fat dry milk with a two  
8 stage dryer?

9           A     You don't need -- Two stage dryers are more  
10 expensive than single stage dryers because there is another  
11 dryer attached to it. The reason why you have to go for two  
12 stage drying for whey powder is because you have to  
13 crystallize lactose in whey before the final drying process.

14                     So what you do is you go from say 54 percent  
15 solids to about 88 percent solids in the main dryer. Then  
16 you allow a timing belt so that there is water available for  
17 the molecules to crystallize. And you allow it a residence  
18 time of maybe something like five minutes. Then you go  
19 through a fluid bed which is another type of dryer, a fluid  
20 bed dryer. That then brings your moisture level to three  
21 percent of the solids up to 97.

22                     It is this fluid bed that adds to the complexity  
23 and the cost of operations of this. That's the only way I  
24 know of where you can make the non-caking, free-flowing  
25 powder.

1 Q Let me phrase the question in a different way.

2 Are there dryers on which you can make both skim milk powder  
3 and whey?

4 A Yes. If you have a two stage dryer, you would use  
5 only stage one to make non-fat dry milk, and then you can  
6 use your stage two combination for sweet whey.

7 Q Are there other types of dryers that you could  
8 make non-fat on but could not make whey powder with?

9 A A single stage dryer. You cannot make -- You can  
10 make always a powder which will be lumpy and you cannot  
11 market it. But if you want a good quality powder it has got  
12 to be a two stage drying.

13 Q Are you familiar with a filter mat dryer?

14 A Yes, I am.

15 Q Around my company we have a couple of them. I've  
16 heard, and again I just listen, I'm no expert. You're the  
17 expert. And by the way, it's good to have a real expert  
18 here rather than the usual suspects.

19 A Uh oh. I'm in trouble.

20 (Laughter)

21 JUDGE HUNT: Mr. Beshore, do you want to respond  
22 to that?

23 (Laughter)

24 BY MR. MARSHALL:

25 Q I've heard that a filter mat dryer is prized

1 because it can be more flexible in what it can do, but that  
2 it cannot dry, is inherently not capable of drying non-fat  
3 at the same low cost as a dryer that is specially suited for  
4 non-fat dry milk. Would you agree with that?

5 A I agree. Absolutely agree. I know people, in  
6 fact your company, and I know the people who tried non-fat  
7 dry, making powder in filter mat in --, and it's a very  
8 difficult -- It's an overkill for skim milk or non-fat dry  
9 milk; it is also a very expensive dryer. Extremely  
10 expensive dryer. It is very applicable for sweet whey, but  
11 yes, you can produce non-fat dry milk at very, very low  
12 throughputs and under very, very difficult run conditions.  
13 You can.

14 Q When you were putting these numbers together on  
15 equipment and depreciation, did you analyze a filter mat  
16 style dryer for skim milk? Or did you think, for example,  
17 in terms of a single stage dryer?

18 A I thought in terms of single stage dryer because  
19 that would be cost effective. Why put a Rolls Royce when  
20 you need something else?

21 Q So you optimized these numbers --

22 A Yeah, so the investment will not be wasted.

23 Q If you were to use a two stage dryer such as the  
24 filter mat for both drying skim milk powder and drying whey  
25 powder, would you anticipate the same kinds of in-plant

1 losses, the same kinds of shrinkage percentage in the two  
2 drying processes?

3 A This would be a guess on my part. We do not dry  
4 non-fat dry milk on filter mat. We have filter mats too.  
5 So my guess would be that the losses should be similar,  
6 expressed as a percentage on the input solids. That's what  
7 I would think.

8 Q I think I just asked a question about the losses  
9 in the dryer, and I think that's what you just answered  
10 about, the losses within the dryer.

11 A Yeah.

12 Q How about in the larger concept of the plant with  
13 this additional handling of whey. Would you expect there to  
14 be additional losses, additional percentage losses of whey  
15 because of the extra handling you've also described in your  
16 testimony?

17 A There would be additional losses for whey, but I  
18 haven't quantified those in my testimony.

19 For example, when you have a second time  
20 separation and clarification you make desludges. Desludges  
21 are solids, and they go into animal feed. That's a loss.

22 But apart from that, the evaporation operation  
23 should be similar, dryer is less energy efficient in terms  
24 of powder losses. I do not anticipate it to be  
25 significantly different. That is an opinion.

1           Q     You're an expert so you get to draw opinions,  
2     favor us with your opinions.

3                     I'm going to ask for one other opinion.  On this  
4     one, I guess I'll first ask if you're familiar with the  
5     changing technology of dryers in general over the last two  
6     to three decades.  Have you seen an evolution in dryer  
7     technology that you're willing to talk about?

8           A     I would rather not.  My real, real expertise is in  
9     evaporation.  I can talk for a whole day.

10                    (Laughter)

11          A     I can empathize.

12                    Dryer technologies, yes, have changed.  Not in  
13     terms of drying per se, but in terms of equipment, equipment  
14     specifications, better burner controls, better controls in  
15     terms of controlling the finished powder, moistures, that  
16     kind of a processing technology has changed.  But really in  
17     terms of drying, spray drying, in terms of either pressure  
18     atomization or spinning disk, those two technologies have  
19     been there for a long time.  Is nothing dramatically new.

20          Q     I won't push your comfort zone there, and I'll end  
21     my questions with a thank you.

22          A     Thank you very much.

23                    JUDGE HUNT:  Mr. Beshore?

24                    BY MR. BESHORE:

25          Q     Do you have, have you had experience in

1 evaporating or drying buttermilk solids?

2 A Not operating a plant, but I have supplied  
3 equipment in my previous job, a design engineering company,  
4 buttermilk evaporators, yes. But very small ones.

5 Q Do you know how does evaporating and drying  
6 buttermilk solids compare to skim milk or whey liquid?

7 A It would be a very erroneous comparison because,  
8 to call an example. Let's take the evaporator. A good,  
9 properly designed evaporator will be a multiple effect  
10 thermal compression system to give you the efficiency. Like  
11 eight pounds of water or more per pound of steam.

12 The only buttermilk plant evaporator that I know  
13 of is a small mickey mouse three stage evaporator with no  
14 thermal compressor. So really, I can't compare the two.

15 The one I supplied is nowhere as efficient as the  
16 one you can buy if you have a big enough unit you can  
17 justify it.

18 Typically buttermilk is very small amount compared  
19 to skim, so you, it's difficult to cost justify so you go  
20 for cheaper alternatives and you want to get the solids, you  
21 want to dry it and get to them. You know.

22 And drying buttermilk, I cannot comment. I don't  
23 want to be a specialist in that.

24 Q But what you've noted in your experience is that  
25 because the volumes of buttermilk solids are small, they're

1 difficult to deal with, to handle evaporation wise  
2 efficiently.

3 A They are not difficult to handle, but people find  
4 it difficult to justify large investments because of the  
5 volume.

6 Like I can invest maybe \$20 million on something  
7 that takes about two million pounds of skim milk a day, but  
8 I can't justify \$1 million for something that takes probably  
9 about .2 million pounds a day. It's very difficult.

10 So I haven't seen large multiple stage evaporation  
11 in my limited exposure to buttermilk. I will qualify my  
12 statement that way. It doesn't mean it doesn't exist.  
13 Maybe there are people who produce a lot and I am not used  
14 to it. What can I say.

15 Q Where are the two plants that Leprino operates?  
16 Whey drying plants?

17 A Whey? One is in Allandale, Michigan, and one is  
18 in Waverly, New York.

19 Q Are there differences in the costs of operation at  
20 the two facilities?

21 A There are little differences between the two, yes.  
22 One is a literally new plant with more modern technology,  
23 while the other one is a relatively older one which in the  
24 next two years we'll renovate make it equal to the  
25 Allandale plant. Be sure of that.

1 MR. BESHORE: Thank you.

2 JUDGE HUNT: Mr. Coughlin?

3 BY MR. COUGHLIN:

4 Q Mr. Venkat, I want to compliment you. You've done  
5 an excellent job here of putting together information that  
6 would basically respond to what the proposal that my  
7 organization put in, was to start with non-fat dry milk  
8 costs and then reflect additional costs of whey. I wish I  
9 had somebody that was knowledgeable enough to pull yours  
10 apart and say is this right, is that right. Unfortunately,  
11 I don't. But you have done an excellent job.

12 A Thank you.

13 Q The quality of the product that would come out of  
14 an operation like this. Is it a standard quality product or  
15 a superior quality product?

16 A No. In fact as far as the whey is concerned,  
17 nobody can market successfully a whey powder unless it is a  
18 free-flowing, non-caking powder. You don't want lumps, and  
19 it should be, to the end user it should be a free flowing  
20 nice powder.

21 Skim milk, coming out of this will be a very good  
22 product on my analysis. Sure.

23 MR. COUGHLIN: Thank you.

24 JUDGE HUNT: Anyone else?

25 (No audible response)

1 JUDGE HUNT: Mr. Venkat, thank you for coming,  
2 sir.

3 THE WITNESS: Thank you very much.

4 JUDGE HUNT: And you closed the hearing with a  
5 ban, I think.

6 (Laughter)

7 THE WITNESS: Thank you very much.

8 JUDGE HUNT: Mr. Yale?

9 MR. YALE: I just have one question.

10 It's my understanding, and I may have  
11 misinterpreted, that the names of the firms who participated  
12 in NCI were going to be revealed. If that list is out, I  
13 haven't seen it. Is that available?

14 MR. ROSENBAUM: I think Mr. Yonkers is prepared to  
15 take the stand and give that list sometime tomorrow.

16 JUDGE HUNT: All right.

17 Do you want to move the admission of his  
18 testimony?

19 MR. OLSEN: Yes, Your Honor.

20 JUDGE HUNT: Does anyone object to Mr. Venkat's  
21 testimony? Does anyone dare object to it?

22 (Laughter)

23 (No audible response)

24 JUDGE HUNT: All right, we'll admit Exhibit 41  
25 into evidence.

1 (The document referred to,  
2 having been previously marked  
3 for identification as Exhibit  
4 No. 41 we received in  
5 evidence.)

6 JUDGE HUNT: We'll start with Mr. Gallaway first  
7 thing in the morning at 8:00 o'clock.

8 See you in the morning.

9 (Whereupon, at 7:40 p.m. the hearing was recessed,  
10 to reconvene at 8:00 a.m. on Friday, May 12, 2000)

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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 AO-14-A69, et al., DA-003

5 Docket No.

6 Alexandria, Virginia

7 Place of Hearing

8 May 11, 2000

9 Date of Hearing

10 We, the undersigned, do hereby certify that the  
11 foregoing pages, numbers 1028 through 1416 , inclusive,  
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