

1 THE UNITED STATES DEPARTMENT OF AGRICULTURE
2 In the Matter of:)
3 MILK IN THE NORTHEAST,)
4 AND OTHER MARKETING AREAS,)
5) Docket No.: AO-14-A69 et al,
6) DA-003
7 Friday,
8 May 12, 2000
9 Virginia Room A
10 Embassy Suite Hotel
11 1900 Diagonal Road
12 Alexandria, Virginia
13 The hearing in the above-entitled matter was
14 convened, pursuant to adjournment, at 8:00 a.m.
15 BEFORE: HON. JAMES W. HUNT
16 Administrative Law Judge
17 APPEARANCES:
18 On Behalf of the USDA:
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21 United States Department of Agriculture
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9 JAMES EICHSTADT
10 CHARLES ENGLISH
11 STEVEN D. ETKA
12 PAM FESTGE
13 TIM GALLOWAY
14 CHARLES GARRISON
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2						
3	WITNESSES:					
4	Tim Galloway	1424	1431			
5			1447			
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7			1504			
8	Gary Gran/	1439				
9	Robert Cropp					
10	Clayton Galarneau	1474				
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E X H I B I T S

	EXHIBITS:	IDENTIFIED	RECEIVED	DESCRIPTION
1				
2				
3				
4	42	1447	1464	Testimony of Gary Gran
5				with attachments
6	43	1458	1461	Testimony of Dr. Cropp
7				from Public Hearing
8				September 3, 1997
9	44	1476	1477	Chart prepared by
10				Clayton Galarneau
11	45	1526	1623	Class II Substitution
12				Analysis
13	46	1527	1623	Comparison of CME and
14				NASS Prices of Block
15				Cheddar, 7-98
16	47	1527	1623	Summary of Impacts
17	48	1528	1623	Measure of change
18				between CII and CIV
19	49	1655	1670	Calculating Component
20				Values from Modified
21				Van Slyke Cheese
22				Formula
23	50	1655	1670	Calculating Component
24				Values from Butterfat,
25				et cetera, from Van
26				Slyke Cheese Formula
27	51	1671	1683	Audrey F. Throne
28				testimony
29	52	1715	1741	Statement of Sue M.
30				Taylor
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32	54	1785	1822	Charts by Douglas
33				Marshall

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

2 (8:00 a.m.)

3 JUDGE HUNT: All right, we are ready to get
4 started. I would like to have a -- anyone who wants to
5 testify, this is so far on the list that I have. Leading
6 off with Mr. Galloway, and then Mr. Gran, Dr. Cropp, Mr.
7 Galarneau, Mr. Wellington, Mr. Hollon and Mr. Scham.

8 Anyone else at this point that -- yes, Mr. Olsen.

9 MR. OLSEN: Yes. Sue Taylor.

10 JUDGE HUNT: Sue Taylor. All right.

11 MR. ROSENBAUM: Larry Lessenes.

12 JUDGE HUNT: How do you spell that or phonetically
13 how is it?

14 MR. ROSENBAUM: It's L-E-M-M-E-N-E-S.

15 JUDGE HUNT: All right.

16 MR. ROSENBAUM: Ms. Throne, T-H-R-O-N-E; Mr.
17 Schanback, S-C-H-A-N-B-A-C-K; Mr. Yonkers needs to retake
18 the stand just to put in the information that was requested
19 about the NCI cost of production survey.

20 JUDGE HUNT: Okay.

21 MR. ROSENBAUM: I think that's my list.

22 JUDGE HUNT: And we can add to that as necessary.

23 MR. ROSENBAUM: Yes, I assume that Mr. Marshall is
24 going to testify.

25 JUDGE HUNT: Okay. sure.

1 All right, is Mr. Galloway here?

2 Good morning, sir.

3 MR. GALLOWAY: Good morning, Judge.

4 Whereupon,

5 TIM GALLOWAY

6 having been duly sworn, was called as a witness

7 and was examined and testified as follows:

8 DIRECT EXAMINATION

9 BY MR. ROSENBAUM:

10 Q Mr. Galloway, have you prepared a written
11 statement today?

12 A Yes, I have.

13 Q Could you please read that?

14 A Thank you.

15 JUDGE HUNT: Excuse me just a second.

16 Out of courtesy to the witness, please don't talk
17 in the room. If you have to have a conversation, do it
18 outside. Thank you.

19 Mr. Galloway, would you state and spell your
20 name, please?

21 THE WITNESS: Yes, my name is Tim Galloway, T as
22 in "Tom," I-M, Galloway, G-A-L-L-O-W-A-Y.

23 My name is Tim Galloway. I am CO of Galloway
24 Company, which is a third generation family-owned and
25 managed dairy processor. We are located in Neenah,

1 Wisconsin, and are regulated under the Upper Midwest Federal
2 Order.

3 We purchase milk from a number of different
4 regulated handlers in our area. We currently employ about
5 55 people and are considered a small business based on our
6 staffing and dollar turnover.

7 Galloway Company manufactures primarily sweetened
8 condensed milk used in the production of candy, and ice
9 cream mixes for quick service restaurants. We are proud to
10 say that we are the largest supplier of bulk sweetened
11 condensed milk in the country, and the largest supplier of
12 ice cream mix in our marketing area.

13 Our products are classified as Class II products
14 by the order. Many of the proposals considered in this
15 hearing would change the initial prices, make rates or yield
16 factors in Class IV, which, in turn, drive the Class II
17 price. Therefore, changes regarding Class IV pricing would
18 impact the pricing of 100 percent of our products. Unlike
19 some broad line product, line proprietary or cooperative
20 manufacturers, we have no products in other classifications
21 in which we could make up for deleterious consequences of
22 price changes in Class II.

23 Galloway Company has submitted a proposal that has
24 been numbered 31. I will speak to that proposal as well as
25 to proposals that have direct consequences on our proposals.

1 As to the remaining proposals, I have reviewed the testimony
2 of Dr. Bonkers of IDFA and would be in support of his
3 testimony with respect to those proposals.

4 In order to stay competitive against other
5 manufacturers of our products or competing ingredients, it
6 is imperative that we know the cost of these competing
7 products and ingredients as well as their utilization and
8 viability. This is why we have fought the battle concerning
9 the price relationship between milk and other dairy
10 ingredients used to make Class II products, and milk used to
11 make competing ingredients in other classes.

12 I have testified at all the national hearing in
13 the 1990s, including the major ones mandated by the Farm
14 Bills, as well as the Class II differential hearing in the
15 early 1990s, the Class I and II floor pricing hearing in
16 1998, and the multiple component pricing hearing in Order 30
17 and 68.

18 My message was always in the same vein. The
19 federal order should do nothing to impair the ability of a
20 manufacturer of any ingredient in any classification to
21 compete due to the misapplication of regulated pricing. I
22 truly felt that that message was heard in the latest final
23 rule when it was explicitly recognized that there must be a
24 rational price relationship between the ingredients produced
25 by milk in Class IV and ingredients or products produced by

1 milk in Class II, or unorderly substitution would result.

2 And although I may still disagree with the size of
3 the differential and the classification of some of the
4 products, I am convinced that the final rule for the most
5 part has prevented the unorderly marketing of milk caused by
6 substituting Class IV fat and nonfat products in place of
7 Class II milk products.

8 I know this because several of my customers have
9 formula pricing requirements to test this relationship
10 monthly. Since January 1, 2000, under the current federal
11 rule we have always been able to use Class II milk instead
12 of Class IV ingredients to make these products.

13 In turn, this has allowed us to make a larger
14 long-term commitment for milk which could not have been done
15 in the past when we did not know from month to month whether
16 our products would be made out of Class II or Class IV
17 components.

18 I also know the consequences of substitution of
19 alternative ingredients in place of Class II milk. In the
20 mid 1990s, when the discrepancy between the old Class III-A
21 milk and Class II was often over \$1.90 a hundredweight, we
22 lost one-third of our sweetened condensed milk volume when
23 one of my largest customers dropped my product and replaced
24 it with lower value Class III-A components.

25 I know through competitive intelligence that

1 several of our ice cream competitors have used butter, and
2 to a greater extent, anhydrous milk fat to replace some of
3 their cream when butter prices were rising weekly during the
4 core of the season in 1997 and 1998.

5 I also know that the lure of unregulated areas for
6 the production of sweetened condensed milk is not as great
7 now, that the Class II price has some logical connection
8 with both the nonfat dry milk and butter prices. I know
9 this because in the late 1990s we investigated that very
10 option.

11 Finally, I know that the use of California-
12 produced milk and components are not as economically
13 advantaged versus Class II as in the past because the
14 formulas are now much closer in design.

15 Therefore, Galloway Company would be content with
16 the status quo as far as it relates to Class IV make cost
17 and yields.

18 It is also important to point out that we compete
19 with Class IV for milk in the manufacture of Class II items.
20 Specifically, we must be concerned about the price of Class
21 II milk compared with butter and related Class IV items like
22 anhydrous milk fat or concentrated milk fat, and nonfat dry
23 milk.

24 The proposals in this hearing that would take six
25 cents off the fat price for Class IV only would destroy this

1 most essential relationship that the USDA has in the current
2 final rule found so compelling.

3 Class II manufacturers must have the same ability
4 to compete for fat as Class IV manufacturers. Already the
5 Class II users pay more for their fat due to their
6 seasonable and therefore less reliable nature than the
7 butter manufacturers, and that increase is caused by a
8 higher -- is the result of a higher multiple.

9 To increase the price discrepancy further
10 encourages Class II manufacturers to return to substituting
11 the lower valued fat products, as stated earlier, therefore
12 returning less money into the pool.

13 While we support a six-cent subtraction from the
14 Grade AA butter price to bring the pricing back to
15 historical relationship, we know that equity demands that
16 the change be made for all classes of milk in order to avoid
17 the problems noted above.

18 Similarly, the make allowance or the yield divisor
19 for nonfat dry milk should not be decreased as that would
20 raise the Class IV skim price without changing the price of
21 nonfat dry milk. If the Class IV skim price was increased,
22 the relationship between Class IV skim and Class II skim
23 would not change. However, the difference between Class II
24 skim and nonfat dry milk prices would increase, causing the
25 substitution of lower valued products for the higher valued

1 Class II milk.

2 Indeed, if any increase in Class IV skim were
3 approved, there would have to be a corresponding decrease in
4 the current 70-cent differential between Class II skim and
5 Class IV skim to keep Class II skim aligned with nonfat dry
6 milk, as the USDA stated was important in the current rule.

7 For a small firm, Galloway Company has a unique
8 perspective on this issue as we make both finished products,
9 ice cream mix, and ingredients, sweetened condensed milk
10 that are both in Class II. Therefore, we know that we can
11 be substituted for on the ingredient side and substitute
12 ourselves on the finished product side. The bottom line is
13 that the customer will make the final decision based on the
14 cost of goods.

15 If the dairy industry tries to change regulating a
16 minimum price for milk into creating a maximum regulated
17 price, there will be a rush to substitute better value
18 alternative dairy and nondairy components. I know this
19 because as a manufacturer of ingredients I have been already
20 asked to that, and as a finished product manufacturer I may
21 be forced to do it to stay competitive.

22 I urge the USDA to make the change in butter
23 pricing for all classes and to let the current class for
24 skim factors remain the same for a longer time in order for
25 the industry to work on ways to increase their sales instead

1 of being forced to try to find ways around them.

2 Thank you for allowing me to testify.

3 MR. ROSENBAUM: At this point Mr. Galloway is
4 available for cross-examination.

5 JUDGE HUNT: Yes, Mr. Beshore.

6 CROSS-EXAMINATION

7 BY MR. BESHORE:

8 Q Good morning, Mr. Galloway.

9 A Good morning.

10 Q Just a couple of questions on -- I just want to
11 make sure we know the analysis that a Class II user such as
12 you would go through in determining whether to substitute
13 products that had been made from Class IV for fresh Class II
14 ingredients.

15 Let's talk about fat --

16 A Mm-hmm.

17 Q -- because that's one of the issues in the hearing
18 is whether the price of Class IV butterfat should be
19 reduced.

20 Now, when you're evaluating whether to use butter
21 in some of your products or any of your products, is it
22 correct that you look at the price for the butter, the
23 finished product versus the price for the butterfat
24 ingredients, the fresh alternatives? That how you have to
25 cost it out?

1 A Well, it actually could be done both ways because
2 theoretically we could buy the milk and place it with a
3 manufacturer of the butter so that they could -- so it would
4 be the Class IV product. They could do the separating. Or
5 we could buy the end product from them. It could go either
6 way.

7 In other words, we are not necessarily looking
8 just for the price of the butter of the anhydrous or the
9 CMF. It may be that we are looking to procure milk for a
10 manufacturer so the ability to buy would be at the lower
11 classification.

12 Q Okay. Well, how would that work?

13 If you -- if you procure -- if you buy milk at the
14 lower -- if you have a buttermaker buy the fresh milk for
15 you, and then reship it to you, you're figuring you can get
16 it at the Class IV price?

17 A Well, if he manufactures a Class IV product, it
18 would come into us at a Class IV price, right.

19 Q Oh, you're talking about having someone custom --

20 A Yeah, we could.

21 Q -- custom make the butter for you?

22 A Sure. Sure, and so --

23 Q Okay.

24 A -- instead we buy milk at Class II, we could buy
25 milk at Class IV if it goes into that handler.

1 Q Okay. So if you bought the milk at Class IV, and
2 they made the butter for you --

3 A Mm-hmm.

4 Q -- you would have to pay them a processing charge?

5 A Sure.

6 Q Okay.

7 A Sure.

8 Q Roughly equivalent presumably to the make
9 allowance per pound.

10 A One could assume that.

11 Q Okay. So then if that -- for that to be
12 economical for you, okay, as a substitution, the cost of the
13 Class IV ingredients, plus the make allowance would have to
14 be less than the cost of your fresh Class II ingredients?

15 A That's right.

16 Q Okay. Same thing would apply for skim solids for
17 that matter?

18 A Mm-hmm.

19 Q Okay.

20 MR. BESHORE: That's all I have. Thank you.

21 THE WITNESS: Great.

22 JUDGE HUNT: Mr. Vetne.

23 BY MR. VETNE:

24 Q Good morning, Mr. Galloway.

25 A Good morning, Mr. Vetne.

1 Q I represent Kraft in this proceeding, and I just
2 have a couple of questions. Well, I'm not saying two. A
3 couple in the more generic sense.

4 You and a prior witness have both used the term
5 "concentrated milk fat" as well as "anhydrous milk fat". I
6 understand that anhydrous milk fat is fat with more moisture
7 removed than butter, but I don't know what concentrated milk
8 fat is. What is it?

9 A Well, concentrated milk fat is merely a similar
10 animal to butter except it doesn't have the diacetyl favor
11 and it doesn't have the salt. So in every other shape, it
12 is like butter. It's 80 - 82 percent solids. It is a solid
13 block form. It's a storable refrigerated or frozen product,
14 but it has a particularly better application in an ice cream
15 mix, for instance, because without the flavoring and without
16 the salt it is much better for reconstituting into cream
17 than butter is. It's actually, in our opinion, a preferred
18 product if one is going to substitute, but the challenge is
19 that it is not one that is as readily sold on the open
20 market, so one better be able to use up your supply because
21 you can't necessarily resell it to other manufacturers.

22 Q Okay. Is it -- if you know, is it a product for
23 which if you called up a butter powder plant and said
24 convert your fat to this product, you called in advance and
25 made a commitment to purchase, you would be able to buy on a

1 regular basis? Do you know?

2 A I know that it is available and I would suspect
3 that any butter manufacturer could manufacture it because it
4 is just not having the salt and the flavoring and the
5 coloring. There is also coloring in some butter.

6 Q So some of the steps involved in making butter --

7 A It's identical except the addition of some added
8 ingredients, so I don't know why a butter manufacturer could
9 not do it, but at the same time I can't state with certainty
10 that anyone could.

11 Anhydrous obviously is a different process and
12 there aren't as many people who do it but it's available
13 from a number of proprietary and some cooperative firms in
14 this country.

15 Q Okay.

16 A As well as being able to be imported.

17 Q Would you agree with me that it would be
18 reasonable to assume that because concentrated milk fat does
19 not involve quite all of the steps of making butter and does
20 not involve quite all of the ingredients in making butter,
21 that the manufacturer's cost to produce the product that you
22 might purchase might be a tad less?

23 A One would like to think but it's not going to show
24 up in the price because the addition of a little salt or a
25 little coloring or a little diacid, I mean, those are less

1 than percent type ingredients, and I don't think it would
2 really change the cost of manufacture significantly.

3 Q Okay. Do you have familiarity with sources of
4 anhydrous milk fat?

5 A Yes.

6 Q Okay. If I wanted to buy some, where would I
7 look?

8 A I don't know if it's -- there are -- put it this
9 way. There are several major manufacturers in anhydrous
10 that are well known to the dairy supply. You could call up
11 almost any dairy broker in the country and they could
12 immediately rattle off the name of four or five proprietary
13 firms and at least one co-op that have the manufacturer
14 anhydrous. I don't know if it's appropriate in this setting
15 to name names.

16 Q Okay.

17 A But it's common knowledge.

18 Q When you buy, you really don't care where it's
19 produced? Al you care that it's delivered to your dock, is
20 that correct?

21 A Well, you do care. For instance, my own firm
22 would not use anhydrous because of some of the flavor
23 profiles you get. But that's just for our products. For
24 other products, it's a fantastic ingredient for those
25 people.

1 Q I'm sorry. That wasn't quite my question.

2 A Okay.

3 Q If you were going to use anhydrous --

4 A Mm-hmm.

5 Q -- you wouldn't care whether it's made by
6 manufacturer A or manufacturer B; you're looking for the
7 price for anhydrous if you're going to use it at your plant?

8 A No, there are quality considerations, flavor.

9 Q Right.

10 A Making sure the packaging, delivery requirements,
11 things like that. All things being equal it is a price
12 issue.

13 Q Okay. And you could -- you would translate those
14 specifications to the broker --

15 A Yes.

16 Q -- or person that you were dealing with?

17 A Mm-hmm.

18 Q Are you aware that a significant portion of
19 anhydrous that is marketed in this country is an imported
20 product?

21 A I know of people -- I know of the use of imported
22 anhydrous milk fat in this country. I do not know if it's
23 significant relative to the domestic manufacture or not. I
24 just know that there is use of imported anhydrous in this
25 country.

1 MR. VETNE: That's all I have. Thank you.

2 JUDGE HUNT: Any other questions for Mr. Galloway?

3 Yes, Ms. Warlick.

4 BY MS. BRENNER:

5 Q Good morning, Mr. Galloway.

6 A Good morning.

7 Q You mentioned a flavoring that goes into butter
8 but not in concentrated milk fat?

9 A Right.

10 Q Could you spell that to clarify it or say it more
11 slowly?

12 A I hope I get this right because I am not a -- I am
13 not even close a dairy chemist, but I believe it's diacitel
14 flavor, and maybe there is someone else in the room how
15 later can confirm that, but it's a flavoring that's added to
16 give butter its distinctive taste.

17 MS. BRENNER: Thank you.

18 THE WITNESS: And again, I'm not a dairy chemist,
19 but that's what I believe is one of the components of it.

20 JUDGE HUNT: All right, thank you very much, Mr.
21 Galloway.

22 THE WITNESS: Thank you.

23 (Witness excused.)

24 JUDGE HUNT: And now we have Mr. Gran and Dr.
25 Cropp. If you want to grab a chair to bring up here.

1 MR. ETKA: Your Honor?

2 JUDGE HUNT: Yes, sir.

3 MR. ETKA: I am Steve Etko, E-T-K-A, with the
4 Midwest Dairy Coalition.

5 Mr. Gran is providing testimony today, the
6 majority of which is in support of Proposal No. 30, and Dr.
7 Cropp is also being offered as a technical witness, and
8 we're asking permission for them both to sit jointly to
9 expedite the question and answer process, if that's okay.

10 JUDGE HUNT: Sure, that's alright. As long as
11 they speak separately.

12 Whereupon,

13 GARY GRAN

14 ROBERT CROPP

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

17 JUDGE HUNT: When you speak, the first time you
18 speak, would you state your name and spell your name,
19 please, so we have it correct for the record.

20 THE WITNESS: (Gran) I am Gary Gran. Gary, G-A-
21 R-Y, Gran, G-R-A-N. No D or T. I'm the assistant general
22 manger of Family Dairies USA. Family Dairies USA, with
23 6,100 members in nine states is the third largest dairy
24 cooperative in membership according to the latest annual
25 survey published in Ords Dairyman.

1 Here is to support me as a technical expert is Dr.
2 Robert Cropp, dairy marketing and policy specialist,
3 University of Wisconsin, Madison, Wisconsin. If there are
4 questions regarding my testimony, I am call on Dr. Cropp to
5 assist me in responding.

6 I appear here today in two separate capacities.
7 First, let me state that Family Dairies USA supports
8 proposals to lower manufacturing allowances, much close to
9 the current levels in the Price Support Program or the USDA
10 RBCS survey, whichever is lower.

11 As a grass roots producer organization, we believe
12 that the new make allowances implemented January 1 are too
13 high and unfairly favor dairy processors at the expense of
14 dairy producers, particularly under current marketing
15 conditions. Rather than raise the federal make allowance to
16 better compete with California state order, we believe
17 California should be brought into the Federal Order System
18 and have its make allowance brought into confirmation with
19 the price support make allowance.

20 Family Dairies USA's support for economically
21 justified make allowances is consistent with the broader
22 goals of simplicity and equity that we pursued during the
23 recent federal order reform process.

24 We recognize and appreciate the role of dairy
25 manufacturers in a healthy dairy industry. However, our

1 members feel it is unfair and inequitable to provide dairy
2 processors with a guaranteed cost of production in the form
3 of high make allowances at a time of divest prices when
4 producers themselves receive no guaranteed cost of
5 production.

6 The rest of my testimony is presented jointly on
7 behalf of Family Dairies USA and the Midwest Dairy
8 Coalition, subsequently referred to as the Coalition.

9 The Coalition represents 14 dairy and farm
10 organizations and state departments of agriculture with
11 about 31,000 dairy farmers represented.

12 Family Dairies USA and the Coalition submitted the
13 proposal referenced as Proposal No. 30 in the hearing notice
14 out of a concern that this hearing procedure not be used to
15 further decouple Class I prices from Class III and Class IV
16 pricing formulas or artificially inflate Class I prices. We
17 argued strongly in the process of developing the final rule
18 that we needed to maintain a direct and close relationship
19 between the Class III and IV pricing formulas, and the Class
20 I mover, and opposed efforts to decouple.

21 Our objective in this hearing is to demonstrate
22 the effect of Class III and IV formulas on Class I and the
23 related issue concerning the distribution of the benefits to
24 producers of Class I pricing.

25 We have now observed the performance of the final

1 rule for five months and have found some disturbing and
2 unanticipated consequences of the new formulas. We are
3 especially concerned with their effect on the Class I mover
4 and therefore the Class I prices in federal orders
5 throughout the system.

6 First, the new pricing system allows for the
7 pricing of milk used for food purposes, approximately 40
8 percent of the federal order milk supply, to be driven by a
9 small proportion, approximately 10 percent of the production
10 under federal orders.

11 The advance Class IV formula price has averaged
12 \$1.26.4 per hundredweight above Class III for the period
13 January through May 2000. Under the final rule, the
14 advanced Class IV prices are used as the Class I mover when
15 they exceed advance Class III prices. Thus, the effect has
16 been to encourage the production of milk for fluid purposes
17 which is inconsistent when market conditions overwhelmingly
18 indicate the opposite should be occurring.

19 Tables 1 and 2 at the back of my testimony there
20 show that national supply and demand conditions for milk and
21 cheese overwhelmingly point to oversupply and lower price
22 levels. Currently, for the first time since 1991, there are
23 weekly sales of cheese to the Commodity Credit Corporation.
24 The nonfat dry milk has been at the support price for nearly
25 a year. Only the butter price is above the support price.

1 However, butter only comprises about 30 percent of the Class
2 IV value.

3 To clear the market in the most effective way,
4 dairy farmers need to receive consistent market signals
5 throughout all aspects of federal order pricing. The
6 current formula mechanism for the Class I mover is sending
7 supply and demand signals that are inconsistent with those
8 necessary to clear the market.

9 These quote/unquote RAM market signals are
10 especially apparent in markets with higher Class I
11 differentials and higher class I utilization. The effect is
12 to overly inflate prices for fluid milk, Class I, and
13 through pooling and fight the federal order price in
14 proportion in proportion to the Class I use in each market.

15 Fluid-oriented markets are receiving increased
16 prices relative to cheese manufacturing areas. Federal
17 orders are thereby frustrating, not facilitating, the
18 functioning of the market. Prior to the final rule's
19 implementation the BFP and Class I prices moved together.

20 The BFP representing dairy product production from
21 nearly 50 percent of the milk supply was used to determine
22 the prices for fluid milk. Using Class IV as the mover,
23 representing only 10 percent of the milk, gives a
24 dramatically different result, which is in direct conflict
25 with overwhelming market pressure in the opposite direction.

1 Second, the skim portion of the Class I mover is
2 being driven much more routinely by Class IV prices than by
3 Class III. Both historically and normally Class III prices
4 are higher than Class IV due to the normally higher use
5 values of cheese relative to butter and nonfat dry milk.

6 Table 3 shows the monthly pattern of final rule
7 Class IV and Class III formulas using simulated data for
8 1999 and actual for 2000. This exhibits demonstrates the
9 advance Class IV price is dominating the mover and leading
10 to production signals inconsistent with the market.

11 In the rulemaking process there was an expectation
12 that from time to time Class IV prices might exceed Class
13 III prices for short periods and by small amounts, but no
14 one predicted or expected the level of differences we are
15 observing.

16 USDA's impact analysis, the fat preconensus
17 forecast and several other public and industry forecasts did
18 not predict or expect this phenomenon to occur at that
19 extent that it has. It is difficult to predict how the
20 Class III and IV relationships will vary long term, but we
21 now know that dramatic changes can incur in prices and that
22 relationships among the various class prices can result in
23 prices inconsistent with market conditions. This result
24 worsens the inequities among dairy farmers regarding the
25 distribution of Class I benefit.

1 Third, historically the MW price series was
2 weighted by the sample dairy plants in the Minnesota and
3 Wisconsin survey. Since June 1, 1995, until the final rule
4 became effective, the BFP was updated from the base month
5 Minnesota and Wisconsin survey pay prices with a weighting
6 factor based on cheese and butter and nonfat production.

7 The final rule formulas do not contain such a
8 weighting. Hence, we see inflated Class IV driving Class I
9 and Class II and related blend prices that levers higher
10 than the market would justify for the majority of use of
11 milk nationally, which would be cheese.

12 Family Dairies USA and the Coalition believe the
13 Department is bound by Section 608(c)(3) to establish all
14 prices in a manner consistent with supply and demand
15 factors. This is clearly not the case currently, nor can it
16 be decisively concluded that the current situation won't
17 occur again.

18 Disorderly marketing is occurring as blend price
19 differences between high versus low utilization markets are
20 increasing due to the effect that Class IV conditions are
21 having on Class I prices. This is creating inequities in
22 blend prices among market and causing unusual pooling
23 arrangements.

24 Proposal 30 should be based on the following
25 mechanism to correct the advanced Class III and IV formula

1 problems.

2 Each month during the calendar year the Class I
3 mover shall be based on the weighted average of the advanced
4 Class IV formula prices. The advanced Class III weight
5 shall be based on the percent of the nation's manufactured
6 milk supply used for cheese in the previous calendar year as
7 recorded by NASS. The advanced Class IV weight shall be
8 based on the percent of the nation's manufactured milk
9 supply used for butter and nonfat dry milk based on nonfat
10 dry milk production as recorded by NASS and using 8.07
11 pounds of milk equivalent conversion factor for the previous
12 calendar year. For 2000, the weights would be 82.5 percent
13 for Class III and 17.5 percent for Class IV.

14 This proposal restores the consistency between all
15 class prices in responding to supply and demand conditions.
16 It uses a weighting factor for Class III and Class IV in the
17 class mover, Class I mover, excuse me, formula to accomplish
18 this consistently. The weights are based on national milk
19 equivalent utilization of manufactured dairy products.
20 Table 4 shows these weights.

21 The Coalition has simulated the changes in Class I
22 mover for 1999 and to date for 2000. The resulting
23 comparisons between the movers are shown on Table 5.

24 This concludes my testimony. Thank you for the
25 opportunity to testify, and I'd like to request that my

1 statement and the attached tables be marked as one exhibit
2 and admitted into the record.

3 JUDGE HUNT: We will mark your testimony and
4 accompanying exhibits as proposed Exhibit 42.

5 (The document referred to was
6 marked for identification as
7 Exhibit No. 42.)

8 MR. ETKA: Your Honor, the witness is available
9 for cross-examination.

10 JUDGE HUNT: Mr. Rosenbaum.

11 CROSS-EXAMINATION

12 BY MR. ROSENBAUM:

13 Q Good morning, Mr. Gran. I have a couple questions
14 to focus on page 1 of your testimony, if I could.

15 As I understand it, you are appearing in two
16 roles, on behalf of the Fairy -- Family Dairies USA, excuse
17 me, and on behalf of the Midwest Dairy Coalition, correct?

18 A (Gran) That is correct.

19 Q Now, your testimony begins by a statement
20 regarding the proposals to lower manufacturing allowances,
21 correct?

22 A (Gran) Correct.

23 Q By the way you set that up, am I correct in
24 understanding that the portion of your testimony which
25 supports low rate manufacturing allowance is only being

1 given on behalf of Family Dairies USA and it's not being
2 given on behalf of the Midwest Dairy Coalition?

3 A (Gran) That is correct.

4 Q Am I correct that the Midwest Dairy Coalition has
5 no formal position on that issue?

6 A (Gran) That's correct.

7 Q And with respect to Family Dairies USA, my
8 assumption would be that those members too have substantial
9 concerns about competition from California.

10 A (Gran) Of course they do.

11 Q I would expect that those are the people who
12 perhaps have suffered as much of the brunt or perhaps most
13 of the brunt of the shift of cheese and other production to
14 California over the last few years, correct?

15 A (Gran) Right. The Midwest is predominantly a
16 manufacturing milk region, as is California now.

17 Q And you've suffered relative to California in
18 terms of where the cheese production has grown over the last
19 few years?

20 A (Gran) That is correct.

21 Q And so you would -- the Family Dairies USA would
22 have a substantial concern, I take it, manufacturing
23 allowances were lowered in the Federal Order System in a
24 manner that adversely affected competitive relationships
25 with California, correct?

1 A (Gran) That's correct.

2 Q And that's why you talk about your view that you
3 think California should be brought into the federal system,
4 correct?

5 A (Gran) That is correct. That's a longstanding
6 position of our members.

7 Q I assume you recognize there is no specific
8 proposal before us today to do that?

9 A (Gran) Exactly.

10 MR. ROSENBAUM: Okay, thank you.

11 JUDGE HUNT: Mr. Beshore.

12 MR. BESHORE: Your Honor, I would like to just
13 note, without belaboring the point on the record, our
14 objection to the testimony, to the extent that it addresses
15 changes in Class I prices, which we believe is properly
16 beyond the scope of this hearing; and secondly, that the
17 testimony articulates a proposal that clearly -- with
18 respect to changing the mover for Class I, prices which
19 clearly is not in the hearing record, and there was some
20 testimony disallowed yesterday for similar reasons.

21 I don't want to belabor the point. I just want it
22 noted here and I didn't want to interrupt Mr. Gran's
23 testimony.

24 JUDGE HUNT: Your comments are noted for the
25 record then about that.

1 MR. BESHORE: Thank you.

2 BY MR. BESHORE:

3 Q Now, I just have one question, Mr. Gran, or maybe
4 this is for Dr. Cropp.

5 Table 5, which I understand to be a graph of the
6 present Class I mover, as it were, and the suggested Class I
7 mover on a weighted basis.

8 Could you tell us, just take the last three months
9 on the graph, which would be March, April and May of 2000,
10 the dollar per hundredweight figures that are represented on
11 the graph by the indicated points?

12 A (Cropp) Yes, I can. I think March was \$1.06;
13 April, \$1.16; and May, \$1.69.

14 Q Difference?

15 A (Cropp.) Yeah.

16 Q Difference between the two?

17 A (Cropp) Right.

18 Q Okay, so that for those under your proposal,
19 Midwest Dairy Coalition proposal, Class I prices nationally
20 in the Federal Order System would have been reduced by those
21 amounts per hundredweight?

22 A (Cropp.) That's correct.

23 MR. BESHORE: Okay, thank you.

24 JUDGE HUNT: Mr. Yale. Mr. Yale, Mr. Gran would
25 like to respond to Mr. Beshore's objections, so if you would

1 wait a moment --

2 MR. YALE: Oh, sure.

3 JUDGE HUNT: while he --

4 MR. YALE: That would be fine.

5 THE WITNESS: (Gran) I'm not an attorney but for
6 the last two days we have sat here and listened to
7 processors explain the arrangement and the change in butter
8 prices, how they impacted Class I processors and costs or
9 costs of profits that were unrecoverable in the marketplace,
10 and asked that those remedies be corrected.

11 The hearing notice does reference Class III and IV
12 prices relative to Class I, and our testimony, we feel, is a
13 clarification of our statement that we made that was
14 referenced as No. 30.

15 Not only do processors have an interest in Class
16 II and Class IV formulas as to how they affect Class I,
17 producers also have an interest in Class III and IV formulas
18 and how the mechanics is constructed to impact their Class I
19 prices.

20 JUDGE HUNT: All right, Mr. Yale.

21 BY MR. YALE:

22 Q That was a great segue to my next question or my
23 question was going to be, and that is, you have also sat
24 here through several days and heard people talk about cost
25 to manufacture products, right?

1 A (Gran) Right.

2 Q And you've heard people talk about drying costs,
3 right?

4 A (Gran) Right.

5 Q And BODs?

6 A (Gran) Right.

7 Q Investment costs, right?

8 A (Gran) Right.

9 Q Have you heard any testimony here that described
10 the costs for producers to produce the milk?

11 A (Gran) Yes, I believe I have. I heard you
12 question yesterday the fellow from Clanbia to that effect,
13 yes.

14 Q But you normally -- but there really isn't, you
15 have not heard the kind of testimony that talks about the
16 cost of cattle?

17 A (Gran) No.

18 Q Cost of feed?

19 A (Gran) Yes, I have heard talk of the cost of feed
20 here.

21 Q Okay.

22 A (Gran) Or the value of feed should be included or
23 should not be included, yes.

24 Q In your area, you're a dairy farmer yourself,
25 right?

1 A (Gran) For 19 years, I was. For four and a half
2 years, I have been working for Family Dairies.

3 Q But you still stay very much in contact with the
4 rural economy, right?

5 A (Gran) That's right.

6 Q All right. What's the cost of a good heifer
7 running today in Wisconsin?

8 A (Gran) In Wisconsin?

9 Q Yes.

10 A (Gran) Eleven to fourteen hundred dollars.

11 Q All right. And if we say we've got a national
12 herd of about 8 million cows, then it's fair to say that
13 we've got almost \$10 billion dairy farmers have got invested
14 in cattle, don't they?

15 A (Gran) Assuming that all cattle are relatively
16 the same price as Wisconsin's, yes.

17 Q Right. Well, they may not be as good as
18 Wisconsin's because a lot of them go up there to get them.

19 A (Gran) Some may be better.

20 Q Right. Some may be better.

21 But it's not unreasonable to take -- that price
22 may be fairly consistent or close across the country, right?

23 A (Gran) I agree.

24 Q And in addition to the cattle, what else does a
25 dairy farmer have invested?

1 A (Gran) Land, facilities, he either has to grow
2 his own or hire his labor, his investments in crop
3 production equipment. In the Midwest normally we grow our
4 own feed.

5 Q Milking facilities?

6 A (Gran) Milking facilities, feed storage
7 facilities.

8 Q Manure handling?

9 A (Gran) Yes.

10 Q All those things, right?

11 A (Gran) All of those things.

12 Q And how do those farmers pay for that?

13 A (Gran) They pay for that out of a margin that
14 they have left from the sale of whatever they sell which in
15 a dairy farmer's case is probably mostly milk.

16 Q Right. And that's why you are here today, because
17 you are concerned about the amount of money that your
18 members are receiving for milk; isn't that correct?

19 A (Gran) And additionally, we are concerned about
20 how much our members receive for milk relative to other
21 regions of the country.

22 Q I understand that but --

23 A (Gran) Yes. Yes.

24 Q -- the overall concern is is that you need to make
25 sure that the dairy farmer in these proceedings, in

1 particular, your dairy farmers that you represent receive
2 enough income to maintain their investment in this program
3 as well; is that right?

4 A (Gran) That's right.

5 Q I've got a technical question of Dr. Gran -- Dr.
6 Cropp. I just have promoted you.

7 A (Gran) I have been esteemed as --

8 Q You have been esteemed.

9 (Laughter.)

10 Well, the company that you keep already esteems
11 you. I think it's just that now we have given you the
12 appellation.

13 Dr. Cropp, isn't it also a situation, aside from
14 this issue of the Class I differentials, which I want to
15 address here in a minute, but simply putting the -- well,
16 let's talk about the Class I differentials.

17 Hasn't it been your presentations and
18 representations over the years that one of the concerns that
19 the upper Midwest has with the Class I differentials is is
20 that money is, it's blended to all producers, in effect,
21 helps subsidize the production of cheese in other parts of
22 the country?

23 MR. COOPER: I'm going to object to getting into
24 Class I differentials. That's something that is clearly not
25 noticed for hearing here. We may be considering the effect

1 of changing the butterfat price and the Class I price or
2 something like that. But when we are starting into the
3 differentials, we are down a path that is clearly outside
4 the scope of this hearing.

5 MR. YALE: Your Honor, I'm not going down -- I
6 just wanted -- not talking about fighting the
7 differentials. I want to get to a point that deals with the
8 cost that the plants that produce cheese get that goes to
9 this make allowance and all those other offsets. And I'm
10 sorry, we --

11 JUDGE HUNT: I'm going to overrule the objection
12 because it seems like broadly the effect on Class I from
13 increasing Class III and Class IV broadly within the
14 question you're asking.

15 MR. YALE: Okay.

16 BY MR. YALE:

17 Q But isn't that, Dr. Cropp, one of the concerns?

18 A (Cropp) Yeah, we get the full draw and it helps
19 on the manufacturing side.

20 Q Right.

21 A (Cropp) That's correct.

22 Q And that can go in two directions. That can go in
23 a situation where you increase Class I differentials, which
24 adds more money to allow for the subsidy, but it can also be
25 a situation if you reduce the contribution from the Class

1 III plants in that order, right?

2 A (Cropp) Right.

3 Q And in fact that's one of the situations in
4 California, isn't it, where they are allowing -- you know,
5 they reduce their manufacturing -- their costs for their
6 manufacturing milk and allowed money from the other classes
7 to keep the dairy farmers on a level keel; isn't that
8 correct?

9 A (Cropp) That's true. It depends on, of course,
10 what share of that producer's milk is Class I --

11 Q Okay.

12 A (Cropp) -- with the quota system.

13 Q Now, one of the important components in the Class
14 III product is a thing called other solids or dry whey,
15 isn't it?

16 A (Cropp) That's correct.

17 Q All right. And if a program or if the price for
18 that was substantially reduced, that would in fact reduce
19 the Class III price the plants pay for their milk, wouldn't
20 it?

21 A (Cropp) That's true. Right now it's running two
22 to five percent of that value, so it's a relatively small,
23 yeah.

24 Q You have done some studies to determine what the
25 impact, at least from an extrinsic standpoint looking in, to

1 see what the impact of that is even on the prices paid to
2 producers in the upper Midwest, haven't you?

3 A (Cropp) Yeah, about nine years ago we did a study
4 looking at trading the market agency and common for dry whey
5 and did some work on what that may do.

6 Q Right. And you also presented some testimony
7 before a hearing in the CDFA, California Department of Food
8 and Agriculture, on that issue several years ago, didn't
9 you?

10 A (Cropp) That is correct.

11 MR. YALE: Your Honor, may I approach?

12 JUDGE HUNT: Yes, certainly.

13 MR. YALE: In fact, I'd like to have marked -- we
14 already had it as part of one of our earlier exhibits, but
15 the Court has ruled that it's not included. We would like
16 to have this marked as a new exhibit. I don't have extra
17 copies. You all have it as part of the addendum that we
18 submitted earlier. We didn't want to kill any more trees.

19 JUDGE HUNT: Well, it will be marked as proposed
20 Exhibit 43.

21 (The document referred to was
22 marked for identification as
23 Exhibit No. 43.)

24 BY MR. YALE:

25 Q You have before you Exhibit 43?

1 A (Cropp) That's correct.

2 Q And have you seen this before?

3 A (Cropp) Yes.

4 Q All right. And that's a copy of your testimony,
5 right?

6 A (Cropp) That is correct.

7 Q All right. And based upon your knowledge even
8 today, is the statements you make in there still
9 fundamentally the same?

10 A (Cropp) I think the concepts are the same. I
11 would question probably the numbers the way things have
12 changed over --

13 Q Right, I understand that.

14 A (Cropp) -- but the concept is the same, yes.

15 Q The concept is the same?

16 A (Cropp) Yeah.

17 Q The importance of dry whey?

18 A (Cropp) That's right.

19 Q In the formulation?

20 A (Cropp) That's correct.

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

22 MR. OLSEN: Your Honor?

23 JUDGE HUNT: Yes, Mr. Olsen.

24 MR. OLSEN: I have questions for Dr. Cropp.

25 //

1 BY MR. OLSEN:

2 Q With respect to proposed Exhibit 43, you
3 mentioned, Dr. Cropp, that the concepts contained in here,
4 and if I misstate your testimony, please let me know, but
5 you're comfortable with the concepts but some of the numbers
6 may have changed over the course of time?

7 A (Cropp) Yeah. What I said concept is that that
8 testimony showed that there was a value on processing whey,
9 still is, and that the processing cost is higher for whey
10 than it is for nonfat dry milk. That's what I state and
11 it's still true, yes.

12 Q Okay. And with respect to the processing costs
13 being higher for whey powder than nonfat dry milk, that's
14 what you just said?

15 A (Cropp) That's correct.

16 Q Okay. And forgive me if you have expertise in
17 this area, are you an expert in whey processing or nonfat
18 dry milk production or costs?

19 A (Cropp) No. The testimony ride on others that
20 were -- I'm not an expert in the processing.

21 Q Okay, if an expert were to testify that the cost
22 differential for manufacturing whey powder as compared to
23 nonfat dry milk, if that were on the order of 2.559 cents
24 per pound, for example, you wouldn't disagree with that?

25 A (Cropp) I cannot disagree. No basis to disagree

1 with it.

2 MR. OLSEN: Okay. Thank you, Dr. Cropp.

3 MR. YALE: Your Honor.

4 JUDGE HUNT: Yes, Mr. Yale.

5 MR. YALE: We would move Exhibit No. 43 to be
6 admitted.

7 JUDGE HUNT: Any objections to 43?

8 (No response.)

9 JUDGE HUNT: No objection. Then 43 will be
10 received in evidence.

11 (The document referred to,
12 previously identified as
13 Exhibit No. 43, was received
14 in evidence.)

15 JUDGE HUNT: What about 42? Your 42, proposed
16 Exhibit 42, his testimony and -- oh, I'm sorry, Mr. Gran
17 moved it. You want to have that part of the record in the
18 case, Mr. Gran?

19 MR. ETKA: Yes, I think he did move that that be
20 made part.

21 JUDGE HUNT: Yes. Any objections to 42 being part
22 of -- testimony exhibits being part of the record?

23 (No response.)

24 JUDGE HUNT: No objections being heard.

25 I'm sorry. Mr. Cooper?

1 MR. COOPER: As indicated earlier, perhaps, and
2 perhaps here to a bit, part of 43 does seem to go more into
3 changing the Class I price formula than to just changing the
4 Class III -- 42, I'm sorry -- than to just changing the
5 Class III and Class IV movers.

6 For instance, the revised proposal says, "Each
7 month during the calendar year the Class I mover shall be
8 the weighted average of the advanced Class III and advanced
9 Class IV formula prices." which is not how it's done at the
10 moment.

11 And now with respect to changing the advanced
12 Class III or Class IV prices, that may be fine. But when we
13 are getting into going to the weighted average of the Class
14 III and Class IV, this is changing the Class I price in a
15 matter that was not noticed in this hearing and it's beyond
16 the scope of this hearing, in our opinion.

17 JUDGE HUNT: Anyone want to make a comment on it?
18 Mr. Rosenbaum?

19 MR. ROSENBAUM: Well, as I understand the
20 proposal, it's not -- he's not proposing to change the Class
21 I differentials, but he's addressing the movers, which are
22 Class III and Class IV, which is what is at issue in this
23 hearing. So it seems to me to be covered by the hearing
24 notice.

25 JUDGE HUNT: All right. Mr. Beshore?

1 MR. BESHORE: I agree with Mr. Cooper.

2 JUDGE HUNT: Okay.

3 MR. BESHORE: It's not part of the hearing notice
4 and it should not be -- should not be heard or considered.

5 JUDGE HUNT: Yes, sir?

6 MR. ETKA: Proposal No. 30 clearly, as summarized
7 by the hearing record, by the hearing notice, excuse me,
8 clearly dealt with the interrelationship between Class III
9 and IV and Class I.

10 The testimony that Mr. Gran provided as an
11 amplification and clarification of that summary proposal
12 also clearly deals with the interrelationship between Class
13 III and IV and Class I.

14 In addition, the hearing notice dealt extensively
15 about concerns about the interrelationship between Class III
16 and IV and Class I.

17 In light of that, I would argue that this is
18 clearly within the scope of this hearing and respectfully
19 request that it be allowed to be admitted into testimony
20 and --

21 JUDGE HUNT: That's alright. I'm going to rule on
22 the motion. I'm unlearned in marketing orders, but it seems
23 to me that it's not clearly outside the scope of the
24 hearing, so I'm going to allow it to remain, and I'll let
25 the secretary overrule me when they decided to rule.

1 So I'll admit Exhibit 42 into the record.

2 (The document referred to,
3 previously identified as
4 Exhibit No. 42, was received
5 in evidence.)

6 JUDGE HUNT: Any other questions of the gentlemen?

7 Yes, Mr. Vetne. Are you going to ask me to
8 consider my ruling?

9 (Laughter.)

10 BY MR. VETNE:

11 Q I think these questions -- I'm not sure, one of
12 you it should be better addressed to. Perhaps I could start
13 with Dr. Cropp.

14 If relative to California the conversion margin or
15 manufacturing allowance or make allowance, whatever term is
16 given it, is narrowed in the federal markets and remains
17 greater or more generous in California, would you expect
18 that production in California relative to the East would
19 continue to expand at a greater pace, Dr. Cropp?

20 A (Cropp) Yes.

21 Q In order to achieve the competitive equity between
22 the two markets, you would hope to achieve similar, if not
23 identical, conversion allowances from milk to cheese; is
24 that correct?

25 A (Cropp) That's correct.

1 Q And when cheese that is produced in a market where
2 the allowance is greater and the price is lower, would it be
3 correct to say that in the competing market, let's say,
4 Wisconsin, that the pressure is on those that do make cheese
5 to bid down the price they pay for raw milk to produce the
6 cheese in order to maintain market share?

7 A (Cropp) Well, that is not a -- you would think
8 that, but that's not occurring simply because the milk
9 supply in the Minnesota - Wisconsin area has not been
10 increasing whereas the growth in cheese has, and so there is
11 rigorous competition to obtain milk and operate on tighter
12 margins to grow with the cheese industry, so it's not
13 occurring. They are not bidding down the prices very
14 competitive, and I think the records show that they pay
15 above the class reprice.

16 Q Okay. And is there expanding cheese-producing
17 capacity in Wisconsin to the same --

18 A (Cropp) There has not been. It's been relatively
19 stable. There has been no major new investment in cheese
20 processing since the late 1980s, or mid 1980s. So
21 basically, other than some reinvestment and technology,
22 modernization basically, not expansion, to get capacity.

23 Q Okay. And would you agree with me that a
24 manufacturer, whether producing cheese for general use or
25 for sale, would have to look at allowances and the

1 availability of competing or cheaper finished product from
2 California before investing in --

3 A (Cropp) That is correct.

4 Q And secondly, you were asked some questions about
5 the pool draw and its availability to cheese plants. A
6 cheese plant operator or a cooperative operating cheese
7 plants, it doesn't matter which, but a cheese plant operator
8 who is in the pool does not have the option to keep in
9 pocket the pool draw if his manufacturing costs increase,
10 does he?

11 A (Cropp) That is correct. It would be paid out to
12 producers, yes.

13 Q The draw from the pool must by mandate of the
14 order simply pass through the bank account of the processor
15 and be paid in full to the producer, correct?

16 A (Cropp) That's correct.

17 Q It can't and it doesn't contribute to margin or
18 costs, correct?

19 A (Cropp) That's correct.

20 MR. VETNE: Thank you.

21 JUDGE HUNT: Anyone else?

22 Yes. Yes, sir.

23 MR. GRANDAGE: I'm Levern Grandage, and
24 representing Grassland Dairy, and I have a question for Dr.
25 Cropp or Mr. Gran.

1 BY MR. GRANDAGE:

2 Q Just to comment, in your testimony you have a
3 Class IV formula price of \$1.26 per hundredweight greater
4 than the Class III price, and you testified that this
5 imbalance or higher Class IV than Class III has been for the
6 last six or seven months.

7 And my question is for Dr. Cropp. Why -- is that
8 \$1.36 per hundredweight a significant dollar figure as far
9 as milk pricing goes? And why wouldn't that encourage a
10 higher than -- higher utilization in IV than what we are
11 seeing?

12 A (Cropp) Well, I think, the \$1.26 IV is average
13 from the year 2000 here, that is a higher mover on Class I
14 milk than would exist if we had to weight it or if we did
15 get more cheese as the larger dominant use of manufacturing
16 milk. So in those areas that have relatively high class
17 utilization is where the concern is, particularly like in
18 the Southeast where they get a substantially higher price
19 because of that, and it occurs at the time of the year when
20 actually milk is shipped down. I mean, there is plenty of
21 milk there.

22 And so why wouldn't more milk go into Class IV
23 when it's --

24 Q What I'm getting at is the Class IV is higher
25 because the component prices for Class IV are higher.

1 Doesn't that --

2 A (Cropp) Right.

3 Q Doesn't that represent demand for those products
4 that's unsatisfied?

5 A (Cropp) The Class IV is made up of nonfat dry
6 milk and butter. Nonfat dry milk has been at support, you
7 know, all year, and in fact, I think, if we look at the
8 records, there is about 87 percent more nonfat dry milk in
9 inventory this year than a year ago. So the Class IV price
10 is mainly that butter has stayed above support.

11 Q So in the pricing formulas the nonfat dry milk
12 portion of the Class IV price has been steady?

13 A (Cropp) That is correct.

14 Q And the increase in the Class IV price had been
15 directly related to the butter price?

16 A (Cropp) The butter price or cheese is at support
17 and makes a discrepancy between III and IV.

18 Q Okay. So my question would be with supply and
19 demand forces, wouldn't that dictate more product to butter
20 manufacturer?

21 A (Cropp) I think the numbers show that the --
22 actually production -- last numbers came out, the production
23 of butter is slightly down from a year ago. Nonfat dry milk
24 production is up about 10 percent mainly because the share
25 of butter being made from excess cream, but there is more

1 milk going into powder right now according to the last
2 production report.

3 Q And with the product prices remaining higher,
4 wouldn't that suggest that there is still demand on the
5 butterfat side for Class IV?

6 A (Cropp) On the butterfat side, it's above
7 support, yes. There is still a -- it's been bouncing around
8 but it's hanging in well above support price.

9 It's been a -- due to a major change in
10 utilization of milk fat due to the drop in the Price Support
11 Program way back in early 1990s down to 65 cents a pound.

12 Q So with the -- the pricing with cheese at support
13 which I think the cheese price is in the nine something
14 range per hundredweight for milk, and the butter powder
15 price being in the \$11.50 range, all of that difference is
16 based on the butter price, actually the price that butter is
17 traded?

18 A (Cropp) Apparently, if you look at the formulas,
19 the skim milk value when you plug in -- add support --
20 generates higher because the way the support price is set,
21 the purchase price of powder versus butter, and the other is
22 fat, good shares of fat, but also the --

23 Q So there is an inequity between these, on the
24 support price for powder versus cheese?

25 A (Cropp) Not necessarily. I mean -- no, I

1 wouldn't say that. It's --

2 Q It's strictly on the butter fat side?

3 (Simultaneous conversation.)

4 A (Cropp) -- butter and powder on -- butter and
5 powder purchase prices are --

6 Q So it's simply on the -- on the butterfat, on the
7 butter side of the calculation?

8 A (Cropp) Well, asking on the -- on the support
9 price for butter powder?

10 Yeah, the question maybe is power is supported
11 higher than it should be. That's a price support question
12 that talked about the tilts, if that's what you're asking.

13 Q No. I'm trying to get to the point that with a
14 higher butter price substantially with all other component
15 prices at support levels, it should encourage production of
16 better, and you just mentioned that in a period of time with
17 milk production at very high levels the butter production
18 actually was down. Stock levels are below a year ago levels
19 and prices are continuing to rise.

20 Shouldn't that stimulate supply and demand forces,
21 milk moving into butter production?

22 A (Cropp) Eventually you would expect some
23 adjustment there, that is correct.

24 Q Have we seen, I mean, are there any numbers,
25 current numbers that show that more milk is moving to

1 butter?

2 A (Cropp) No. The last report comes out actually
3 shows, as I said somewhat surprises me, showed that butter
4 production was down slightly from a year ago. Powder was up
5 but butter was down.

6 Q Speculation, what in the formulas do you feel is
7 there that is keeping supply and demand forces from allowing
8 milk to flow to where the market is saying its needed?

9 A (Cropp) Well, I suspect part of it is the fact
10 that the majority of the butter is made from excess cream
11 out of the fluid side rather than buy milk from the farm and
12 running the butter powder plant necessarily.

13 So evidently -- and the other factor is -- well, I
14 don't know. The reason I'm hesitating a little bit here I
15 have been struggling a little bit with the numbers on the
16 fat side to try to make it balance with the increased
17 production and everything else. The numbers show production
18 is down some, stocks are down a little bit, which means that
19 people are maybe buying this butter and put it into their
20 hands so they can move it later on because as we move into
21 the hot summer months we know there is not the opportunity
22 for this butter. And I think, look at '98, where butter
23 went very, very high. I think there is, you know, sometimes
24 speculation, trying to cover yourself in change it gets hot,
25 it's getting hot early, whatever it is that may drive it up.

1 So it may actually keep high --

2 Q During that time period --

3 A (Cropp) -- even though, you know.

4 Q So during that time period when the butter went
5 high, I think it went to \$2.81 a pound, did that increase
6 the flow to butter production?

7 A (Cropp) Not really, not in the short run there.
8 That was an entirely different situation. Milk production
9 was down. Cheese price was also high. And powder being
10 relatively cheap simply standardized higher solids, used
11 more of the fat in cheese, and so cheese was the dominant
12 use and actually really tightened up the cream supply and
13 also that occurred in the summertime when milk production is
14 down, butterfat test is down, and ice cream makers are
15 making ice cream, and sucked up the fat at that time. So
16 that was kind of a seasonal thing. It was not the
17 opportunity to increase butter. It started to occur later
18 on as we moved into November - December.

19 Q You mentioned that most of the butter is made from
20 excess cream.

21 A (Cropp) That's correct.

22 Q And so is it a fair statement to say relatively in
23 the last few months with butter production going down, stock
24 numbers going down, that the use of the milk fat in other
25 areas other than butter, even though the butter prices are

1 going higher, which are increasing those fat costs in other
2 area, continue to fill the fat away from the market that is
3 saying there is a demand there?

4 A (Cropp) That's correct. I guess, to make another
5 comment here, whichever part of the country that made butter
6 is making less butter today than they did five years ago.
7 And so part of the factor here is is the ability to increase
8 the butter production capacity.

9 I can't really answer that, but the fact is that
10 some of the buttermakers have moved over to cheese
11 production because of stronger demand. So to say -- I mean,
12 there is some flexibility. At our part of the country
13 there's not much flexibility since 90 percent of our milk is
14 already going into cheese. So there is a little
15 flexibility, I see a little bit of it in the West, but as I
16 said, the number is showing it on the powder side and the
17 numbers aren't showing the increased production on the
18 better side at the last report.

19 MR. GRANDAGE: Thank you. That's all I have.

20 JUDGE HUNT: Any other questions?

21 (No response.)

22 JUDGE HUNT: Thank you very much, gentlemen.

23 (Witnesses excused.)

24 JUDGE HUNT: Mr. Galarneau.

25 (Pause.)

1 Whereupon,

2 CLAYTON GALARNEAU

3 having been duly sworn, was called as a witness
4 and was examined and testified as follows:

5 JUDGE HUNT: And would you state and spell your
6 name, please, Mr. Galarneau.

7 THE WITNESS: My name is Clayton Galarneau with
8 Michigan Milk Producers Association. That's
9 G-A-L-A-R-N-E-A-U. I'm the director of manufactured
10 operations and sales for Michigan Milk Producers
11 Association.

12 MMPA is a member owned and operated dairy
13 cooperative, serving over 2,700 dairy farmers in Michigan,
14 Ohio, Indiana and Wisconsin.

15 I am here to support simplifying the presentation
16 of the Class III protein price formula. There are many
17 people in the dairy community that have a significant
18 interest in the protein price calculation. However, the
19 current formula presents the calculation of protein value in
20 a manner that is very difficult for most people to readily
21 understand.

22 By following a few simple mathematical steps the
23 current protein price formula can be reorganized into a much
24 simpler format and made consistent with the formulas used
25 for butterfat, nonfat solids and other solids. Each of the

1 other component calculations starts with a commodity price,
2 subtracts a make allowance, and divides by yield factor to
3 determine the component value.

4 We recommend using a similar format for the
5 calculation of protein value. By reorganizing the current
6 mathematical formula, the calculation can be presented as
7 follows:

8 Protein price equals (NASS G survey price minus
9 the make allowance of .1702) minus the butterfat price, as
10 calculated in the butter fat formula, times .3732 (the
11 percent butterfat in cheese) divided by the yield factor of
12 .2915.

13 This presentation makes it much easier to explain
14 that the protein value is determined by subtracting a make
15 allowance from the cheese price and then subtracting the
16 butterfat value in the cheese price (cheese being
17 approximately 37 percent butterfat) and then dividing the
18 remaining value associated with the protein by the yield
19 factor of .2915. (For each .2915 pounds of protein you get
20 approximately one pound of cheese.)

21 The attached exhibit, if I may be allowed to enter
22 as Exhibit 43 --

23 JUDGE HUNT: That will be marked 44.

24 THE WITNESS: Oh, 44.

25 //

1 (The document referred to was
2 marked for identification as
3 Exhibit No. 44.)

4 THE WITNESS: Details the mathematical steps taken
5 to reorganize the current protein formula into the proposed
6 format. This recommendation is presented strictly as a
7 means of presenting the protein value calculation in a
8 simpler and hopefully easier to explain format for the uses
9 of the dairy industry.

10 This proposal is not intended to endorse any of
11 the current make allowance or yield factors. If the
12 industry determines that it is necessary to modify the make
13 allowance or yield factors in the current formula, the
14 simplification steps outlined in Exhibit 44 and any
15 necessary modification should be used to present a protein
16 value formula similar to this proposal.

17 I ask that my exhibit be received into evidence
18 and I appreciate the opportunity to testify today.

19 JUDGE HUNT: Are you now ready for questions?

20 THE WITNESS: Yes.

21 JUDGE HUNT: Yes, Mr. Coughlin.

22 CROSS-EXAMINATION

23 BY MR. COUGHLIN:

24 Q Clay, just so you will know that I have looked at
25 your formulas and I agree it does come out with the same

1 price, but let me ask you a question with respect to the --
2 your testimony indicates that if the industry determines it
3 is necessary to modify the make allowances or yield factors
4 in the current formula, the simplification steps outlined in
5 Exhibit A, with any necessary modifications should be used.

6 Is Michigan Milk Producers supporting the
7 modifications proposed by National Milk Producers
8 Federation?

9 A Yes, we are.

10 MR. COUGHLIN: Thank you.

11 JUDGE HUNT: Anyone else have questions of Mr.
12 Galarneau?

13 And would you like Exhibit 44 a part of the record
14 in this proceeding?

15 THE WITNESS: Yes, we would, Your Honor.

16 JUDGE HUNT: Anyone object to Exhibit 44 being
17 made part of the record?

18 (No response.)

19 JUDGE HUNT: Hearing no objections Exhibit 44 will
20 be received in evidence.

21 THE WITNESS: Thank you.

22 (The document referred to,
23 previously identified as
24 Exhibit No. 44, was received
25 in evidence.)

1 JUDGE HUNT: Thank you very much, Mr. Galarneau.

2 (Witness excused.)

3 JUDGE HUNT: Mr. Wellington. Thanks for being
4 patient.

5 Whereupon,

6 ROBERT WELLINGTON

7 having been duly sworn, was called as a witness
8 and was examined and testified as follows:

9 JUDGE HUNT: State and spell your name please,
10 sir.

11 THE WITNESS: Okay. My name is Robert Wellington,
12 W-E-L-L-I-N-G-T-O-N. I am senior vice president for
13 economics, communications and legislative affairs for Agri-
14 Mark Dairy Cooperative. I have served in that capacity
15 since October of 1989. Prior to that, I worked for 11 years
16 at the Market Administrator's Office for the New York - New
17 Jersey, the former New York - New Jersey Market
18 Administrator back when they were located in New York City.

19 My co-op is a full service co-op. We have about
20 1500 members throughout the six New England states and New
21 York. We own three manufacturing plants. One is in
22 Middlebury, Vermont that makes just block cheddar; one is in
23 Cabet, Vermont that makes block cheddar but it also makes
24 other varieties of cheeses as well as Class II products such
25 as yogurt and cottage cheese; and then we have a plant that

1 makes butter and powder and condensed milk located in West
2 Springfield, Massachusetts that is a primary balancer for
3 the New England market and much of the Northeast also these
4 days.

5 I do not have a written statement only because I
6 was trying to limit my testimony. Instead of commenting on
7 all the proposals, I felt that I could just put in those
8 that differ from National Milk. In just about all the
9 proposals, except those that I will note, I have -- Agri-
10 Mark supports National Milk. I will note the particular
11 proposal that we do have a difference in.

12 Also, I wanted to be able to have the ability to
13 put some data in that I think would helpfully be useful for
14 the Department in terms of some of our cost and some of our
15 information.

16 Agri-Mark is somewhat unique in that if you were
17 to describe us, I would describe us as really sitting on a
18 three-legged milk stool.

19 The first leg is that we are owned and controlled
20 by our dairy farmers, who are members of Agri-Mark, and in
21 that capacity we seek to return the highest price to them.
22 That's really one of my functions is in terms of federal
23 orders, making sure we can get as high as possible, fair
24 price for them; also on issues such as compact, which I
25 don't really want to discuss, as well as forward contracting

1 of milk and cheese and those products. That's really one
2 leg of that stool.

3 The second leg is our members have chosen to
4 invest substantial amounts of money in value-added products.
5 We have recognized that consumers are getting a smaller and
6 smaller share of the consumer dollar, and we need to be able
7 to capture some more of that. So we have done that by
8 investing both in a wholly owned subsidiary of Agri-Mark,
9 which is called Cabot Cooperative Creamery. They sell
10 primarily cheddar cheese, although we have a number of other
11 Class II products. I noted yogurt, cottage cheese.

12 And they have -- right now we have moved into
13 national distribution and our sales have increased
14 dramatically in the last few years, but our members have had
15 to put a substantial amount of investment to do that and
16 then try to get a return on that investment.

17 We also have invested in selling butter in
18 consumer-sized packages out of our West Springfield
19 operation. In the past, we would just sell 68-pound block
20 prior to about six - seven years ago. So we are moving in
21 that direction also. About half our milk goes into our own
22 facilities.

23 The third leg on this stool is that other half of
24 our milk, which goes into our customers. We have to make
25 sure that we have customers for our milk, that we have

1 markets for our milk. As much as we work on raising the
2 price levels for our members, the only thing worse than low
3 price for their milk is no price for their milk if you have
4 to take that milk and ship it long distances.

5 For example, I noted that one witness was saying
6 that 10 cents a hundredweight is a lot to a dairy farmer. I
7 agree. But I believe that they also were noting that when
8 they didn't have enough facilities, it was costing several
9 dollars a hundredweight for that additional milk to be
10 shipped out. And so if 10 cents was worth a lot, I can
11 imagine what several dollars a hundredweight is worth to
12 them.

13 So we have to recognize the needs of our customers
14 also. It's a balancing act. You need all three legs of
15 this stool. If you take one out, you have a serious problem
16 in the marketplace. Really it's what's called disorderly
17 marketing if that occurs.

18 Now, I noted that we supported National Milk on
19 just about all their proposals. There is three areas I want
20 to talk about. The first will be the area in which we have
21 somewhat of a disagreement with National Milk, and it really
22 has to do with those make allowances. There are a number of
23 proposals dealing with those. The record will show those.
24 I don't need to repeat them.

25 But we have two cheese plants, and it's the cheese

1 make allowance that we have the most concerns about. We
2 have participated in the Rural Cooperative Business Survey
3 for as long as I've been with Agri-Mark, and longer than
4 that. I imagine, probably from the very beginning. And we
5 have done so for -- I have been responsible for that since I
6 came to Agri-Mark over 10 years ago.

7 The purpose of this survey, as it was explained to
8 me originally and as we have treated it for most of the
9 time, was not to calculate the total cost. It was to look
10 at the components of that cost, and that's really the way we
11 looked at it. That's why we weren't concerned about what
12 this included, was that included.

13 I can tell you that there were some questions about
14 when plant managers come in do they estimate high, do they
15 estimate low, you know, what are their interests?

16 I can tell you what their interests are. Their
17 interests are getting it off their desk, okay. They have a
18 lot -- I mean that's -- in all honesty that's really what it
19 is. When I came in 10 years ago, I got this survey from Dr.
20 Ling, and I've known Dr. Ling for a long time, and so I put
21 a lot of effort into it. Went to our plants, harassed our
22 plant managers saying we had to get this done, and they
23 finally got it done.

24 And then I -- you know, Charlie prepared his
25 report, Dr. Ling prepared his report and I prepared a report

1 for my organization, and it promptly got shoved to the side.
2 I mean, we talked a little bit about it. You know, we
3 looked at some cost structures and say, you know, we need to
4 look at our electricity costs. They are higher than the
5 national average. We need to look at the taxes we pay. We
6 can't do nothing about it but they are higher than the
7 national average in Vermont that we have to pay. But not a
8 whole lot was done with that.

9 And I continued to do that for a couple of years,
10 and eventually it was just -- it became a very side affair.
11 I mean, we got it back from -- we got the survey each year
12 from Dr. Ling, we moved it onto our plant people. I would
13 call them a half a dozen times and harass them for it. Dr.
14 Ling would call me half a dozen times and harass me for it.
15 And eventually we would get it to him. But to be honest
16 with you, there wasn't a tremendous amount of effort.

17 Now suddenly this survey is going to be used for
18 something that it wasn't really intended, and that's my
19 problem. I have nothing wrong with the way Dr. Ling has
20 calculated it for the intentions that it was geared to do,
21 and I think that we could develop a survey, either with Dr.
22 Ling, I understand that Cornell is looking at one.

23 We can properly look at the costs, and that's what
24 our goal is. Sitting on a three-legged stool, we need to
25 look at what the proper costs are. I'm concerned about

1 using vehicles that weren't meant for that. It's like
2 buying an electric car that was meant for, you know, just
3 local traffic, local commuting and suddenly you're taking it
4 across country and you run into problems with it and you
5 wonder why, and that's the problem we have with the survey.

6 We also decided to participate in the NCI survey
7 that Dr. Yonkers talked about, and we put together numbers
8 for that. Actually, our finance and marketing people put
9 together numbers for that, and they came to me and showed it
10 to me. And low and behold, they did not agree with the
11 numbers that we had originally submitted to Dr. Ling.

12 And so we had a meeting on that because I wasn't
13 going to come up here and testify on two different sets of
14 numbers for the same year, the same information. And so we
15 looked at why that was the case, and it was because our
16 plant manager at Middlebury had filled out Dr. Ling's report
17 and had basically not put a tremendous effort into it and
18 didn't include all the cost structures.

19 So we did a more detailed look at this for NCI and
20 came up with a different set of costs based upon their
21 criteria. At that time I submitted the new data to Dr.
22 Ling. I offered him the opportunity to immediately come to
23 our office and look through our records to verify these new
24 numbers. I know they are suspect whenever suddenly you
25 change them.

1 I also offered Dr. Ling the opportunity to come in
2 and talk with our operations staff, our finance people and
3 our senior staff, to talk about what needs to be done in the
4 survey to do a complete total cost. And in fact, Dr. Ling
5 said he would probably take me up on this in the next couple
6 of months, as well as probably visit others.

7 When we put the NCI numbers together, we came up
8 with a cheese manufacturing cost of -- our fiscal year 1997
9 of 19 cents, .190 dollars per pound. In 1998, it was 17.7
10 cents or .177 dollars per pound. In 1999, it was 18.5 cents
11 per pound or .185 cents per pound.

12 We just did that for Middlebury plant. We chose
13 not to do it for are Cabot plant because our Cabot plant
14 makes so many products. It makes about a quarter of the
15 volume of our Middlebury plant. Middlebury is solely
16 dedicated to 40-pound block of cheddar, and just about all
17 of it goes for aging, by the way, so we don't participate in
18 the NASS survey.

19 But our Cabot facility, our cheddar costs run at
20 least one to three cents higher, but I could tell you right
21 now I could make them be five or 10 cents higher because we
22 do all kinds of products there. It depends on how you
23 allocate your cost.

24 In Middlebury, it's a lot clearer when you're just
25 making one product. When you are making yogurt, cottage

1 cheese, Monterey Jack, cheddar, all kinds of flavored
2 varieties of cheeses, you know, you can do a lot of
3 allocation on that, and it's going to be important.
4 Whatever survey we come up with helps us do that allocation
5 consistently among everybody, and right now we don't really
6 have that, so I didn't want to do that for Cabot because I
7 didn't think it would be a fair number.

8 In terms of our butter cost, we didn't do a survey
9 like NCI. No one was doing that. Basically, we looked at
10 Dr. Ling's numbers, adjusted it for the marketing cost, the
11 return on investment, and our numbers were 11.9 cents for
12 butter.

13 Now, we also understand that Dr. Ling's study did
14 not include all the costs that were involved, the plant
15 manager, other costs. But just using that and using the same
16 criteria that Mr. Coughlin used for the National Milk, we
17 came up with 11.9. For nonfat dry milk using that same
18 criteria, we came up with 17.2 cents per pound.

19 Now, I'm not proposing that either of these costs
20 be used as the make allowance. We have some issue with
21 going to a make allowance under 10 cents given our cost
22 structure. I could tell you our manufacturing people would
23 prefer to leave it at 11.4.

24 But nonfat dry milk, clearly we could not go to a
25 make allowance of 17.2 cents because our 17.2 cents on

1 nonfat dry milk relates to the fact that our plant is a
2 balancer of milk, and it is operating at much less capacity
3 in the mid part of the week most of the year, and during
4 most of the week in the fall part of the year. That's why
5 our costs are over 17 cents, because of those factors.

6 We think that the National Milk proposal of 14
7 cents is nearer to where it probably should be. If we could
8 operate our plant around the clock basically throughout the
9 year, we think it would probably be in about that level.
10 The additional cost, at some point we're going to have to
11 seek market service payments to look at that. That's not a
12 topic here and I don't really want to discuss it. But
13 that's where we think that should come from.

14 If you gave every powder manufacturer over 17
15 cents to make powder, everybody would be making powder, and
16 we recognize that. So we have to find a different way to
17 accommodate that for the marketplace.

18 In terms of buttermilk powder, I don't really have
19 a number on that, although I do agree with the other people
20 who put out the information. I've talked to our staff at
21 our plant. There is additional energy cost with buttermilk
22 powder. There is, of course, additional shrinkage because
23 we have much smaller runs of buttermilk powder, and in fact
24 that was originally noted by Dr. Barbano, that you have a
25 certain amount of fixed cost, fixed milk that goes through

1 the system. If you have half the amount of the amount or
2 quarter the amount you would have in another product, your
3 costs are going to be proportionately higher because you are
4 going to leave the same amount of shrinking.

5 And on buttermilk powder, in fact, the buttermilk
6 doesn't run from the churn right to the dryer, okay, like it
7 would run from the evaporator to the dryer for skim milk.
8 Because you are making a much smaller quantity, the
9 buttermilk from the churn is usually running to a silo and
10 is stored there until we have to do a run. So you have also
11 shrinkage in the silo and other factors involved.

12 Plus, the buttermilk powder by law has to contain
13 five percent butterfat. And also noted by Dr. Barbano,
14 butterfat tends to be stickier than the rest of the
15 components and that affects your yield also.

16 I'll be talking a little bit about that buttermilk
17 powder yield when I get to my second point, or actually my
18 third point.

19 We don't have information on whey. We do not dry
20 whey at this point, although we are in the process of
21 building a whey facility attached to our Middlebury plant.
22 The original cost of that, in progress right now, was \$18
23 million. As with most construction projects, it will
24 probably cost closer to \$20 million by the time we get done.
25 It's meant to handle all the whey capacity at our Middlebury

1 plant.

2 That Middlebury plant makes approximately bout 4
3 million pounds of cheddar a month. It uses 40 million
4 pounds of milk to do that, so therefore it has about 36
5 million pounds of whey left over that has to process, and
6 that will be the capacity of this particular whey facility
7 costing, like I said, probably about close to \$2 million by
8 the time we get done. It's supposed to be up and running by
9 late summer, early fall.

10 By the way, we don't really plan on trying to make
11 too much dried whey there. We want to make whey protein
12 concentrate because our people did look at the whey and we
13 felt there wasn't any money in making whey. The costs were
14 so much higher than nonfat dry milk that we felt the only
15 way we could make it really a profitable endeavor was that
16 we made whey protein concentrate.

17 But keep in mind, we aren't even looking at
18 profitability right now. We are looking at what do you do
19 with 36 million pounds of whey. You cannot dump it into the
20 local river or get rid of it some other way. I can tell you
21 that we have landspread that way at various times because it
22 was more economical to do that than to ship it hundreds of
23 miles away to a facility and get a very low price. But I do
24 not include that factor in my calculations.

25 We also have dumped buttermilk, by the way,

1 whenever our plant is at a high capacity, particularly
2 during holiday seasons, and we don't have enough capacity to
3 run all the powder. Why run lower buttermilk powder with
4 lesser value, so it will go to a manure pit of about a half
5 a dozen farms that we have within 30 miles of the plant. So
6 it's something we get no value and we have no transportation
7 costs. I had not factored those in either, but that's a
8 reality of running a balancing plant.

9 Basically, I would say that we support NCI's
10 position on the cheese make allowance because we feel we
11 need to look at a real cost. We think that their numbers
12 were more representative. We think that Dr. Ling's can be
13 with some work and including all of the costs. But right
14 now given the data on the record, we think that NCI combined
15 with California are really the true real numbers. And as
16 you can see, they certainly reflect our numbers better than
17 what Dr. Ling has put in.

18 In terms of butter, as I said, our position would
19 be that we would support leave it alone at 11.4 because of
20 our cost numbers.

21 On nonfat dry milk, we support National Milk,
22 their proposal at 14 cents, although in all these products
23 we would prefer to have studies and we actually look at
24 actual costs involved in doing that. We would be happy to
25 participate in that, and work with whoever is involved in

1 doing it, whether it be Dr. Ling, Dr. Stevenson at Cornell
2 or someone from AMS, whatever. We would certainly be
3 involved.

4 Our second issue has to do with the proposals. I
5 believe it's Proposal No. 8 on lowering the butterfat price
6 by six cents per pound. I sort of disagree with some of my
7 peers on this. I don't think that was an unintentional
8 consequence of the Department. I think the Department made
9 it very clear each step of the way where they were heading
10 on this, but I would also agree that we were very involved
11 in other issues at the time, and so we did not take proper
12 note of that.

13 I can tell you at Agri-Mark who was the first
14 person to notice this, and that was a cost accountant in the
15 beginning of last December, and I was out that way, who came
16 to Dr. Stammer, who is our chief operating officer who has
17 testified at previous hearings, and noted the six cents.
18 And Dr. Stammer then went on to contact IDFA, National Milk
19 Producers, the Butter Institute, everybody else and sent the
20 word out, and I think it was probably the first word that
21 came out in regard to this.

22 And so we were looking for a solution on the six
23 cents that would not negatively impact producers to a great
24 extent but would address the issue.

25 And so Land O'Lakes came up with a suggestion. We

1 agreed that there are additional cost in handling the
2 outside cream. And in fact, we looked at our operations and
3 about 60 percent right now of our cream comes from outside,
4 usually Class I bottlers, I'd say probably just about all
5 Class I bottlers.

6 That percentage, by the way, has gone down a
7 little over the last few years because our Class I bottlers
8 have been consolidating at a very rapid pace. One company
9 has come in and bought about a dozen plants. I don't know
10 the official percentage they represent, but people were
11 bantering around 70, 75, 80 percent of Class I sales in New
12 England.

13 But within their own system now instead of buying
14 it from different Class I bottlers, and on occasion, selling
15 it back to a different Class I bottler, now they coordinate
16 their own efforts and there is less cream available, and
17 cream sales that we have, so we have less coming in from the
18 Class I bottlers. And in fact, I anticipate that percentage
19 will probably continue to shrink down and maybe it will
20 settle at somewhere about half, 50 percent or less, at least
21 that's what our marketing people have told me.

22 I asked our marketing people to give me a cost on
23 handling that outside cream, and that was a very tough
24 number to come up with, once again because how you allocate
25 these costs. They came up with an estimate that for the

1 receiving, handling and pasteurization the additional cost
2 of that is about half a cent per pound of butterfat, which
3 I'm glad to say is somewhat near where Land O'Lakes is. I
4 believe they were .4. We came up with half a cent. I'm not
5 sure why we vary above them but we were slightly above.

6 Our transportation was not as high as Land
7 O'Lakes. Our people estimated 3.5 cents. I know these are
8 round numbers. I mean, when they first told me this I said,
9 "Well, can't you give me a number like 3.498765 because then
10 it looks like a real number?"

11 And they said, "Well, we could, but this is what
12 we're looking at all the costs and what we are trying to
13 do."

14 And I think that's one of the problems. We were
15 trying to come up with this exact number to the four
16 decimals and it's a very precarious number to come up with.
17 So I felt more comfortable saying 3.5 cents on
18 transportation.

19 Once again, I can't relate that to Land O'Lakes'
20 number other than that our plant in West Springfield,
21 Massachusetts is actually closer to the Class I bottlers in
22 Boston. We have -- H.B. Hood has plant in Agawam, which is
23 only a few miles away. So I think that's probably why there
24 is lower transportation costs. I think Land O'Lakes is
25 probably drawing from a larger area for their cream.

1 However, we also have something that Land O'Lakes
2 did not include and that is that the yield factor is
3 diminished on cream that we receive from outside handlers.
4 And the reason that is, is because the more you handle the
5 cream the more you break down the fat globulous, okay?
6 Tough time with that word. But the more you break down the
7 lower the yield you're going to get of that, and so they
8 have estimated that our yield is probably down between one
9 and two percent of that particular cream that we receive.

10 But it's not only just the additional handling and
11 the transportation of the cream that breaks it down, a lot
12 of our Class I bottlers takes -- can take one, two, three
13 days to generate a load of cream to sell, and so it sits in
14 a silo for a couple of days, and often they don't have the
15 same capacity to condense it down to the proper percentage,
16 so that cream can come in at all different percentages. It
17 doesn't come in at 40 percent. Some will come in at 42
18 percent. Some will come in at 38 percent.

19 We have some of our customers that we purchase
20 from that comes in at 35 percent, and that will destroy our
21 yield unless we come in and try to boost it up, which is
22 another cost to doing that. So there are other factors
23 involved in handling that outside cream.

24 Now, one of the points that was made was that we
25 can pass along -- the fact that we have a disproportionate

1 amount of value in the butterfat -- to the people we buy the
2 cream from. In other words, the Class I dealer has to deal
3 with that additional six cents in cost, and we can just say,
4 you know, you eat it, not us. We eat it on our own, meaning
5 we absorb that in our operations.

6 I agree with you that this time of year that is
7 the case. However, we don't anticipate that to be the case
8 as we get into the summer, and we have a butter businesses
9 apply various private label accounts, supermarket accounts,
10 plus our own Cabot business, and we need that butter. We
11 anticipate that they are going to turn around and say,
12 "Well, we had to absorb it now. You're going to absorb it,
13 you know, for this time period." So some of that we think
14 is going to be passed back to us. But in either way, in
15 either case, that is a real cost.

16 There was a point noted during the hearing that we
17 use the Grade A price to price the butterfat to producers
18 and then we sold it off of the AA price, and there was that
19 nine cents difference. Okay?

20 And I understand why the Department would say,
21 "Well, gee, why don't you buy and sell off that AA price?"
22 I can tell you that there are costs involved, these costs
23 that we talked about that add up to five and three-quarter
24 cents for us. They were some of the costs that came out of
25 that nine-cent spread.

1 I can tell you if there was nine cents profit in
2 there, everybody would have been making butter. But there
3 were costs involved in doing that, and they sort of became
4 the way we retrieve those costs were we paid double -- the
5 Grade A for the butterfat and then we got the AA and we
6 didn't have to go back to our customers and explain why we
7 have to charge them more now because it's based on the AA
8 that we pay for the butter.

9 So there was cost involved in that, and there was
10 a marketing structure that built around that, and we're
11 trying to accommodate that now, and that's very difficult.
12 One of the reason it's difficult because we have a circular
13 structure that was also noted. That when you increase the
14 price of butter, and in fact if we have tried to do that to
15 accommodate these higher costs involved, that increase in
16 the price of butter will get built back for the most part
17 back into the NASS survey, and it will just increase our
18 butterfat cost.

19 The other classes don't have that circularity, and
20 that becomes a problem for us.

21 A second problem for us, of course, is California.
22 The prices under the federal order prior to January 1st of
23 this year were pretty much in alignment on butterfat. I
24 think people have testified to that. Now it is no longer in
25 alignment with California, and we have a lot of California

1 butter that even moves into New England and the Northeast,
2 and we have some of our butter that will move out
3 particularly to the Southeast, can move 1,000 miles or more.
4 We don't really sell on the West Coast on butter, but we do
5 have substantial movements of that.

6 So we would be in support of that other proposal
7 on the six cents. Our five and three-quarters doesn't
8 include a lot of the overhead, G&A, general and
9 administrative costs and other things that was also noted by
10 Land O'Lakes, so we think going up to six cents is not
11 unreasonable on butterfat, not on butter. It has a
12 different impact on butter than butterfat.

13 Our third area that I wanted to talk about was
14 using the 1.02 yield deviser that they use in nonfat, in the
15 nonfat solids price formula. There is a lot of confusion on
16 that and understandably so because why are you dividing by
17 1.02, particularly if you have moisture content in the
18 powder.

19 I want to try to explain a method to explain why
20 the 1.02 works, and I'm not sure how the Department came up
21 with this. Perhaps this is their method, perhaps not. But
22 it's a method that we think really reflects the value of why
23 there has to be a 1.02 deviser, not multiplier, but deviser.
24 And the example I'm going to give and I will got through it
25 slowly. I apologize I don't have it to pass out as an

1 exhibit. But it's pretty straightforward and I tried to use
2 numbers that most of us in this room are familiar with.

3 If we -- at the first step if we have 100 pounds
4 of producer milk, and let's just assume it's testing 3.5
5 percent butterfat, and it arrives at a Class IV plant, and
6 it's going to be used to make nonfat dry milk and then
7 eventually some buttermilk powder.

8 This milk goes through the separator and 91.25
9 pounds of skim milk is sent to the dryer. These are
10 familiar if you're familiar working with support prices and
11 how we work through that. 8.75 pounds of 40 percent
12 butterfat cream is sent to the churn.

13 Okay, now, that 8.75 pounds of 40 percent
14 butterfat cream has 3.5 pounds of butterfat, okay, 3.5
15 percent milk, and I'm not assuming any shrinkage or anything
16 at this point, just to get -- show you a method, and it
17 contains 5.25 pounds of skim milk. Okay, that's the -- if
18 it's 40 percent butterfat, it's 60 percent skim milk, and
19 that's a ratio that works out.

20 Now, in my calculations I'm going to try to use
21 some numbers that other people have used to be consistent.
22 In fact, I've chosen numbers that Mr. Shad put in from Land
23 O'Lakes. He looked at the average 1999 nonfat dry milk
24 price and he came up with a price of \$1.0389. That's within
25 his testimony. The average 1999 buttermilk powder price,

1 also within his testimony, was .7686; in other words, 76
2 cents, almost 77 cents.

3 I'm assuming in my analysis that the nonfat dry
4 milk make allowance of the current .137. This is a method.
5 You can use 14 cents, you can use whatever the Department
6 feels is appropriate.

7 Buttermilk power make allowance, I'm assuming
8 .147, a penny above what it is for nonfat dry milk.
9 Actually, our plant people have said it's probably a few
10 cents above. I asked what's the range. They said probably
11 one to three, so I chose one just to try to say it was -- I
12 didn't want to overexaggerate the impact of it.

13 Then I look at our nonfat dry milk yield of milk
14 going into the dryer -- well, really solids going into the
15 dryer and powder coming out of the dryer, and our yield is
16 actually 1.00 on it, very similar to Land O'Lakes, and
17 that's the number my people gave me back. I said, well,
18 Land O'Lakes had 1.004, and they said, well, ours is 1.000.

19 And we talked a little bit about the three percent
20 moisture and that's about the shrinkage that we're getting
21 from this. Our dryer, I'm not sure if it's older or
22 whatever than everybody else's, it's probably about 20 years
23 old or so, so I'm not sure what the degree in the rest of
24 the industry is. This is what my people are telling me
25 that.

1 The buttermilk powder yield, because of all the
2 reasons that I stated, our people said it's probably about
3 two percent less than what we get for nonfat dry milk. So
4 I'm using a .98 yield factor. Once again, this is a method.
5 You can use whatever you think is appropriate when we get
6 through this.

7 Now, under the existing orders using this
8 information that I put in the price per pound of nonfat
9 solids is .884, 88.4 cents per pound.

10 Okay, now, the problem that we have is that when
11 these nonfat solids come into the plant they don't all end
12 up in powder. Some of it ends up in buttermilk powder at a
13 different value, and so we need to be able to account for
14 the fact that there is a different value to it.

15 When I plug in the data that I put together for
16 buttermilk powder, basically I said .7686 dollars per pound
17 of powder minus a make allowance of .147 divided by a yield
18 of .98, I end up with a value of the nonfat solids in
19 buttermilk powder of .634 cents; in other words, about 63
20 cents for buttermilk powder solids using that same formula.

21 When I do the same thing for nonfat dry milk using
22 our numbers, which would be 1.0389 price for nonfat dry milk
23 minus .137 divided by 1.0, I end up with 90 -- .9019. Okay,
24 keep in mind the current formula uses 1.02, I use one, and I
25 got a higher value which is what you would expect.

1 But then I look at it and say, okay, what
2 percentage of those nonfat solids go into powder and what
3 percentage of those nonfat solids go into -- I don't mean
4 powder, I mean nonfat dry milk powder, buttermilk powder.
5 And when we looked at those calculations, we estimated that
6 94.56 percent of the nonfat solids go into nonfat dry milk
7 powder, and 5.44 percent go into buttermilk powder.

8 If you then weight those two prices for nonfat
9 solids together, you end up with a value of .887, very
10 similar to what you got when you divided by the 1.02, okay,
11 but you did it in a much simpler way with 1.02. And in fact
12 if you -- using my assumption if you wanted to use the exact
13 numbers you could divide by 1.017 and get it; not that I'm
14 promoting 1.017, but that's what you would come up with.

15 And in fact I took another step and I looked at
16 some numbers that were put in yesterday by Mary Ledman and I
17 believe that Dennis Schad also put numbers in showing that
18 the average butterfat of Class IV milk is over six percent
19 because you are using a lot of cream and other things for
20 that milk.

21 And if you're doing that at six percent, it means
22 that you even have a higher proportion of buttermilk powder
23 in Class IV. When you do the same method with that using,
24 in fact using just six percent because I thought six -- it
25 came out to like 6.6, but that was for the first part of the

1 year. I think on average it will probably be closer to
2 six -- we ended up with a deviser of 1.05 given those.

3 Now, once again, I'm not promoting 1.05. I'm just
4 saying that there is a reason why it's 1.02. I think where
5 we stand right now we would just support remaining the
6 number at 1.02 because there is a lot of numbers you could
7 play around with on this. Other people will probably get a
8 better yield than us, they might. I don't know. You can
9 plug your own numbers in.

10 I'm just saying that given where Class IV is right
11 now the 1.02 is not an unreasonable number and may be even
12 low.

13 Those are the three issues that I wanted to
14 address. Once again, in terms of all the proposals that are
15 there, we are a member of National Milk, we support them on
16 those other proposals.

17 Oh, the one other thing I do want to talk about is
18 marketing costs. The .0015 cost we feel is very low
19 relative to our own numbers. Once again, I have a range
20 from our people. And they said, depending on how you want
21 to allocate the cost, it would be between a quarter and a
22 half-a-cent. So it is somewhat low.

23 We're not proposing using between a quarter and a
24 half-a-cent. But we think that it certainly justifies the
25 0015 cost involved in that, and we think that that's another

1 cost that should be looked at thoroughly and come up with
2 the correct number.

3 What we want out of this system is to come up with
4 the correct number because we are trying to balance the
5 needs of farmers as well as the needs of our operations as
6 well as the needs of our customers who buy the milk from
7 farmers in our area.

8 With that I conclude my testimony. I have no
9 exhibits, and I'm available for questions.

10 JUDGE HUNT: And before Mr. Wellington takes
11 questions, let's take a 10-minute break.

12 MR. BESHORE: Can I --

13 JUDGE HUNT: Excuse me. We're still on the
14 record.

15 MR. BESHORE: For everybody's information, it
16 doesn't have to be but --

17 JUDGE HUNT: Okay, off the record.

18 (Discussion off the record.)

19 (Whereupon, a recess was taken.)

20 JUDGE HUNT: Take your seats, please, and we'll
21 start the questioning of Mr. Wellington.

22 And are there questions of Mr. Wellington? Mr.
23 Beshore?

24 //

25 //

1 CROSS-EXAMINATION

2 BY MR. BESHORE:

3 Q Good morning, Bob.

4 A Good morning.

5 Q I just have one question or one line of questions,
6 and you know, we agree on so much I had to dwell on the
7 disagreements here.

8 With respect to the use of the RBCS study, isn't
9 it correct that when National Milk submitted the proposal in
10 the hearing notice to use that study, whatever the results
11 may be before it was known what they were, for the make
12 allowances in the hearing.

13 You recall that?

14 A Yes.

15 Q Okay. And at that point in time before the
16 results were in Agri-Mark and the other members of National
17 Milk supported that proposal being made for this hearing;
18 isn't that correct?

19 A I was not nor was there a representative who
20 understands the issues at the meeting where they first did
21 that back, I guess, about six months ago or so. So I can't
22 really say that Agri-Mark was there.

23 We had a subsequent meeting where there was a
24 consensus decision. That did not necessarily include
25 everybody.

1 So no, we hadn't looked at it. We knew the
2 problems with the Charlie Ling study, and it wasn't just
3 because we came up with different numbers that we decided to
4 change them. We looked at it and said what are the real
5 numbers in terms of the cost.

6 MR. BESHORE: Okay, thank you.

7 JUDGE HUNT: Mr. Marshall.

8 MR. MARSHALL: Thank you, Your Honor.

9 BY MR. MARSHALL:

10 Q Following along the same line of questioning, Mr.
11 Wellington. As you know the several proposals incorporate
12 methodology of using a weighted average price in the survey,
13 and I would like to ask you if you believe that USDA should
14 automatically inflexibly use a weighted average price or
15 should simply use the surveys as an indication of a range of
16 costs and apply additional policy and/or other
17 considerations in setting make allowances?

18 A Well, I understand the attraction for using a
19 weighted average. Given the fact that our costs would be on
20 the high end of those weighted averages, and you're really,
21 you can gear in some automatic losses, I mean a weighted
22 averages tells you half is going to lose and half is going
23 to gain, I think we would certainly be supportive of the
24 Department having some discretion on that level.

25 MR. MARSHALL: Thank you.

1 JUDGE HUNT: Yes, Mr. Coughlin.

2 BY MR COUGHLIN:

3 Q Bob, you are probably in the unique position of
4 having participated both in the cost survey that was done by
5 NCI as well as the one that was done by Charlie Ling.

6 Were the data that you submitted to both surveys
7 the same?

8 A Oh, yes. The data was, but I do have to mention
9 one factor which I didn't know when I came down here.
10 Subsequently found out that our -- I'm not sure if I
11 mentioned it -- our data was submitted to them but they
12 never included it because it came in late. So actually our
13 data was above theirs. It would probably would have raised
14 their numbers slightly.

15 But we did -- in terms of the individual cost that
16 we had, that's why we sent corrections into Charlie Ling and
17 talked about that, and in fact after our corrections and
18 also some resubmissions from some other co-ops, actually the
19 manufacturing cost went down from what it was before.

20 Q On the Charlie Ling survey that --

21 A On Charlie Ling's.

22 Q Then you had an opportunity to review what he was
23 doing, look at it in relationship to your cost numbers and
24 make such corrections --

25 A Yes.

1 Q -- as you saw that needed --

2 A Yes.

3 Q -- to be made?

4 A Yes.

5 Q In other words, you verified what he had done in
6 the survey?

7 A In terms of the cost that he covered, yes. The
8 problem was that they were incomplete on what they covered.

9 Q Okay. What's in the orders now, it uses -- one of
10 the elements that is used is the Charlie Ling survey. That
11 was used with an average of the California survey data?

12 A Correct.

13 Q I take it then that there are certain elements of
14 your costs that you feel are not included in the Charlie
15 Ling survey numbers?

16 A Yes.

17 Q Can you enumerate what those are? In other words,
18 what we're talking about here is USDA has or did make a
19 decision in the make allowance that's out there now to use
20 the RBCS, one element of that. There are certain costs that
21 are not in that that you feel should appropriately, I take
22 it, be in the costs, and could you enumerate for us what
23 those would be?

24 A A number of people have already done those, but in
25 general, some of the larger costs that we would have are

1 general and administrative costs involved, if it was a
2 stand-alone plant you would have -- you would have cost
3 involved in doing that. We do that at our main office so it
4 wouldn't have been included. You've got be careful how you
5 allocate that, of course.

6 I understand that we didn't include the cost for
7 the plant manager, and that of course can be, you know, a
8 large plant, can be a substantial cost when you spread it
9 over even -- even a high volume of cheese, it can be, you
10 know, a quarter of a cent or something like that. I have to
11 do the calculations.

12 And I'd have to look up in my notes. I don't have
13 them available. There are some additional ones that we
14 felt, and I believe they were covered by Dr. Yonkers on some
15 of those costs.

16 Q Okay. One of the other positions that I don't
17 think you specifically commented on was the NCI proposal
18 with respect to cheese would change the calculation of --
19 the comparison calculation, if you will, between barrels and
20 block cheese. In other words, the present order provision
21 contains a -- where you add three cents to the barrel price.

22 Does Agri-Mark have a position on that issue?

23 A That's one of those other proposals that we
24 support National Milk on, on their position.

25 MR. COUGHLIN: Okay, thank you.

1 JUDGE HUNT: Mr. Rosenbaum.

2 BY MR. ROSENBAUM:

3 Q Mr. Wellington, just to clarify your earlier
4 testimony because we have two different surveys and I want
5 to be clear.

6 Agri-Mark participated in the National Cheese
7 Institute Survey, correct, the NCI study?

8 A We submitted our data, but I understand it didn't
9 get included.

10 Q Okay. And that's the survey that you're talking
11 about when you said your data was not included, correct?

12 A Correct.

13 Q And the weighted average reflected in the NCI
14 survey, as testified to by Dr. Yonkers, was a cost of
15 manufacturing for cheese of 16 point -- I think it's eight,
16 16.87 cents, I think, correct?

17 A That's my understanding.

18 Q And that's for 1999 figures, correct?

19 A Yes.

20 Q Now, you testified earlier that Agri-Mark's cost
21 of manufacturing as submitted to NCI but not in the NCI
22 results because they came in too late were 18.5 cents,
23 correct?

24 A Correct.

25 Q So that if Agri-Marks' numbers had been included

1 in the NCI survey, it obviously would have raised the NCI
2 number?

3 A I think it would have raised it probably -- I'm
4 not sure what level, a small amount.

5 Q Okay.

6 A But yes, it would have raised it.

7 MR. ROSENBAUM: Okay, thank you.

8 JUDGE HUNT: Mr. Vetne.

9 BY MR. VETNE:

10 Q Good morning, Mr. Wellington.

11 A Good morning.

12 Q The plant at Middlebury, you testified, you make
13 40-pound blocks and you keep them for aging?

14 A Or we sell them to customers who keep them for
15 aging.

16 Q Okay. You have a place at Middlebury where you
17 age cheese?

18 A Actually, we just completed a \$5 million warehouse
19 about eight months ago.

20 Q And the cheese that you age you sell through your
21 own marketing systems?

22 A Yes.

23 Q Is there a ratio of how much you sell that's
24 produced there to how much you keep?

25 A I don't -- there is a ratio. I'm just not sure --

1 Q There is one, yes. I'm sorry. Wrong question.

2 Good point.

3 You gave your numbers and indicated that they
4 would be the numbers that were called for in the NCI survey,
5 but they weren't included in the NCI tally.

6 A Yes.

7 Q And to the extent that NCI survey did not include
8 certain line items as a matter of the way the survey was
9 constructed, your costs would also not include other line
10 items?

11 A That's correct.

12 Q Does the Middlebury plant for which you gave us
13 numbers receive milk on a fairly uniform basis throughout
14 the year?

15 A Yes, more so -- we try not to use it as a
16 balancing facility. We try to just do it on demand at the
17 plant. But there is some seasonality as you would expect
18 because of milk supplies.

19 Q Okay. To the extent that -- well, you strive to
20 keep the supply there uniform to meet the demand, and to the
21 extent you need to balance, you balance off the West
22 Springfield butter powder plant?

23 A That's correct.

24 Q If you did not use that plant for uniform receipt
25 but instead balanced at the plant, your make costs would

1 probably be higher because of underutilized capacity.

2 Am I correct in my assumption?

3 A It depends on the balancing portion. I would say
4 probably yes. We do use it for some balancing but most of
5 the balancing is not to short the plant, okay, it's to put
6 extra milk into the plant as opposed to moving it long
7 distances during the flush season of the year.

8 So I would agree with you. It probably would be
9 slightly higher.

10 Q Okay, when a plant like that receives extra milk
11 that maybe isn't in the --

12 A Budget?

13 Q In the budget or planning projections, that
14 results in increased costs?

15 A Well, let's see, it depends. You're talking about
16 increased costs, yes, in absolute levels, but you also
17 spread out your overhead over different volumes too, so I'm
18 not sure where the number would come out. I would expect
19 the total cost would go up. Per pound, I'm not sure in all
20 honesty.

21 Q Okay. With respect to the function for which you
22 employ the Springfield balancing plant, did any of your cost
23 estimates allocate a balancing cost of Springfield back to
24 the Middlebury plant to keep its receipts fairly uniform?

25 A No, no.

1 Q That plant at one time was operated by Kraft; is
2 that correct?

3 A Yes, it was. It was a swiss cheese plant.

4 Q And Kraft, like you, like to keep its receipts
5 fairly uniform to meet demand for product?

6 A Yes.

7 Q And when Kraft operated the plant, there was a
8 charge above the minimum Class III price in order to produce
9 the desired result of uniform cheese?

10 A Yes, there was.

11 Q Uniform milk, I should say.

12 A Yes.

13 Q Which to some extent is simply translation of your
14 costs at Springfield to balance back to the plant?

15 A Correct. It's a service that we offer customers
16 even supplies of milk.

17 Q The products that you make in New England, nonfat
18 dry milk and cheese, you've indicated you've expanded your
19 markets or your distribution nationally for your cheese.

20 A Correct.

21 Q Okay. Is it also not accurate that those
22 products, I'm not sure about butter, but those two products,
23 cheese and nonfat dry milk, are also moved in international
24 markets?

25 A Yes. In fact, we're the largest participation in

1 the DEIP program, Daily Export Incentive Program on the east
2 coast.

3 Q With respect to power?

4 A Powder, nonfat dry milk powder.

5 Q And cheese also moves in international markets but
6 without any DEIP subsidy?

7 A Correct, but it's very small volumes. We are one
8 of the only -- our Cabot cheese, I believe, is one of the
9 only American cheddars in England and also Israel. We're on
10 the internet some I figured that would be a good thing to
11 mention.

12 Q Pretty impressive to sell cheddar back to the
13 place where cheddar was first created.

14 A That's true and they do not like us doing that
15 either.

16 Q Is any butter moved from your facilities into
17 international markets?

18 A I don't believe so. I don't believe so. Most of
19 our butter is kept internally now that we have a packaging
20 operation, so we very rarely sell butter outside of the
21 plant. We keep it internally for our own uses.

22 MR. VETNE: Okay, thanks.

23 JUDGE HUNT: Mr. Rosenbaum.

24 BY MR. ROSENBAUM:

25 Q Mr. Wellington, on the Rural Business Cooperative

1 Survey versus the NCI survey, that's what my questions are
2 going to address, there are some issues surrounding the fact
3 that the Rural Business Cooperative Survey excludes certain
4 costs here.

5 Are you aware of that?

6 A Yes.

7 Q But even if one adds in those costs as currently
8 composed, the Rural Business Cooperative Survey would be
9 substantially less than the NCI survey.

10 Are you aware of that?

11 A Given where their numbers came out, yes.

12 Ours wouldn't because I used the same database.

13 Q Okay. And given that circumstance, your view is
14 the NCI numbers are, at least from your perspective, closer
15 to what you view as the actual cost of manufacturing?

16 A Certainly from our operations, yes.

17 Q Okay. And as a result -- well, I won't say "as a
18 result," but in any event, you are supportive of the NCI
19 proposal as to what the make allowance should be for cheese?

20 A Yes.

21 MR. ROSENBAUM: Okay, thank you.

22 JUDGE HUNT: Anyone else? Yes, Ms. Brenner.

23 BY MS. BRENNER:

24 Q One is just a clarifying question about your
25 testimony. And because you don't have a written statement,

1 I thought I would try to get it in the record.

2 A Okay.

3 Q Early on in your testimony you said that consumers
4 are getting a smaller part of the consumer dollar, and
5 consumers may feel that way, but --

6 A No, I'm sorry. I mean producers. I'm sorry.

7 Q Producers. Okay.

8 A Yes, thank you.

9 Q And with relation to the dryer that you are
10 building or planning at Middlebury, you're going to be
11 making whey protein concentrate there or --

12 A We'll be able to make whey or varieties of whey
13 protein concentrate. My understanding, it's a two-stage
14 dryer that was described -- the same thing was described
15 yesterday.

16 Q To make the whey protein concentrate --

17 A Yes.

18 Q -- or the --

19 A Yes. It's a little different procedure in it to
20 do that. But to be honest with you, I'm not familiar with
21 it at this point.

22 Q And you said that at some time you had spread whey
23 as a means --

24 A Oh, absolutely. In fact, it was --

25 Q -- getting rid of it?

1 A We had -- Vermont Whey was a company in Vermont
2 that took most of the whey from the cheese plants. But even
3 that, they couldn't accommodate all our whey. And so we
4 would landspread it. But then when they closed down, the
5 fact of the -- the problem is we would have to move whey
6 several hundred miles and all we could do was condense it.
7 And so by the time we got it some place, we'd get like three
8 cents a pound for dry solids, the equivalent. And under the
9 order other solids were running four - five cents. So we
10 couldn't even cover our cost of ingredients.

11 So we landspread -- basically, if we could sell
12 and get something back, we did, but often we couldn't even
13 do that, and then you would have to bring trucks long
14 distances, and we had farmers who thought there was some
15 benefit to putting -- put it on their land. I don't know if
16 there really was or not, but they thought there was and it
17 worked out well for both of us.

18 Q Is there a municipal sewer system that you use to
19 dispose of whey or?

20 A Absolutely not. Absolutely.

21 Q I was going to ask you how much it cost.

22 What do you do with it now?

23 A We basically condense it, sell it off. We don't
24 get very much for it. That's one of the reasons we are
25 building a facility. But even that we're having -- we're

1 having a hard time getting outlets for whey.

2 I mean, I understand in the Midwest they have a
3 lot of outlets. We just don't have them. We have to move
4 them into New York, Pennsylvania, Ohio, further and further
5 away.

6 Q What's the relative value difference between whey
7 protein concentrate and dried whey?

8 A Whey protein concentrate at 80 percent goes --
9 I've heard different numbers on that. I think it goes well
10 over a dollar a pound for that, but I'm not sure of the
11 exact number. Whereas whey we know goes for -- the latest
12 numbers now is like 17 - 18 cents.

13 Q So it's a big --

14 A There is a lot of value added to it. The only
15 problem with whey protein concentrate is that when you do
16 that you end up with a permeate, okay, that's worth hardly
17 anything. I think someone testified on that also, how it
18 creates a problem. But we felt that, given the amount of
19 money we could get from whey protein concentrate versus
20 whey, it was a better investment for us over time,
21 particularly the fact that the ingredient costs were almost
22 zero because we weren't getting it. It wasn't even covering
23 us.

24 Q Do you think that's a rational decision in the
25 future for many cheese plants to make?

1 A I would hope so if we made it.

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

3 THE WITNESS: I think that would be the case. I
4 think more and more are doing that, and one of the reasons
5 may be environmental reasons too.

6 MS. BRENNER: Thank you.

7 JUDGE HUNT: Yes, Mr. Yale.

8 BY MR. YALE:

9 Q I had to get a signal from my expert so that's why
10 I was out.

11 Mr. Wellington, and bear with me as I walk through
12 this on this yield.

13 A Sure.

14 Q Is it my understanding for 100 pounds of solids
15 nonfat that enter your plant that you are getting a yield of
16 94.56 percent nonfat dry milk?

17 A That's not the way I interpret it, but that may be
18 true. I have to think about that then. Well, yeah, I guess
19 you could say that. We said that of the solids that come
20 through, if I want to weight the value of them accordingly,
21 that probably would be the case. If I had 100 pounds of
22 nonfat solids, 94.56 would go to nonfat dry milk and 5.44
23 would go to buttermilk powder. That's my assumption on
24 this. Keep in mind it's a method. If you want me to -- I
25 can't really testify to the exact yields and other things on

1 this. I'm just trying to develop a method to how you -- how
2 you get to the 102.

3 Q Right. Well, that was a nice segue into my next
4 question.

5 A Good. Glad I could help.

6 Q You've always been a help, Bob.

7 A Thank you.

8 Q The California study that we put into the record
9 indicated that that yield should have been, or not -- I
10 shouldn't say "should have been". Their study found the
11 yield was 97.5 on the nonfat dry milk, and I think you did
12 indicate back here, I think earlier, that you did a deviser
13 and it came out to one on your yield.

14 A For nonfat dry milk, yes.

15 Q Right.

16 A It was basically a balancing effect between the
17 additional moisture and the shrinkage.

18 Q Right. Had you had a BOD analysis of your plants
19 like the guy from the Echo Labs talked about yesterday?

20 A I'm sure -- I imagine we have but I'm not aware.

21 Q You're not aware of what they are?

22 A No, I don't.

23 Q So in other words, you were just talking about the
24 methodology, you're not necessarily testifying that those
25 were the exact numbers --

1 A No, not at all.

2 Q -- but you applied -- you applied the appropriate
3 yield numbers and run this methodology and it gives you a
4 method, a means to come up with a deviser or multiplier,
5 depending on what you want to invert or not, right?

6 A Right. What I am trying to do with this is
7 reflect that not all the solids go to nonfat dry milk. Some
8 go to buttermilk powder.

9 Q Right.

10 A You can put your own numbers in and come up with
11 that percentage, or the Department can, or whoever.

12 Q Right. In the end what we are wanting to say is
13 is that in that pound of -- that there is a value for the
14 nonfat solids or for the nonfat dry milk and there is a
15 value for the dry buttermilk powder?

16 A Right.

17 Q It's just that one is not as equal to the other?

18 A Right, and that's the problem. In fact, I believe
19 Mark Stephenson had an article where he assumed they were
20 the same, and they are not. There is a lower price. There
21 is a higher make. There is a lower yield, and so we just
22 want to be able to reflect that.

23 It doesn't seem like much but it can certainly
24 make a difference between a deviser of one or 99 or 1.02.

25 Q Right. One next thing I just want to talk briefly

1 about, the issues of the make allowances.

2 You shared a lot of, I guess, questions about the
3 RBCS and the like.

4 A Yes.

5 Q And one can raise questions on all of the
6 testimony this week in terms of the make allowances. We
7 really don't have the total -- the totality of the situation
8 in front of us.

9 Isn't it ultimately a policy issue that the
10 Department has got to use to balance the -- making sure that
11 there is plants that can buy the milk and that there is also
12 producers to supply the milk?

13 A Oh, and that's what I said. When I tried to
14 describe a three-legged stool, I think the Department
15 probably sits on a similar stool. Maybe it's only two legs
16 because they don't value a product, that's why they are more
17 precarious.

18 (Laughter.)

19 Q Well, thank you, Bob, because I want to make sure
20 that they understand that there is at least two legs.

21 A Yes.

22 Q All right. One producer and one processor.

23 A Absolutely, Ben.

24 MR. YALE: All right, very well. Thank you.

25 JUDGE HUNT: Yes, Mr. Coughlin.

1 BY MR. COUGHLIN:

2 Q Bob, you've indicated that Agri-Mark has made some
3 substantial capital improvements in recent years.

4 A Yes.

5 Q When you go to your board of directors and propose
6 those, what kind of a return on investment do you talk to
7 the board of directors about?

8 A It depends on the type of investment and what we
9 are trying to accomplish with it. A return like on a whey
10 facility, we will probably accept a lower -- we would accept
11 a lower return initially because this meeting environmental
12 issues. We don't have a set number that we're after, in all
13 honesty. I mean, the higher the better, of course. But
14 some of our investment you make for the long term they might
15 not even have a high return.

16 Producers -- I don't know how to say this kindly.
17 Producers are often willing to accept a lower return because
18 they have to market their milk. There is a value to that
19 also. I don't think it's necessarily fair and we're trying
20 to do something about it through our own brand and other
21 things, but that will happen.

22 Q Well, that certainly is one of the issues here --

23 A Absolutely.

24 Q -- that the Department is going to have to wrestle
25 with.

1 A Right.

2 Q We heard some proposal, some suggestions yesterday
3 in the -- the last witness last night had a return on
4 investment on whey plants.

5 What advice do you have for the Department people
6 in making a judgment call as to what kind of a return on
7 investment that ought to be incorporated into the make
8 allowance which then results in a level of price that
9 producers are going to receive?

10 A I think that's a balancing act again. I mean, is
11 one or two percent too low? Yeah, I think it is. I
12 wouldn't encourage investment. Is 15 or 20 percent too
13 high? Yes. Where is the in between? I think that's going
14 to be a balancing act. I don't -- I don't have a good
15 suggestion on that only because we're -- our finance people
16 would say one thing, our marketing people would say another
17 and my department would say a third. So I don't have a good
18 suggestion.

19 I think, reasonable. How's that?

20 (Laughter.)

21 JUDGE HUNT: Mr. Rosenbaum, did you have a
22 question?

23 MR. ROSENBAUM: No, Your Honor.

24 JUDGE HUNT: Anyone else?

25 (No response.)

1 JUDGE HUNT: Thank you very much, Mr. Wellington.

2 THE WITNESS: Thank you.

3 JUDGE HUNT: And Mr. Hollon.

4 Whereupon,

5 Elvin Hollon

6 having been duly sworn, was called as a witness

7 and was examined and testified as follows:

8 JUDGE HUNT: State and spell your name, please?

9 (Pause.)

10 DIRECT EXAMINATION

11 BY MR. BESHORE:

12 Q Would you give us your name and address, please,
13 Mr. Hollon?

14 A I'm Elvin Hollon, E-L-V-I-N, H-O-L-L-O-N, and my
15 address is 10220 North Executive Hill Boulevard, Kansas
16 City, Missouri, 64190-9700.

17 Q What's your educational background?

18 A Have a Master's Degree in agricultural economics,
19 dairy marketing, and a B.S. Degree in dairy science
20 manufacturing.

21 Q From what institution of higher learning?

22 A Louisiana State University.

23 Q Both?

24 A Both.

25 Q Okay. What years did you get your degrees?

1 A Seventy-five and '79.

2 Q How have you been employed since that time? Is
3 that in your statement?

4 A It's in my statement, yes.

5 Q Okay.

6 MR. BESHORE: Actually before you begin your
7 statement, we have -- I have presented four exhibits, six
8 copies of four exhibits that will accompany, be referred to
9 or be involved in Mr. Hollon's testimony, and perhaps we
10 could have them identified and given numbers for the record
11 at this time.

12 The first -- three or four.

13 BY MR. BESHORE:

14 Q Class II Substitution Analysis, is that an exhibit
15 you've prepared?

16 A Yes, sir.

17 Q Okay.

18 JUDGE HUNT: We'll mark that 45 then.

19 MR. BESHORE: Okay.

20 (The document referred to was
21 marked for identification as
22 Exhibit No. 45.)

23 BY MR. BESHORE:

24 Q Do you also have an exhibit which is titled --
25 which compares some of the CME and NASS prices?

1 A That's correct.

2 Q And the title of that exhibit is what?

3 A Comparison of CME and NASS Prices Block Cheddar
4 July 1998 to Date.

5 Q Okay.

6 JUDGE HUNT: Okay, I'll mark that 46.

7 (The document referred to was
8 marked for identification as
9 Exhibit No. 46.

10 BY MR. BESHORE:

11 Q Okay, third, do you have an exhibit, Summary of
12 Impacts?

13 A Summary of Impacts, correct.

14 Q One page?

15 A Yes.

16 MR. BESHORE: Could we have that one marked as
17 Exhibit 47, Your Honor?

18 JUDGE HUNT: Yes. Marked as 47.

19 (The document referred to was
20 marked for identification as
21 Exhibit No. 47.)

22 BY MR. BESHORE:

23 Q And finally, a one-page handwritten exhibit,
24 Measure of Change Between Class II and Class IV?

25 A I didn't want Mr. Vetne and Mr. Rosenbaum to cover

1 the market on handwritten exhibits so I thought I would
2 provide one. Yes.

3 JUDGE HUNT: Forty-eight. It will be marked as
4 48.

5 MR. BESHORE: Okay.

6 (The document referred to was
7 marked for identification as
8 Exhibit No. 48.)

9 BY MR. BESHORE:

10 Q With the identification -- are those all the
11 exhibits that are referred to in your written testimony or
12 that --

13 A Yes.

14 Q -- you plan to offer?

15 A Yes, sir.

16 Q Okay, with that identification, could you proceed
17 with your statement, Mr. Hollon?

18 A I've been employed by DFA or it's predecessor
19 since 1979. My job duties have always included general
20 economic analysis associated with the dairy industry
21 working with Federal Milk Marketing Orders from both a
22 regulatory and a daily marketing activity standpoint and
23 the buying and selling of milk. I am familiar with the
24 nuances of marketing milk on a daily basis, the costs
25 associated with supplying customers with their fluid milk

1 needs and the interactions of the Federal Order system with
2 milk commerce.

3 Dairy Farmers of America (DFA) is a qualified
4 Capper-Volstead cooperative owned by 22,000 plus members who
5 produce milk on more than 17,500 farms. There are DFA
6 member owned farms in every state except Alaska, Arizona,
7 Maine and Rhode Island. DFA is a regular reporting handler
8 on all the Federal Orders except Arizona/Los Vegas Order and
9 we also pool milk in most state milk marketing orders.

10 In calendar year 1999 marketed 42.2 billion pounds
11 of milk, which represents approximately 26.1 percent of the
12 national supply. DFA markets it's member milk production
13 directly to it's customers or processes it in member owned
14 plants.

15 DFA had total revenues of \$7.6 billion in calendar
16 year 1999. Of that total, 73.8 percent was derived from
17 sales of fluid milk, 2.2 percent from butter sales, 2.3
18 percent from NFDM sales, 17.8 percent from cheese sales and
19 the balance from various other dairy products sales
20 activities. DFA is the sole owner of one fluid -- milk
21 processing business and a joint owner of 13 others.
22 Combined these businesses operates 91 plants in 35 states.

23 DFA has 24 "value added manufacturing" operations
24 in ten states that are wholly owned by DFA members. These
25 plants manufacture American and Italian cheeses, processes

1 cheese, butter and condensed milk products. Additionally
2 DFA members wholly own and operate seven "balancing
3 operations" that manufacture nonfat dry milk and condensed
4 milk products. We are also part owner in two nonfat dry
5 milk condensing plants in the Northeast.

6 In calendar 1999 DFA plants manufactured
7 approximately 7.5 percent of the U.S. cheese supply, 8.4
8 percent of the U.S. butter supply and 4.2 percent of the
9 combined U.S. production of nonfat dry milk and buttermilk.

10 The goal of DFA is to have a "voice" in the U.S.
11 dairy economy. In order to do so, we have a cooperative
12 business strategy to have a presence in all major dairy
13 product markets. We believe that in the marketplace of
14 tomorrow, dairy farmers must invest in the marketplace in
15 ways that are affordable and allow them to reach down the
16 marketing channel towards the consumer. The execution of
17 our philosophy gives us more than a perfunctory knowledge of
18 the U.S. dairy economy. In each of the business operations
19 mentioned above we have multiple plants and multiple
20 marketing strategies.

21 The data we will present both represents our
22 opinion and is based upon our actual business experience.
23 We point out again that our view is not narrow in scope.
24 The "bottom line" for DDFA producers is not determined by
25 one plant or by a singular marketing channel. For this

1 reason we expect that the Secretary will give our data a
2 serious review when considering the record.

3 There is a tension between the amount of the
4 detail presented for the record and the limits of business
5 confidentiality. Our aim as to present enough detail to
6 support our position and yet not share all details of our
7 business with our competitors. We reserve the right to be
8 the final judge of where that line gets drawn and we also
9 respect the right of others in this process to do the same.

10 The task of the Secretary. Fluid Use milk markets
11 have prices that are always related to the market prices of
12 milk used in manufactured dairy products; if for no other
13 reason, the composition of Federal Order pricing formula's
14 guarantee it. We accept that fact and endorse it. The job
15 of the Secretary is to find the correct balance between
16 market prices, product yields and make allowances so that
17 the Fluid Use markets can operate within the guidelines set
18 by Congress for Federal Orders. Federal Orders policy in
19 the past has aimed for reasoned minimums and expected the
20 market to operate above that "minimum level" rarely if ever,
21 covering all the costs of any market operation. We expect
22 this same principle to be at work in this Hearing.

23 DFA is a member of the National Milk Producers
24 Federation. The positions taken by NMPF in this hearing are
25 fully supported by DFA. Occasionally, however, we may

1 represent data in support of those positions that is not
2 identical to the NMPF testimony. Since NMPF is a trade
3 association it has no data of it's own. The proposals it
4 forwards will use either RBCS data or California Department
5 of Food and Agriculture data or data from members such as
6 us. In certain instances we have chosen to present our own
7 data to augment the record.

8 Price series for use in manufacturing formulas.
9 We support the continued use of the NASS price series for
10 all the pricing formulas under consideration at this
11 hearing. We would, at this time, oppose switching from the
12 NASS price series to the use of the CME price or other
13 proposals we have heard as alternatives.

14 The use of a NASS survey price enables the
15 industry to collect the broadset range of price information.
16 Product definitions and specifications have been devised to
17 allow for a reliable price discovery mechanism. We have
18 found that NASS has been diligent in searching out product
19 manufactures and sellers over time to add to the survey.

20 The CME does not offer prices for whey and the non
21 fat dry milk market does not trade enough to be reliable
22 indicator of price. So for these two products the CME is
23 not even an alternative to debate.

24 The NASS survey does have defects. The lag
25 between the NASS theories and CME price due to the time

1 necessary to collect the data is an issue. Since the NASS
2 survey price drags as prices rise and falls slightly faster
3 as markets decline, producers lose some income. This fact,
4 however, is a real world phenomenon and would be generally
5 true no matter how it was measured.

6 There is also a limited spread between the two
7 series, but it is small. Our examination reported in Tables
8 1 and 2 --

9 Q And are Tables 1 and 2, Mr. Hollon, part of what's
10 been marked as Exhibit 46?

11 A Yes.

12 Q Okay, thank you.

13 A Suggest that the NASS block cheddar U.S. price
14 averages from .002 to .014 cents per pound less than the CME
15 block cheddar price, depending on your view of which weekly
16 measure is the most accurate. A similar measure reveals
17 that the NASS butter price averages from .004 to .032 cents
18 per pound less than the CME butter price. A mandatory
19 collection process would likely correct most of the spread
20 concern.

21 The current voluntary procedures gives incentives
22 for sellers with higher than the average price to
23 underreport or not report at all, thus lowering the price
24 series average.

25 The major defects in the survey, we feel, can be

1 corrected if the survey are made mandatory and the result is
2 subject to some verification. We realize the ability to do
3 this is not available to the Secretary at present due to a
4 lack of legislative authority. We feel that the necessary
5 legislative authority can be obtained and thus the NASS
6 surveys improved upon.

7 If we find that this is something that is not
8 true, we will return to the hearing process to seek a
9 change, and would not want our present qualified endorsement
10 of the NASS surveys to be held against us.

11 As to the question of which cheese processors to
12 survey, DFA supports the continuation of existing practice
13 of measuring prices for 40-pound blocks and 500-pound
14 barrels. Furthermore, we support adjusting the barrel price
15 by three cents. It is our opinion that these products give
16 the Department a clear message as to commodity price levels
17 and additional commodities would not provide additional
18 information.

19 The industry does recognize that there are cost
20 differences between making barrel and block cheddar.
21 Packaging and customer product specifications are some of
22 the reasons for the cost. For many years -- I'm sorry.
23 Yes, for many years three cents has been a reasonable and
24 accepted spread and we see no compelling reason to change
25 that factor.

1 We would point out that our position on accepting
2 the use of barrels in the formula is predicated on the
3 continuation of the three-cent adjustment and the method
4 currently used of adding the adjustment to the barrel price.
5 We would oppose any methodology that narrows the spread or
6 altered the calculation method.

7 We oppose the inclusion of 640-pound block cheddar
8 prices as a component of the pricing formula. The
9 Department did not include that product in the final rule
10 despite several proponents' request, and we see no reason to
11 change it this time.

12 Our experience is that most, if not all, of the
13 commerce in the 640's is made on a long-term contractual
14 basis and would rarely be reflective of changing market
15 conditions. As a part of DFA's cheese marketing strategy,
16 we do not intentionally inventory this product and make it
17 only the contract specifications.

18 Because of the varying customer specifications, it
19 may be difficult to develop a uniform product definition to
20 be used in a general price survey. We supported the
21 continued collection of price data for butter, nonfat dry
22 milk and dry whey are they are being done by NASS, including
23 marketing cost and return on investment in the make
24 allowance formula.

25 DFA supports the inclusion of a marketing cost and

1 an ROI component in the make allowance formula. These
2 practices were included and supported in the final rule and
3 should be continued. The witness for the National Milk
4 Producers Federation has outlined several reasons for these
5 values and we concur.

6 As to the level of the marketing cost factor,
7 DFA's data suggests that our costs are in the range of .0018
8 dollars per pound.

9 Since the marketing functions are all within a
10 single department with common management, common
11 administrative support and use common data processing and
12 management information systems, it is difficult to break out
13 an exact per unit cost for each product line. Therefore, we
14 would support using a single number for each product. As to
15 the ROI component, we support the .0103 dollar per pound
16 taken from the California survey in reference to the
17 National Milk testimony.

18 Data to determine make allowances: We understand
19 the limitations of the Secretary to collect make allowance
20 data. Specifications are difficult to determine.
21 Procedures are varied across the industry. Everyone
22 considers their process to be a key component of their
23 competitive position in the marketplace. Thus view sharing
24 the data with anyone else is a serious issue.

25 That said, if we're going to have regulated

1 pricing, which DFA supports, and use the current system of
2 determining those prices, then we must have reliable make
3 allowance data. Everyone supports a voluntary program but
4 distrust their neighbor. So for future use there will need
5 to be a mandatory collection process. We would like the
6 Secretary to develop a program for such collection. If that
7 program requires additional legislative authority, then we
8 would be supportive in a -- we would support obtaining it
9 from Congress.

10 The RBCS survey and the California process serve
11 as reliable models so the system would not have to be built
12 from scratch. Market administrator personnel, with
13 additional training, can certainly serve as the base to
14 collect the necessary data. RBCS personnel can assist in
15 compiling and analyzing it.

16 In preparing for this hearing, we did have
17 discussions with personnel from the California Department of
18 Food and Agriculture's Dairy Marketing Branch. From those
19 discussions, we concluded that their survey process is
20 rigorous and stringent. Plant cost surveys are done
21 periodically but not necessarily on an annual basis. The
22 final results are published regularly but not automatically
23 used by the industry. A hearing must be held in order to
24 alter the existing formulas and the publication of a survey
25 does not automatically trigger a hearing.

1 The last make allowance change occurred in 1997,
2 when the current allowance of .1690 dollars was instituted.
3 It's a per pound number. At that time the most recent
4 survey dated July 1997 was available and showed a weighted
5 average cost of .1840 dollars per pound. Since that time
6 two additional surveys have been performed, resulting in
7 make allowance costs of .01759 and most recently .1693.

8 The existing product formula has not been changed
9 even though the make allowance in use is below the survey
10 cost. We would expect the Secretary to continue to exercise
11 conservative principles regarding the implementation of the
12 results of this hearing.

13 The Secretary should perform a compilation on a
14 regular basis and make the data available to the industry
15 for inspection. If warranted, interested parties could
16 request a hearing to review the price formulas. We would
17 oppose the concept of automatic changes in the formula or
18 mandatory hearings based on the publication of cost surveys.

19 Since this is not possible at this juncture, DFA
20 supports the methodology established by the Department in
21 the final rule as the basis for computing a make allowance.
22 We support the combined and weighted use of the RBCS and
23 California surveys. We would expect the Secretary to use
24 the most recent data available to him in order to make his
25 determination. DFA supports the National Milk Producers

1 Federation make allowance data.

2 Cheese: DFA supports the make allowance proposals
3 submitted by the National Milk Producers Federation of
4 .01536 dollars per pound. We participated in both the RBCS
5 survey and in the State of California survey. Our
6 experience indicates this to be a reliable and accurate
7 reflection of the cost of manufactured cheese.

8 The plants and their product mix that were part of
9 the surveys were: Monett, Missouri, barrel cheddar cheese;
10 Smithfield, Utah, block cheddar cheese; Zumbrota,
11 Minnesota, block cheddar cheese; Corona, California, block
12 cheddar cheese.

13 In total, these plants produced 250,762,979 pounds
14 of cheese. They operate at a weighted average capacity rate
15 of more than 75 percent. Milk supply needs, seasonal
16 balancing requirements, capital improvements, and expanded
17 production capabilities all affected the operating schedules
18 of these plants.

19 Cost data is maintained monthly as a part of our
20 regular business routine. All of the data is based on
21 actual plant experience and is weighted by the volume of
22 cheese manufactured. Every plant manufacturers product for
23 a mix of customers with different packaging and product
24 specifications. Several plans run lines for other DFA
25 plants, in addition to outside customers. No plant is sold

1 out to a single customer.

2 Whey: DFA proposes .1478 dollars per pound make
3 allowance for a whey manufacturer. This factor is computed
4 the same -- using the same cost account structure detailed
5 below and it includes ROI and marketing cost data as
6 previously presented. The make allowance is based on the
7 DFA plant at Smithfield, Utah. That plant is a cheddar
8 block plant and runs throughout the year.

9 The whey plant condenses and dries whey from the
10 cheese manufactured in the Smithfield plant only. It does
11 not produce any specialty whey products or plants.

12 The cost included in this total are represented by
13 the following breakdown: Direct labor, labor involved to
14 produced whey; supplies; disposable items used in daily
15 manufacturing; cleaning supplies, material for in-plant use;
16 pallets, material for in-plant use; packaging; repairs and
17 maintenance, regular and emergency in-plant activity;
18 repair costs; cost tracking for items that require
19 management approval; utilities processed specific; safety;
20 equipment seminars, instruction and inspection.

21 Indirect: personnel that support in-plant
22 activity but cross department lines; outside services,
23 consulting legal product management not in plant; other
24 would be a category of not specifically provided for items;
25 depreciation, whey equipment and portions of plant assigned

1 to whey products -- assigned to processing; lease rental,
2 cost tracking for leased versus owned items; marketing cost.
3 I've seen the National Milk testimony for that description
4 ROI the same, see National Milk testimony.

5 Butter and nonfat dry milk: DFA supports the make
6 allowance proposals submitted by the National Milk Producers
7 Federation of .096 dollars per pound for butter and .014
8 dollars per pound for nonfat dry milk.

9 We did not participate in the RBCS survey for
10 these products. The respective plants did not participate
11 in the survey prior to the formation of DFA and did not have
12 the RBCS requirements programmed into their reporting
13 software. We find the make allowance data though to be
14 representative of our experience.

15 Comments on the cheese formula: The question of a
16 proper constant for butterfat recovery in the Cheese Yield
17 Formula is complicated and technical. The Van Slyke Formula
18 states that 93 percent of the buttermilk -- I'm sorry -- the
19 butterfat in milk is expected to be retained in the cheese
20 making process.

21 Dr. Barbano states that the cheese plants bleed
22 whey cream back into the process, which makes a retention
23 rate of 93 percent highly probable. Such a rate would
24 indicate a factor of 1.635 in the formula used in the reform
25 final decision. We can confirm his analysis and results

1 from our own operating experience. We also did not achieve
2 this maximum level of performance on an every vat basis.

3 The question then is should the Secretary write a
4 decision that selects an optimum yield and captures the
5 highest possible return under the Federal Order Program for
6 dairy farmers. In many cases the question is purely
7 academic as the cheese plants in question are owned by dairy
8 farmers and the return from the plants are paid to the
9 owners in the form of earnings or prices in excess of
10 federal order minimum prices.

11 Competitive factors in many markets cause
12 proprietary plants to pay federal order prices as well.
13 However, there are cases where the diary farmers do not
14 receive complete and proper compensation for milk used in
15 the production of cheese as the federal order minimum price
16 becomes the actual price paid.

17 The most compelling reason for not using a 1.635
18 yield for cheese under the Federal Order System is the fact
19 that regulated plants compete with nonregulated plants for
20 sales. Nonregulated plants are not obligated to pay based
21 on federal order yield factors. Federal order pricing
22 should not put regulated cheese plants that purchase
23 regulated milk at a severe competitive disadvantage in
24 relation to nonregulated cheese plants.

25 It is our belief that the current yield figure of

1 1.582 translate into a 90 percent butterfat retention is
2 overly conservative and overly protective of cheese plants
3 purchasing regulated milk.

4 We believe federal order minimum prices should
5 more accurately reflect the true value of milk used to
6 produce cheese. Thus we are proposing that the yield factor
7 be increased to 1.60, translating to a 90 percent retention
8 of butterfat in cheese processing. We believe this factor
9 is a reasonable compromise in the debate of theoretical
10 yields and competitive factors present in the marketplace.

11 Furthermore, to set the pricing formula to achieve
12 the higher end of the theoretical yield would have a gross
13 negative financial implication.

14 Computation of separate butterfat prices for Class
15 III and Class IV: We do not challenge Dr. Barbano's
16 testimony regarding cheese yields or component values in the
17 cheese making process. He obviously has done more research
18 in the field than anyone else we know.

19 Inclusion of an additional butterfat price will
20 raise the complexity level of orders from the standpoint of
21 an additional price factor. That is a negative.

22 The arguments raised by Dr. Barbano dealing with
23 price signal issues and underlying negative implications
24 from the present formula if the price of butterfat were to
25 be extraordinarily high relative to cheese are compelling

1 reasons to support the change.

2 At this point we wish to hear additional debate on
3 the issue -- I might say when I wrote this I didn't know I
4 would hear as much debate as I have -- before endorsing a
5 position to change the order language.

6 Data in support of the proposal adjusting the
7 Class IV butterfat price: DFA supports the proposal for
8 change in the Class IV butterfat price. We support the
9 rationale of extra cost given by the Land O'Lakes witness
10 and by the National Milk witness and find it to be true from
11 our manufacturing experience. This also serves as a valid
12 reason for not lowering the butterfat value in other classes
13 that do not incur any excess cost.

14 We manufacture butter primarily in two locations.
15 Butter production from the two plants in 1999 amounted to
16 more than 50 million pounds. Both plants purchase a
17 significant amount of cream from DFA locations and from
18 outside firms. The butter manufacture from purchases of
19 cream amounted to more than 76 percent on a weighted basis
20 of the total butter production.

21 Purchased cream must be handled twice, thus
22 incurring extra cost that must be compensated somewhere in
23 the system. Additionally, because of geographic
24 considerations nearly 10 percent of the total cream
25 purchases were from a secondary staging location, which

1 meant that this particular cream supply was handled for a
2 third time.

3 With regard to Proposals 25, 26, 27 and 28, these
4 proposals deal with yield and make allowances for nonfat dry
5 milk. We oppose the make allowance factors offered by
6 Associated Milk Producers, Inc. and propose a 25, as we
7 believe it to be excessive.

8 I have added a sentence here in addition to my
9 statement and it reads. I note that it is even more
10 generous than proposals made by Dr. Yonkers who posited that
11 make allowances should err on the too high side.

12 We also support the continued use of the divide by
13 1.02 factor in the final rule as it reflects our experience
14 and thus oppose the computation factors offered in Proposals
15 26, 27 and 28.

16 With regard to Proposal 29, DFA is mired in the
17 concept advanced by the proponents of Proposal 29. We also
18 note that the concept has been noticed and reviewed several
19 times in the 1990s without success at other federal order
20 hearings. If a proposal with sound mechanical concepts can
21 be advance that is able to overcome the objections raised in
22 earlier hearings, we would consider whether or not to
23 support it. Absent that, we are unable to comment further.

24 I would add a sentence, I guess, in contradiction
25 to comment further, but I do want to add a sentence at this

1 point that we would be opposed to any type of regionalized
2 Class III and Class IV price.

3 With regard to Proposal 30, DFA opposes the
4 position endorsed by the Midwest Dairy Coalition and Family
5 Dairies USA that would assure any increase in the Class III
6 and IV formulas not be allowed to increase Class I prices.

7 At the point that this was written all we had to
8 go on was what was in the Notice of Hearing, so the
9 following comments, mechanically this would be difficult, if
10 not impossible, to administer. It would require that a dual
11 pricing system be maintained to ensure that Class I price
12 not be allowed to increase. From month to month a price
13 calculation would have to switch back and forth between the
14 not increase and does increase set of formulas. Attempts to
15 predict prices for business planning purposes would become
16 exceedingly complex.

17 One of the intents of the federal order reform was
18 to try to make price calculation more transparent and easier
19 for the industry to use. In our view, this objective was a
20 success.

21 Proposal 30, I would add as we understood it at
22 that time, would destroy that accomplishment and result in
23 disorderly marketing. It would also reduce farm prices in
24 the upper Midwest as well as anywhere else.

25 With regard to Proposal 31, Proposal 31 should be

1 denied because Congress did not request the Secretary to
2 examine or alter the Class II differential. Our
3 understanding of the proposal, again that understanding was
4 based on what we had at the notice, that if as a result of
5 this hearing the Class IV price were to increase, then a
6 corresponding decrease would be applied to the Class II
7 differential such that the constant dollar historical
8 relationship between the two prices be maintained.

9 If Proposal 31 wants to be considered at the
10 hearing, then the Secretary should also consider that if as
11 a result of the hearing the Class IV formula is adopted
12 results in lower Class IV prices, that Class IV differential
13 should be increased in the same manner proposed by the
14 proponents of Proposal 31 so that the constant dollar
15 historical relationship between the two prices be
16 maintained.

17 DFA position on the issuance of the final
18 decision: We understand that there may be time constraints
19 affecting the ability of the Department to publish a
20 recommended decision and then a final decision. If that
21 were the case, we would support the issuance of a tentative
22 final rule that would allow for implementation but still
23 allow the industry to make comment and allow the Department
24 to make some revision in the final decision. This process
25 was used in the Class III-A decision. This process would be

1 preferred to an emergency final decision which allows no
2 comment or review.

3 Q Now, Mr. Hollon, I have just a few additional
4 questions and clarifications I would like to go into with
5 you.

6 You read from a prepared statement which everyone
7 has available to them in the room, which we're not making an
8 exhibit in the hearing record. But I want to make sure
9 we've got the right reading in a couple of places.

10 A Okay.

11 Q On page 10 of the written statement, the last line
12 where you're addressing Proposal 31.

13 A Correct.

14 Q Is it your intention -- you may have read what's
15 Class II there as Class IV, and I think you did in the last
16 line. Your intention there was to state that if the hearing
17 results in a lower Class IV price from what it would have
18 been otherwise that the Class II differential should be
19 increased under the logic of the proposal?

20 A Correct.

21 Q Now, you referred a couple of times, you used the
22 term ROI. Could you just identify what --

23 A Return on investment.

24 Q Return on investment.

25 Any time you said ROI that's what you meant?

1 A Yes.

2 Q Okay, now, on page 5 of the text of your statement
3 that you read from, the bottom paragraph referred to a make
4 allowance at California of dollar sign 0.1690. That was for
5 what product?

6 A Cheddar cheese.

7 Q Okay. Now, let's go to your exhibits. Four
8 exhibits have been marked. The first exhibit marked as No.
9 45 is titled Class II Substitution Analysis.

10 Is this exhibit intended to depict the economics
11 that a Class II processor would need to look at in
12 evaluating whether to use solids, butter or nonfat dry milk
13 rather than fresh fluid milk solids for Class II purposes?

14 A That is correct.

15 Q Okay. Could you describe the exhibit and what you
16 believe it demonstrates?

17 A The first column is labeled "AA Butter," a range
18 of prices from 65 cents to \$2. The second column would be
19 the formula for coming up with the butterfat price. That is
20 the price of .65 minus a make allowance of 096, which is in
21 the proposal that I happen to be supporting, but you could
22 substitute any make allowance -- you could substitute 11.4
23 in there under the "current," divide by yield factor of .82
24 and that calculation results in the .6756 butterfat price.
25 By adding the fixed differential to that price to go from

1 the butterfat price, which will be the same under III or IV,
2 would get you up to the .6872 price.

3 At that point the thought is that by some change
4 that a Class II user might want to go source -- fat from a
5 different source, that being butter. So you would say,
6 well, instead of paying 6872 I'm going to go buy some butter
7 and pay 65 cents for it, but that butter is not -- it only
8 contains 80 percent fat. So you would have to -- you have
9 to inflate the 65 cents by that or divided by .8 to get 81
10 cents.

11 When you subtract the two, the results of making
12 that decision is a negative .1299 cents, so it really would
13 not make sense to make that substitution. And over any
14 range of prices from 65 cents to \$2, it would not make sense
15 to make that substitution.

16 Q Okay. Now just stop there for a second.

17 The column labeled "III butterfat".

18 A Yes.

19 Q I assume that that could be and perhaps should be
20 labeled as "IV" or Class IV butterfat?

21 A Correct. That's right.

22 Q Okay. And that's intended to show the -- you
23 know, the existing price of butterfat for Class IV purposes?

24 A That's correct.

25 Q And you're comparing -- okay. And then the Class

1 II butterfat column is based on the existing differential
2 structure of 70 cents?

3 A That's correct.

4 Q And the price for butterfat in Class II. The
5 substitute butterfat calculates the AA butter price into a
6 butterfat per pound price?

7 A That's correct.

8 Q And then the difference shows that it's still 13
9 cents more expensive to use butter than fresh Class II
10 butterfat?

11 A That's correct.

12 Q Now, that doesn't factor in any cost for
13 converting the butterfat -- the butter back into a wet
14 butterfat produce, correct?

15 A It does not.

16 Q And if you were converting even a drier product
17 like anhydrous milk fat, I assume you'd have even -- you
18 would also have a conversion cost?

19 A That's true.

20 Q Does Exhibit 45 then show that for any range of
21 butter prices from 65 cents to \$2 there is no conversion
22 incentive with a differential of 70 cents?

23 A That's correct.

24 Q Now, by the way, if that differential of 70 cents,
25 if the butterfat price in Class IV was reduced six cents a

1 pound as proposed in Proposal No. 8, does that change the
2 incentive to use butter as opposed to fresh Class II
3 butterfat?

4 A It would change the absolute value of the column
5 labeled "Difference", but in every case it would still be
6 negative.

7 Q So you could just take six cents off the
8 difference and you still have --

9 A Yes.

10 Q -- a negative, and that doesn't include anything
11 for the cost of --

12 A That's correct.

13 Q -- reconstituting?

14 A That's correct.

15 Q Okay, let's go to the nonfat dry milk, the right-
16 hand portion of Exhibit 45 then.

17 A The same, similar type of analysis under range of
18 prices for nonfat dry milk from 80 cents to \$2.15; a similar
19 method for converting, taking a price minus make allowance.
20 I used .14 divided by 1.02, and those numbers resulted. I
21 did the same thing to compute a Class IV skim price, added
22 the 70 cents differential, came up within the Class II skim
23 price. I converted that back to a solids, not fat, by
24 dividing by nine, and again you get a resulting difference
25 and again it appears that is negative at every turn.

1 So for nonfat dry milk solids it doesn't look like
2 there would be any economic incentive to substitute that
3 level also.

4 Q Okay. Now, again, that doesn't have any -- there
5 is no cost of reconstitution factored in there?

6 A No, it's just the product.

7 Q And Mr. Blaise yesterday for one testified he
8 factors in at least six cents as a cost of reconstitution,
9 add six cents to the dry solids when he compares these,
10 these equations.

11 A Yes.

12 Q Okay, now, Proposal 8 doesn't change the cost of
13 skim solids or nonfat solids --

14 A It does not.

15 Q -- in Class IV? Okay.

16 In fact, are there any proposals in the hearing
17 that change that, the relationship between Class IV skim
18 solids and Class II skim solids?

19 A Not that -- perhaps some of the -- no, not that
20 I'm aware of.

21 Q Okay. So although there has been some allusions
22 in testimony to incentives perhaps being affected, you're
23 not aware that there really are any proposals that would
24 affect that --

25 A I'm not.

1 Q -- equation anyway?

2 A I'm not.

3 Q Okay. Exhibit 46, with the tables regarding NASS
4 and CME prices, I think you described in your -- in your
5 testimony, and I don't have any additional questions about
6 that at this time.

7 Let's go to Exhibit 47, if we could. Could you
8 describe proposed Exhibit 47, please?

9 A On Exhibit 47 I made an attempt to measure some
10 impact of the various price proposals, something similar to
11 what Ms. Ledman did yesterday in her testimony.

12 And I took a spreadsheet which I have used for
13 some time now that runs all the formulas for all of the
14 class prices each month. I get frequent calls to ask to
15 compute those, compare those, project those.

16 And so I took the assumptions under the National
17 Milk proposal, for example, of -- you know, what those
18 proposals were, the Class IV butterfat price minus six
19 cents, the make allowances that are proposed, the whey make
20 allowance that I propose, since there was not one directly
21 in the National Milk proposal, and I ran that back through
22 those formulas for the entirety of calendar year '99.

23 I looked at the classification from ten months of
24 the federal orders in '99, and I also looked at the
25 classification breakdown for the first three months of this

1 year, and I arrived at a national weighting of 42 percent
2 Class I, ten percent Class II, 39 percent Class III, and
3 nine percent Class IV.

4 So I looked at the differences between what the
5 1999 actual result of those formulas would be and what the
6 results would be if the factors in those proposals, 6, 14,
7 21 and 23 were adopted, and I arrived at a breakdown by each
8 class and then weighted it across all classes, and then
9 multiplied that by annual national milk production to come
10 out with a \$194,589,200 effect of increasing producer income
11 from the result of the change in the formulas.

12 I did the same type of analysis under the
13 proposals, primarily in two, three and four, that had the
14 NASS minus six cents computation for all Classes I, II, III
15 and IV. I adjusted barrels by the increase of only one
16 cents versus the current three, and used the whey and cheese
17 make allowance changes as proposed by those proponents. I
18 did not make an adjustment for including 640-pound blocks
19 because I couldn't figure out a way to do that.

20 The result of that proposal was, again using the
21 same methodology, 35 cents on all classes or removing
22 \$570,914,300 from producer pay prices back over to processor
23 bottom lines.

24 And then also I took a look at Proposal No. 25
25 just in isolation, what would that make allowance change

1 produce, and it would be a negative of \$90,461,200 using the
2 methodology I've just described.

3 Q Now, the type of analysis you did here in Exhibit
4 41, is that a kind of analysis that perhaps has been
5 referred to as a static analysis?

6 A It is.

7 Q So you didn't factor in any assumptions regarding
8 implicit changes in supplier demand that could be affected
9 by combinations of price changes or things of that sort?

10 A I did not.

11 I would point out that I happened to yesterday
12 walking around the room and asked everyone who had a
13 calculator, either a calculator or a PC running on their
14 desk, and I asked them had they been analyzing price changes
15 being proposed at the hearing, and my sample, which was
16 complete with three, everyone told me that they had been
17 analyzing price changes.

18 I asked them if they got prices that they
19 considered relative to their analysis. They said yes. And
20 I asked him if they factored in any demand data in their
21 analysis, and they all told me no.

22 Q Okay. You're in that sample in --

23 A I'm in that sample also. Actually, I went --

24 Q -- unanimous --

25 A I'm not in that sample because I didn't happen to

1 do mine in the room. But if I add myself, it would be four
2 people that would be in that sample.

3 Q And you would all be on the same page?

4 A We would all be on the same page for methodology.
5 And in fact I would point out that when I tired to duplicate
6 Ms. Ledman's numbers, I came in the same general direction.
7 Magnitude wasn't exact, but same general direction.

8 Q Okay. Her analysis was the same also?

9 A Correct.

10 Q Let's go to Exhibit 48 then, Mr. Hollon, the
11 handwritten exhibit. Could you describe that and explain it
12 for the record?

13 A Since I had a work sheet that did do the entirety
14 of 1999, each individual month with price formulas, I wanted
15 to try to get some measure of the change between just the
16 decrease of the six cents in the Class IV price. So I set
17 up one model. That was the "as is" 1999 column, and that
18 would be the prices as they were computed throughout that
19 whole year.

20 And for Class I on an annual average -- I'm
21 sorry. No. On an annual as for Class II. The skim price
22 was \$8.53. The butterfat price was \$1.3672 per pound, and
23 the 3-5 price was \$13.02.

24 I did the same thing for Class IV and came out
25 with a skim price of \$7.77, a butterfat price of 1.3602, and

1 a 3-5 price of \$12.26.

2 Then I moved over and decreased only the Class IV
3 portion of the butterfat price by six cents, and came out
4 with an identical skim price and identical butterfat and
5 identical 3-5 price, and that is because the way the
6 proposal is written that butterfat value does not affect the
7 computation of the Class II price, the specific language and
8 the specific, you know, the way the computation works.

9 In the Class IV, there is a difference, not in
10 skim milk, there was no difference in that price. The
11 butterfat price, as you would expect, would be six cents
12 less, and the effect on the 3-5 price was 21 cents less. So
13 that would mean that producer income would be decreased on a
14 blend basis, if you will, by some portion of that 21 cents.

15 As far as the spread between the two prices, that
16 is something that has been referred to in the hearing, there
17 would be butterfat -- the relationship between Class IV and
18 Class II, butterfat would cost six cents more and on a 3-5
19 basis 21 cents more.

20 When I looked through this, there is no doubt that
21 these numbers are how they compute. We have looked at the
22 substitution, you know, impact and said we don't see where
23 there can be a substitution effect on either nonfat or fat,
24 so it's only a question of the relative position of the
25 prices. Are they at the right level in the final rule? Are

1 they at the right level now and that's why we're having the
2 hearing to determine that?

3 Q Okay. And it's your position that the Class IV
4 butterfat price is not at quite the right price it ought to
5 be?

6 A That's correct.

7 Q It ought to be reduced.

8 Why do you feel the Class II and III prices should
9 not be reduced commensurate?

10 A Because they do not experience the added cost
11 values that were mentioned by several witnesses. There were
12 documented cases -- there were evidence put into the record
13 of the added cost of the Class IV manufacturer in attracting
14 some of that cream supply. Many times that buyer is the
15 buyer of last resort.

16 Mr. Yates, for example, in his testimony pointed
17 out that through his day-to-day business he uses all of that
18 fat that he can, and then he sells the rest, and he seeks
19 out the highest price. And when he gets down to the
20 buttermaker, then that's the price of the residual product.

21 Dr. Barbano pointed out that the Class III user
22 uses all the fat that they can economically, and then they
23 sell off the rest. From time to time they even buy
24 additional solids to try to make use of that fat. But
25 again, when they get ready to move it out it's at the lowest

1 use value.

2 Many times the buyer ends up being the buyer of
3 last resort. I would point out that our products, when we
4 tend to be able to buy the most, in other words, when the
5 quantity is the most the price is the less, and that would
6 be at balancing times of the year, and so you build
7 inventories and then shortly after those seasons when your
8 inventories are pretty flush, then the price drops.

9 There was some comments about the negotiating that
10 takes place and there was a mistake in assumption that just
11 the buyer, up until Mr. Wellington's testimony, that just
12 the buyer has all the negotiating ability. But I would say
13 that those that I know that negotiate, for example, with Mr.
14 Yates would rate him as an excellent negotiator and that
15 certain times of the year his ability is very good and the
16 market favors his position.

17 There is a wide array of buyers, so that ability
18 to negotiate and find a price, until you get down to the
19 price of last resort, there are other processors. Mr. Welde
20 pointed out that within the system or within the large
21 processor in the Northeast, their system, they use fat in
22 their plant system from plant to plant to plant. There are
23 fat buyers, there are brokers, and even the Chicago
24 Mercantile Exchange could offer a potential outlet until it
25 gets down to the buyer of last resort.

1 And so, you know, for those, for that array of
2 reasons that buyer of last resort doesn't have the same
3 opportunities, and many times it's at a time of the year
4 when you are a residual buyer and balancing the market.

5 Q Does the fact that Grade A butter is still made
6 and Grade B butter is still made affect your analysis in any
7 way?

8 A No. The comments that were made about that as a
9 viable market I would point out that neither AMS nor NASS
10 publish any price series data, and they publish no volume
11 data, which would indicate that those are small markets. It
12 would be small, and also it was scattered and it was hard to
13 collect and get that data.

14 I would also point out that the Chicago Mercantile
15 Exchange discontinued trading in that. And if you have any
16 exposure to the CME, you will know that they try to have
17 markets in everything. So just the fact that they decided
18 to discontinue those markets I would also have to point out
19 that there are -- they are becoming inconsequential and
20 small.

21 Q Let me turn to one of the issues with respect to
22 cheese price for a moment, Mr. Hollon.

23 The present three-cent spread between barrels and
24 blocks, in Dairy Farmers of America's operations, does it
25 cost more -- you produce both barrels and blocks, correct?

1 A We do.

2 Q Does it cost more to produce 40-pound blocks than
3 500-pound barrels?

4 A Yes.

5 Q Okay. What are some elements of those costs?

6 A The two most easy identified elements are in the
7 label of packing, in the area of packaging and labor. And
8 from our cost data, we find it slightly over two cents of
9 value. There are also the other areas of particular
10 customer specifications may require ingredients that are not
11 part of the regular make process that would require some
12 extra cost.

13 Q Okay. So it's your view that the three cents
14 remains a viable reflection of a difference in --

15 A That's correct.

16 Q -- in cost and should be reflected for these
17 products?

18 A That's correct.

19 Q Okay. Do you have a -- in selling milk to plants
20 and marketing milk from farms to plants, is there -- there
21 has been a lot of discussion in reference to shrinkage, loss
22 of volume.

23 Is there a benchmark factor that Dairy Farmers of
24 America has used in its marketing or shrinkage from farm to
25 plant?

1 A In that particular area we sell quite a bit of
2 milk to others in all classes. And typically those
3 negotiations include, you know, provisions for shrinkage.
4 We find in the majority of those contracts that a quarter of
5 a percent is considered an acceptable level, and that
6 shrinkage above that level generally requires action, either
7 financial penalty or just to maintain a good relationship
8 with the customers, and that's something that's even
9 codified in supply contracts; that shrinkage of above a
10 certain amount, and many of those contracts contain that as
11 the level.

12 Q In other words, your customers expect you to
13 deliver milk to the plant if it's being delivered on farm
14 weights and test --

15 A Yes.

16 Q -- at a loss of a quarter of a percent or less?

17 A That's correct.

18 Q Okay. And you're able to do that?

19 A Yes. It requires work on both parts, but yes,
20 that's a goal that's achievable.

21 Q Does Dairy Farmers of America make the product
22 we've all heard a little bit about here called anhydrous
23 milk fat?

24 A We do make anhydrous milk fat. Over the course of
25 the last couple of days I've been investigating that a

1 little bit, but we do make anhydrous milk fat.

2 Q By the way, are there any published data that
3 you're aware of with respect to volumes of anhydrous milk
4 fat produced in the Federal Order System?

5 A I have not discovered any published data, and I
6 would like to point out that in the -- just entered for the
7 record -- there is a table --

8 Q That's the annual federal milk --

9 A That's correct.

10 Q -- market order statistics for 1998?

11 A That is -- it's Table 46. And it points out milk,
12 skim milk and and cream utilizing the manufactured dairy
13 products by handlers regulated under federal milk marketing
14 orders by months 1998. The table points out that -- sorry,
15 wrong table.

16 Table 47 points out -- well, wrong again. It is
17 Table 48. Table 47 is the same data for CY-97 and Table 48
18 is data for calendar year '98, and it points out or attempts
19 to summarize butter, cheese, frozen desserts, cottage
20 cheese, skim milk powder, condensed milk, Class II and III
21 milk solids used to fortify, and finally other factory
22 products and uses. And there is no listing there for
23 anhydrous milk fat.

24 So if you look over in the other column, which is
25 a total of 4.1 billion pounds, and you look over in the

1 footnotes you find that there is 2.8 billion pounds of milk
2 that is in the other factory use product. And if you look
3 in that footnote you still don't find a label for anhydrous
4 milk fat. There are labels for whole milk powder, whey milk
5 powder, aerated frozen and plastic cream, but no subdivision
6 for anhydrous milk fat.

7 So within the Federal Order System, it is not a
8 large enough quantity of product to be measured. And in our
9 own scenario, we make that product in one plant, in
10 Winthrop, Minnesota. We make limited volumes. It's made
11 to order. It's not a residual use product at Christmas, at
12 New Years, at Memorial Day at Fourth of July when milk
13 supplies are long. We don't crank up the anhydrous milk fat
14 line. Our customers are few. They generally have some
15 requirements for why they want the product.

16 One example that was given to me was -- a
17 particular customer is a popcorn maker and they want the low
18 moisture product so that there is not moisture in the
19 product that affects the process when they need it and when
20 the consumer used it.

21 It does cost more to make. It does have sell for
22 a higher price. The identified -- I agree with Mr. Galloway
23 that it appears like there are four to five makers outside
24 of our own plant. I'm aware of three in Wisconsin and one
25 on the east coast. The product is storable. I agree with

1 Mr. Galloway that it was not readily made. With regards to
2 competitive issues, since it is clearly not a product of
3 last resort, it would certainly not belong in Class IV for
4 the residual use products are. Certainly it probably
5 doesn't belong in Class I or II for competitive reasons.
6 Since it is a storable product, perhaps Class III is an
7 appropriate place because that is the lowest product or
8 lowest class of price available for something that's not a
9 residual product.

10 Q In any event, Class II processors haven't turned
11 to DFA for anhydrous milk fat to use in their Class II
12 products, to your knowledge?

13 A If they have, it's been in extremely small
14 quantities, and the primary customers were not that
15 classification.

16 Q Okay, let me ask you one final question and then
17 make you available for questions from other parties.

18 Dairy Farmers of America has operations, as you've
19 described, in most of the federal orders and most of the
20 state of the United States.

21 Are you familiar with the payment, over order
22 payments for milk in various regions of the country
23 generally?

24 A In general, yes.

25 Q Okay. Would you agree with me that in the present

1 scenario that there is a broad range of over order payments
2 made in particular by cheese plants with a great range on
3 the high side in the -- tending to be up in the upper
4 Midwest and substantial range on the lower side in other
5 regions of the country, such as the far West or mountain
6 areas?

7 A I did investigate the level of premium over Class
8 III prices in the upper Midwest and the mountain state. And
9 in general, the over order premiums in the upper Midwest
10 were in excess of a dollar, and this was a calendar year
11 '99, so it was an average over an entire year, and over
12 order premiums in the mountain states were in the range of
13 40 to 45 cents.

14 MR. BESHORE: Thank you. Mr. Hollon is available
15 for further questions.

16 JUDGE HUNT: Mr. Yale.

17 CROSS-EXAMINATION

18 BY MR. YALE:

19 Q Let me just follow up on that question, Mr.
20 Hollon.

21 What about in the Southwest?

22 A There are some over order premiums. There are
23 over order premiums paid to producers in the Southwest.

24 Q What about is there a situation in the Southwest
25 due to some institutional factors and some long-term

1 circumstances and also some competitive balance in response
2 to that that makes the obtaining of additional over order
3 premiums for Class III in the Southwest difficult, if not
4 impossible?

5 A Mr. Yale, I can't speak to all of the reasons, but
6 I am familiar with the over order price announcements in
7 that market, and generally the Class III over order price
8 announcements do not carry as much value as the Class I and
9 the Class II.

10 Q And how much is the over order for Class III
11 carried in those over order announcements?

12 A Probably 10 to 30 cents might represent a range,
13 and the Class I and Class II premiums would be, you know, 50
14 to 75 cents.

15 Q And isn't that other range on the Class III mostly
16 to handle some issues involving with the handling of the
17 milk and dealing with some service costs associated --

18 A In some cases, in some cases that's true. Not all
19 cases, but in some cases that is true.

20 Q Based upon your experience and knowledge in the
21 Southwest, what is the -- under its current structure, what
22 is the potential for obtaining any significant addition to
23 the Class III premiums in that market?

24 A Well, over the past several years there have been
25 a few times when those premiums have been raised. I would

1 say going forward there will again a few times, but likely
2 that structure that I outlined will probably stay in
3 somewhat relative position on strictly that -- that basis of
4 measure.

5 Q I want to ask you some questions. You did some
6 comparisons with the NASS versus the CME. There has been
7 some discussion in this week that would suggest either by
8 questions, implication and maybe some direct testimony that
9 one of the things that the NASS does is it reflects a tilt
10 towards the West and provides a lower price level.

11 Have you heard that testimony?

12 A I have.

13 Q But your table, the exhibit that you indicated in
14 the blocks is, is that that difference is really very small;
15 that the CME is very close to representing in a sense a
16 weighted average of what milk or cheese, block cheese is
17 sold in the nation; isn't that correct?

18 A Yes.

19 Q So that the choice of the CME over the NASS is not
20 one for purposes of price enhancement would probably be a
21 futile effort. If that was your purpose was to get price
22 enhancement by choosing the CME in terms of just a direct
23 relationship, it probably would not be successful?

24 A Yes, I would agree with that.

25 Q And also as I understand your testimony is, is

1 that your support for NASS is qualified on the basis that
2 some of these other issues get fixed?

3 A Yes, that's true.

4 Q And one of those, as I indicated -- you indicated,
5 was mandatory and audited, right?

6 A That's correct, and we have a greater interest in
7 the mandatory and to some lesser extent the auditing.

8 Q Right. And then the other one thought that's very
9 significant is that three-cent adjustment for the block and
10 barrel?

11 A Yes, that's correct.

12 Q Now, while we're talking about the block and the
13 barrel, I did not see in your testimony or hear in your
14 cross-examination, unless I missed it, any discussion of the
15 adjustment of the barrel price to 39 percent as opposed to
16 38 percent.

17 Do you have a position on that?

18 A We've investigated that back and forth, and with
19 some of the numbers that we've put together you can justify
20 just on a moisture basis alone, there being about a two
21 cents value.

22 Q By making that adjustment, that there is a loss or
23 a reduction or what --

24 A A block price and a barrel price to be equivalent,
25 the block price would need to be \$1.30 and the barrel price

1 \$1.28.

2 Q At what moisture?

3 A The moistures that were in Dr. Yonkers' tables;
4 one was 35 and one was 38.

5 Q Do you have any position of adjusting the barrel
6 price to 38 instead of 39 in the current pricing?

7 A At this time, no. I mentioned that we heard lots
8 of debate this week. That was one of the pieces of debate
9 we heard it for the first time, so we have no-- no position
10 on that.

11 Q Now, you indicated you participated in the RBCS
12 study. Do these plants that participated in the RBCS study
13 also report sales to NASS?

14 A Yes.

15 Q All right.

16 A To the extent that they meet the product
17 definitions. We report -- maybe I should rephrase that.

18 We participate in the NASS survey. Whether or not
19 it's these exact plants, I can't tell you exactly. But
20 wherever we meet the definition, we participate, and we
21 participate in cheese, butter, powder and wet.

22 Q And by the way, I want to -- from a marketing
23 cooperative and marketing producer's standpoint within the
24 limitations of exposing too much confidentiality, we do want
25 to praise DFA for providing the detail that they did to

1 support those make allowances and making yourself available.

2 You've sat here through most, if not all, the
3 testimony of some other plants around the country. Have you
4 seen and heard any testimony from any of those that give
5 hard numbers or explanations of how their costs are in
6 producing cheese?

7 A No, I have not.

8 Q You indicated in your testimony on the yields
9 you're concerned about dealing with competitive
10 relationships with unregulated or other regulated areas,
11 right?

12 A That's correct.

13 Q Are you aware that California's regulated pricing
14 for IV-B does include a value for the whey cream?

15 A Yes.

16 Q But you didn't propose making that available?

17 A Did not.

18 Q And in those truly unregulated areas, those plants
19 are in a sense working off their entire yield, right? I
20 mean with what they have available; isn't that correct?

21 A That's some of their dollars available to run
22 their business, that's correct.

23 Q And that's one of the reasons those areas that you
24 mentioned in the upper Midwest and the mountain states tend
25 to be less regulated, a lot more milk in an unregulated

1 fashion or nearly unregulated fashion than what we have
2 elsewhere in the country going into Class III?

3 A Well, I would say that most of the upper Midwest
4 is in a regulated area to some extent.

5 Q Less contribution from the Class I pool.

6 A Oh. Okay, yes. Right.

7 Rephrase that one more time. I'm sorry.

8 Q Well, the point is, is that other than in the
9 mountain states and the upper Midwest most of the rest of
10 the regulated markets that have Class III, there is also a
11 significant Class I presence that --

12 A Okay.

13 Q -- can --

14 A So you are saying in those markets the Class I
15 utilization is lower than in most of the rest of the
16 country?

17 Q Right.

18 A Yes, I agree with that.

19 Q And in those areas is where the cheese plants tend
20 to pay more for their milk over and above the Class III
21 price than they do in the rest of the country?

22 A Yes. I can't say that there is a link between
23 those two, but yes, that's true.

24 Q Now, right now we have a -- I think domestically a
25 strong demand for butterfat, right?

1 A Yes.

2 Q Okay. Why would we be suggesting to lower our
3 butterfat price at a time at which we have a rising demand
4 for butter?

5 A The rationale that was developed primarily from
6 the other witnesses, I can only summarize that there is some
7 additional cost factors that are in there in there, and that
8 the present scenario didn't recognize those; and that
9 typically the fat buyer is a buyer of last resort; and that
10 there were some factors there that again, primarily cost
11 factor differences.

12 MR. YALE: I have no other questions.

13 JUDGE HUNT: Anyone else? Mr. Marshall, do you
14 have a question?

15 MR. MARSHALL: Yes, Your Honor.

16 BY MR. MARSHALL:

17 Q Mr. Hollon, I appreciate your testimony and I was
18 doing real fine with it until you got into some of that
19 examination about over order premiums that Mr. Yale asked
20 you about, particularly the premium levels in what I think
21 you described as the mountain states, and I'm concerned that
22 we need to explore that now --

23 A Okay.

24 Q -- because there is an implication about
25 profitability of cheese, butter and powder in that region

1 that I don't believe to exist.

2 A Okay.

3 Q In your analysis you described the mountain
4 states. You didn't mean to include Idaho in that, did you?

5 A Yes.

6 Q Do you believe that there is a premium paid over
7 the blend price in Idaho?

8 A Premium paid over the blend price.

9 I imagine that those premiums is premiums over
10 Class III, and that would be comprised as a plant premium, a
11 quality premium, a protein premium, a volume premium.

12 Q All right. So now I understand that you're
13 referring to the actual pay off price relative to the Class
14 III price?

15 A Right.

16 Q Are you aware that in this calendar year the blend
17 price in Idaho has been perhaps a dollar over Class III?

18 A I don't think I've heard anybody tell me that it's
19 been that high. But if you say that, I will accept that.
20 My comparison there was based on 1999 and what our
21 experience was in paying producers in that the premiums --

22 Q I'm sorry. 1999?

23 A Yes, calendar year '99.

24 Q Please proceed.

25 A And that the comparison between that area and the

1 upper Midwest area shows that the upper Midwest area, there
2 was considerably more premiums paid than on the mountain
3 states.

4 Q Again these are premiums relative to Class III?

5 A Mm-hmm. That was just the base of measure.

6 Q Right. And I believe when Mr. Williams testified
7 yesterday he was referring to a premium above Class III as
8 well, so based on that I can accept your characterization of
9 the Idaho market.

10 With respect to -- did you mean to characterize at
11 all the Pacific Northwest market?

12 A No.

13 Q And with respect to the Salt Lake City area, did
14 you mean to include that in your analysis?

15 A No, because probably the northern part of DFA is
16 Mountain Council when I refer to mountain region.

17 Q Quite apart from whatever Mr. Yale was asking you
18 about, would it be fair for the government, for the
19 Secretary to interpret your testimony here to imply in any
20 way that there is additional money available from the Class
21 III market to pay premiums in the mountain states area?

22 A I think that the -- I think that the point that I
23 was driving at was that there has been an assumption laid
24 out that a too high make allowance is an okay thing, and
25 that the market activity will correct that, and that

1 producers' interests will be treated equitably.

2 So there is some assumptions there. One of those
3 assumptions is that processors will be able -- or will pay
4 that too high make allowance out.

5 If you assume that cheese as an example moves in a
6 national market, which I think it does, and then those who
7 make cheese in one part of the country should have
8 generalized availability of those margins everywhere.

9 Q Well, it's not your testimony, is it, that the
10 make allowance available in the year 2000 under the new
11 Federal Order System in two cheese processors in Idaho
12 accounts for the payment above the federal order price,
13 Class III price? It's not your contention that that money
14 is coming from the Class III make allowances, is it?

15 A To finish the thought is if -- if that is -- if
16 currently competition pushes out all of that too high
17 margin, too high make allowance, if that's where the source
18 of that comes from, then you would expect that in areas that
19 are similar, which would be the upper Midwest and the
20 northern part of the mountain area, they are highly Class
21 III. There are a lot of cheese manufacturing. You make the
22 assumption that they both have access to those dollars, and
23 that competitive factors will say pay them out. You should
24 expect similar premiums.

25 That's not the case. The premiums are not

1 similar. So something is making premiums be higher in the
2 upper Midwest and lower in the mountain states. And my
3 contention is that the competitiveness level is not the same
4 and therefore there is not something that is forcing that
5 margin which if it's available in one reason of the country
6 it probably should be available in the other because it
7 comes from the same source.

8 So the theory that too high make allowance is an
9 okay thing, I'm saying it's not necessarily true, and that's
10 part of my rationale to support that.

11 Q Well, I disagree with a lot of what you said there
12 in that conclusion but that's argumentative. I'm simply
13 trying to determine whether you are telling the Secretary
14 that you believe that there is money within the Class III
15 make allowance in Idaho being used to pay the premium above
16 Class III rather than say pool draw.

17 A The point I am making is that there is some --
18 there are some dollars there as evidenced that they are
19 available in another part of the country that aren't being
20 paid out, and therefore if there were, the premium in Idaho
21 ought to be as high as the premium in Wisconsin paid to
22 producers if the primary source of revenues are similar and
23 competition forces them out. But they are not all out, so
24 something must be out of whack in the competitiveness.

25 Part of my assertion is that Idaho is not as a

1 competitive market as the upper Midwest and doesn't force
2 all of its premiums out. If they are in, they must be --
3 you know, they must be available, but they are not on the
4 pay price.

5 Q I would love to be able to cross-examine your
6 colleague, Mr. Jendo, on that point about not being
7 competitive.

8 Do you know how many buyers of cheese there are in
9 southern Idaho? Excuse me -- of milk for cheese?

10 A I would guess there are six or eight, but I would
11 guess there are 60 or 80 in the upper Midwest.

12 Q Would you agree to six or eight in the Magic
13 Valley alone?

14 A Okay.

15 Q And with respect to your assertion -- assumption,
16 I think, would be a better term -- in what you have just
17 analyzed that --

18 A Assertion sounds good.

19 Q With respect to your assertion that the revenue
20 base ought to be the same between Idaho and the upper
21 Midwest, are you familiar with the fact that the NASS cheese
22 survey shows that there is a considerable difference between
23 the FOB values in the West versus the Midwest?

24 A Yes, there are some difference between the West
25 and -- between the NASS other and the NASS upper Midwest

1 price, or Minnesota - Wisconsin price. There is some
2 difference, but I don't think that's enough to account for
3 the difference between the dollar and, you know, 45 cents.

4 Q Are you familiar with the Cornell model that was
5 run on manufacturing price services which does predict that
6 kind of a difference?

7 A I'm familiar with the study. I'm not familiar
8 with the intimacies of the details.

9 Q Well, I will be putting it into evidence a bit
10 later in this hearing and invite you to help cross-examine
11 me on that subject.

12 A Okay.

13 MR. MARSHALL: Thank you, Mr. Hollon.

14 JUDGE HUNT: Mr. Vetne.

15 BY MR. VETNE:

16 Q Good morning, Mr. Hollon. I'm John Vetne. I
17 represent Kraft.

18 A Good morning.

19 Q I'm looking at your Exhibit 48, the handwritten
20 exhibit.

21 A Okay. Yes, sir.

22 Q Under Class II prices in the, or Class II analysis
23 in the top one-third of the exhibit, to the far right after
24 a different calculation you have written "No need to charge
25 consumer."

1 A Correct.

2 Q Am I correct that those words in that analysis are
3 an expression of your opinion because what you calculate as
4 the difference of 0.00 in each of the three lines doesn't
5 result in an increased cost?

6 A Yes.

7 Q Okay.

8 A 1302 and 1302 are the same number, so if that was
9 your base raw material cost and that was all that you had
10 sit around, not taking into consideration interest, taxes,
11 et cetera, et cetera, but from that standpoint it's the same
12 in both scenarios.

13 Q Okay. And since you are dealing only with the
14 difference in regulated prices, one set of calculations
15 compared to another and you observe that there is in fact
16 0.00 difference, you also do not take into account
17 differences in nonregulated competitive factors; is that
18 correct?

19 A That's correct.

20 Q So if in fact the proposal plays out so that there
21 is a change in competitive relationship which changes,
22 increases or decreases, but changes the competitive
23 nonregulated part of the cost, your opinion expressed, would
24 you agree, would have to be changed, either no need to
25 charge consumers or you have the ability to pass along a

1 benefit to consumers?

2 A Yes.

3 Q With respect to the Exhibit 45 now, Class II
4 substitution analysis exhibit.

5 A Okay.

6 Q The third column that was labeled "II Butterfat,"
7 did we amend or further explain that to mean the Class II as
8 well as the Class IV butterfat price per pound?

9 A It would be Class II because it has the added
10 double 07 differential into it.

11 Q Pardon?

12 A It would be the Class II price, Class II butterfat
13 price because it has the differential added into it.

14 Q The per pound differential between Class IV and
15 Class II?

16 A Yes.

17 Q Okay. The Class II and Class IV butterfat price,
18 in each case is it now a price that's not known until the
19 month is over?

20 A Correct.

21 Q The AA butter price that you have in the first
22 column, that is a price that -- at whatever level it is --
23 you assume is the result of a survey process?

24 A Correct. Butter is published as the --

25 Q At the price upon which federal butterfat --

1 A Yes.

2 Q -- differential are based, or butterfat prices
3 now, not differential?

4 A Yes, that's right.

5 Q Okay. With respect to the second part of the --
6 the right half of Exhibit 45.

7 A That is opposed to the correct half?

8 Q That is true. I hate to say that's correct.

9 The right half of the exhibit deals with
10 substitution analysis for nonfat dry milk versus solids
11 nonfat.

12 A Yes.

13 Q Unlike the fat portion the skim milk portion of
14 Class II, is that something that's known in advance?

15 A Yes.

16 Q Okay. And it's a skim or solids not fat value
17 that is based on a past trading period for nonfat dry milk
18 rather than the current month's trading period which we
19 don't know when we are receiving?

20 A Yeah. In order to get an advanced price you'd
21 have to do that. The mechanics would -- unless you want to
22 base them all on a crystal ball -- would have to be done
23 that way.

24 Q Okay. So the nonfat dry milk price in the
25 calculations would represent -- in your exhibit -- would

1 represent not the current month's nonfat dry milk price;
2 that is, the month in which the handler has to make the
3 decision to substitute or not, but it would represent a
4 prior month's nonfat milk price?

5 A That's correct.

6 Q Okay. Do you have information or knowledge, to
7 spare me some time of going back and perusing all these
8 pages, of the variation between the current month's nonfat
9 dry milk price and the prior month's reference price upon
10 which skim solids are based?

11 A Some.

12 Q Any ballpark range that you can share with me --

13 A No.

14 Q -- while you're sitting there?

15 A I don't.

16 Q Okay. And the nonfat milk price that is
17 referenced in that first column in addition to being a prior
18 month would you agree with me that it represents a price
19 derived from a range of prices?

20 A One more time.

21 Q Would you agree with me that the first column
22 labeled "NFDM" --

23 A Yes, ranges of prices. Yeah, 80 to 215.

24 Q Pardon?

25 A The 80 cents to the 215 range of prices.

1 Q Yes. Right. But with respect to each number on
2 there, for example, the first one, 0.8 dollars, that when
3 NASS comes up with a number, that number -- in addition to
4 being a prior month, that number is a result of some
5 arithmetic --

6 A Right.

7 Q -- from a range of prices?

8 A Right. Right.

9 Q Do you know what that range of prices commonly is?

10 A You mean from week one, week two, week three, week
11 four or --

12 Q Well, let's say 80 cents. I mean, let's say that
13 it's a 10-cent range. It could go from 75 cents to 85 cents
14 or 79 cents to 81.

15 Do you know what the range is in the prices that
16 end up to be the reported survey price?

17 A Historically, it's very narrow. The nonfat price
18 from week to week to week to week --

19 Q Not week to week.

20 A It has to be.

21 Q Yeah, week to week.

22 A So week to week has been narrow.

23 Q There is a week to week --

24 A And then you average them up and there has not
25 been a tremendous amount of spread in the nonfat dry milk

1 price for some time.

2 Q Okay. So there is a variation from week to week?

3 A Yes.

4 Q But for a specific reporting day, there is also a
5 range of prices between sellers that make up the weekly
6 price.

7 A Daily Market News reports that nonfat dry milk
8 price as a range of X to Y, and then the midpoint of that
9 price or -- yeah, the midpoint of that price is used -- no,
10 not the midpoint, the average of that price is what goes
11 into the formula.

12 Q Yes. Okay.

13 With respect to the ranges that we have described,
14 that is, ranges in a specific week in transactions ranges
15 from week to week, which includes time variations --

16 A Mm-hmm.

17 Q -- as well as weekly spread variations, and
18 differences representing a past reporting period for the
19 survey price and a current application of that price to a
20 solids nonfat price at which the NFM prices continue to
21 range.

22 A Mm-hmm. Mm-hmm.

23 Q Do you have any information with respect to the --
24 for example, in the first line, the 7.56 cents, what you
25 calculate as a disincentive, do you have any information

1 given those ranges what percentage of milk would -- or
2 nonfat dry milk would fall outside the range for a current
3 month?

4 A No, I don't have a clue.

5 Q Okay. Thanks.

6 A I would be glad to look at what you would have to
7 see to show that.

8 MR. VETNE: Thank you.

9 JUDGE HUNT: Mr. Rosenbaum.

10 BY MR. ROSENBAUM:

11 Q Mr. Hollon, I assume that we are all in agreement
12 that under the current pricing system once the cheese
13 manufacturer has sold his cheese and paid the regulated
14 minimum price the yield -- the make allowance is what's left
15 over to cover his costs of taking that milk and turning it
16 into cheese, correct?

17 A For those products that are defined by the NASS
18 price, et cetera, yes. In general, I would agree with that.

19 Q Okay. Now, I want to -- and you're proposing a
20 make allowance of around -- what's the exact, 15 point
21 something?

22 A 1536.

23 Q Now, we heard testimony from a fellow cooperative
24 earlier today, Agri-Mark. Mr. Wellington testified that his
25 costs are 18 and a half cents, correct?

1 A If that's what he testified, I agree.

2 Q For 1999.

3 A I heard him but I don't remember.

4 Q Okay. Do we both agree that the impact of the
5 make allowance you're proposing is such that -- assuming Mr.
6 Wellington has to pay the regulated minimum price for
7 purposes of this question -- he's losing three cents a pound
8 for every pound of cheese he makes there?

9 A Assuming everybody is right, everybody has got the
10 right numbers, yes, there is a difference and that would be
11 a loss.

12 Q Okay. Well, the only number I'm having to assume
13 is right is his number of 18.5 cents because your number is
14 going to be a regulated number, correct?

15 A Okay. Yes.

16 Q So that is the impact of your proposal to having a
17 15-cent make allowance, right?

18 A On the first blush, yes.

19 Q Okay. And --

20 A You would also need to include that -- for
21 example, he described, you know, product that he makes that
22 doesn't fit in his definitions that, you know, generates
23 premium dollars over that.

24 Q Oh, he may be making some money off those other
25 products, maybe losing them. I don't know --

1 A Yes.

2 Q -- what the costs are of making those products.

3 A Yes.

4 Q But in terms of whatever he's making that would
5 fit the NASS criteria --

6 A Yes, yes.

7 Q -- of 40-pound blocks, 500-pound blocks, I don't
8 think he makes those, but if he did, that's the loss he'd
9 suffer?

10 A I would agree. I would agree with you in that
11 scenario.

12 Q Okay. You make a statement on page 8 that's
13 commenting on the cheese formula, and in the middle you say
14 there's a compelling reason for not using the 1.635 yield
15 factor for cheese.

16 A Yes.

17 Q And the reason being the fact that regulated
18 plants compete with nonregulated plants for sales, correct?

19 A Yes. That is a reason that we have here
20 identified.

21 Q And you say nonregulated plants are not obligated
22 to pay based on federal order yield factors, correct?

23 A Yes.

24 Q I wonder if it's also true that nonregulated
25 plants are not obligated to pay based on federal order make

1 allowances.

2 A Yes.

3 Q And in fact, for example, the current make
4 allowance in California is 16.9 cents, correct?

5 A Correct.

6 Q And your proposal, if adopted, would put federally
7 regulated plants at a 1.54-cent per pound disadvantage as
8 compared to plants that make cheese and are regulated in
9 California, correct?

10 A Yes.

11 Q On Exhibit 47 you've done a calculation of impact
12 of various proposals without, as you stated, taking into
13 account supply/demand responses to these change in minimum
14 prices, correct?

15 A That's correct.

16 Q Now, you are aware that USDA -- you said you went
17 around the table --

18 A Yes.

19 Q -- asking other witnesses whether they had
20 attempted to do so. But you are aware that in fact USDA
21 attempted to do so, correct?

22 A Yes. I've read that and I've talked with Mr.
23 McDowell.

24 Q Okay. Have you performed any analyses of your own
25 that would cause you to have any numbers you could

1 substitute for Mr. McDowell's?

2 A I have looked at Mr. McDowell's study. I read it
3 with the announcement. I have not done a comparable. Dr.
4 Yonkers takes quite a bit of capability ability,
5 information, detail. At the same time as I looked through
6 Mr. McDowell's -- just one case in point to some of his
7 assumptions I don't completely agree with. And so if I
8 could do it all, you know, then there were some things that
9 I would change which may alter it back and forth.

10 But no, I have not attempted to duplicate his
11 research.

12 Q Okay.

13 A Or his study.

14 Q All right.

15 A But I would also point out I don't think it makes,
16 you know, this comparison any less valid.

17 Q Well, it might have a dramatic impact on what the
18 ultimate effect is on dollars going into dairy farmers'
19 pockets, correct?

20 A The difference between the two, one leaned to the
21 right, one to the left, you're saying those differences
22 could be --

23 Q I'm just suggesting that -- well, Mr. McDowell
24 repeatedly found that the changes in minimum prices had a
25 noticeably different effect in terms of actual dollars per

1 hundredweight than the change in actual all milk prices for
2 the federal order farmers.

3 A Okay.

4 Q That's the kind of impact you can see by running
5 that kind of supply/demand impact on top of this, correct?

6 A Mm-hmm. You can see impacts just -- you know, I
7 mean these are some sizeable impacts that you can see by
8 doing this type of analysis.

9 Q Okay. But the size of those impacts may very
10 well be reduced substantially once supply/demand factors are
11 placed on top of them?

12 A Or enhanced. They could get bigger.

13 Q Are you sure they could get bigger?

14 A Well, aren't there -- well, there are assumptions
15 embedded in Mr. McDowell's analysis that may or may not be
16 correct.

17 Q Do you agree with me that he found that the
18 ultimate impact of each of the changes he analyzed was less
19 than the impact that simply was felt by the -- experienced
20 by the federal order blend price?

21 A Are you reading that from the impact analysis?

22 Q I am.

23 A Then I agree that's the way it reads.

24 Q I'm looking at the numbers. I'm not reading the
25 sentence from the impact statement. I don't want to mislead

1 you.

2 A Okay.

3 Q I'm comparing the two.

4 Let me ask you a question about why make
5 allowances. And you provide a figure in your testimony on
6 page 7, correct?

7 A Yes.

8 Q That's based on a single plant?

9 A Correct.

10 Q Do you all make why elsewhere?

11 A Yes.

12 Q And what was the reason for excluding those
13 figures?

14 A The primary reason was we felt this plant best fit
15 the definition of an average scenario and it does not make,
16 you know, specialty products. I don't remember if the
17 language is in the Price Support Program or the Federal
18 Order Program. But there is some discussion about the
19 Secretary trying to find an average situation, not an
20 extreme situation. Something, you know, like the ability of
21 an average plant to return X.

22 And so when we looked at some of the plants that
23 we felt this was the most straight up comparison.

24 Q Was any consideration given to doing a survey that
25 would reflect more than one plant?

1 A For Dairy Farmers of America? You're talking
2 about --

3 Q Or any --

4 A To produce this number?

5 Q Well, or any larger organization to which Dairy
6 Farmers of America belongs.

7 A Run that by me one more time.

8 Q Well, it's just one plant, that's all I am saying,
9 and was there any consideration given either by Dairy
10 Farmers of America or National Milk Producers to doing a
11 cost of manufacturing for whey that would reflect more than
12 one plant?

13 A Other than what was in the RBCS survey, no. We
14 didn't attempt to create our own survey. We felt it would
15 have some credibility issues.

16 Q Okay. RBCS doesn't have a whey make allowance,
17 right?

18 A That's correct.

19 Q Okay. Now, let me see if I -- I want to list some
20 costs and see if I'm right that these are left out of your
21 calculation of the whey make allowance, and I'm simply using
22 your description of what you covered for that.

23 A Okay.

24 Q Procurement of milk?

25 A Yes.

1 Q From the way I asked my question, I don't know
2 whether the answer is yes -- which way the answer yes goes.

3 Were procurement of milk costs included?

4 A No, they were not.

5 Q Were administrative expenses included?

6 A No.

7 Q And by that I mean plant manager.

8 A No.

9 Q Plant office?

10 A I doubt that that was excluded. I don't think we
11 track explicitly square footage and allocate it out, so I
12 don't know that you could, you know, make on a building case
13 scenario. But there was no -- you know, if it included the
14 cost of another office somewhere else, I could say no, it
15 would not be.

16 Q Okay. Any effort to allocate any corporate
17 overhead?

18 A No. It's not included.

19 Q It's not included. Okay.

20 So you're aware that, for example, when CDFA does
21 their cheese make allowance survey, they actually interview
22 corporate people and try to allocate some of that --

23 A Yes, I am aware.

24 Q -- at individual plants?

25 A I've talked with some of those folks. They go

1 into and do the look and have the people and check it out
2 and say, "Yes, you can put this in. No, you can't put that
3 in."

4 Q Okay. Well, I'm trying to address not merely
5 their general auditing efforts, but the efforts specifically
6 to try to allocate --

7 A Yes.

8 Q -- corporate overhead.

9 A Yes.

10 Q But you didn't undertake this effort?

11 A Did not, did not do that.

12 Q I didn't see anything in her for taxes. Are taxes
13 included or excluded?

14 A Excluded.

15 Q And what about insurance?

16 A Did not include that either.

17 Q I want to ask you a question about the use of CME
18 versus NASS prices.

19 A Yes.

20 Q Which, of course, is an issue as to which we are
21 in agreement.

22 A Yeah, I noticed that.

23 Q But that's not going to stop me from asking a
24 question.

25 (Laughter.)

1 A I would say that I noticed several other things in
2 your proposal that we are in agreement on.

3 Q Yes, and I will not subject those to vigorous
4 cross-examination either.

5 A Okay.

6 (Laughter.)

7 Q But I simply want to ask you if you could look at
8 Exhibit 46 because there has been some notion that the CME
9 and the NASS present really the same result, and I want to
10 see whether the rather elaborate work you have done on this
11 issue --

12 A It does not include demand though.

13 Q Does not include demand? Well, we'll leave that
14 aside for now.

15 You've done some hard work on this issue to put
16 this together and I want to focus on the conclusion you
17 reach on the last page.

18 Now, if I understand standard deviation
19 correctly --

20 A Okay.

21 Q -- which may or may not be true.

22 A -- if I understand it correctly.

23 Q Once standard deviation means that 67 percent of
24 observations fall within that range; is that accurate?

25 A I would characterize it as one being better than

1 two and two being better than three. To the exact where
2 that falls out, I can't tell you if it's 67 or 66 or 50.
3 But that's the general measure of variation, and so lower is
4 better.

5 Q Okay. But if I'm right that one standard
6 deviation captures 67 percent of observations, then based
7 upon your analysis 33 percent of a time that it was a nine-
8 cent or greater difference between the CME price and the
9 NASS price? Is that an accurate way to read your able?

10 A I don't think so. Why don't we go the other way.
11 Let me tell you what I did and you can at that point decide
12 if you like it or still agree with it.

13 I took the NASS price and the CME price for the
14 current week. I lagged them one week and I lagged them two
15 weeks. And I got a -- over this entire period, for example,
16 we're looking at butter now. In the middle column, the
17 smallest, or in this case it would be the largest negative
18 variation was 13.8 cents. The maximum variation between
19 those two was 4.6. Since the average variation was a shade
20 under two cents, and that particular measure by lagging
21 those prices one week was -- had the lowest standard
22 deviation.

23 And so I concluded that was the best predictor.
24 And if I look across the column labeled "Average," I would
25 say that over this entire period the difference between the

1 CME and the NASS price was slightly under two cents.

2 Q Okay. Does the standard deviation attempt to
3 capture the --

4 A Deviation in the averages.

5 Q Yes, the deviation in the averages.

6 A Yes.

7 Q Yes. And that would be in terms of cents, right?

8 A Yes.

9 Q So that the deviation in the averages lagged one
10 week is 3.3 cents; is that right?

11 A No. The averages is 1.9 cents. And that column
12 varied less than lagged two weeks or lagged two weeks or
13 varied less than the current week. That was my goal.

14 Q You're not personally responsible for selling
15 cheese for DFA?

16 A I am not.

17 Q Okay. And I take it your notion of the market for
18 640-pound blocks would therefore be based on something you
19 heard from other people?

20 A The information that I've testified to I asked our
21 cheese salespeople several questions about that and those
22 were their conclusions.

23 Q Okay.

24 A And I'm reporting them.

25 Q The testimony from Kraft was that perhaps a much

1 as 20 percent of the cheddar cheese market is now 640-pound
2 blocks.

3 Do you have any --

4 A I do not.

5 Q -- reason to doubt that?

6 A I did not ask that question.

7 Q Okay. And you've described in your testimony
8 DFA's practices --

9 A Yes.

10 Q -- in terms of how you sell that.

11 A Yes. Yes.

12 Q But I take it you're not sufficiently familiar
13 with that market to know how others might do it?

14 A I asked that question. I asked did our people
15 know of others who has a practice inventory that product,
16 and the purpose for that question was to see if it was a
17 contract made to order, or if you built inventory in
18 anticipation of orders, or indicate different business
19 operations.

20 And the answer that I got from our sales personnel
21 and people was that they were not broadly familiar that
22 people inventory that product.

23 Q Okay. All right. You've heard some testimony at
24 the hearings of people saying that's what they do?

25 A Yes, I've heard two folks who have said that

1 testify.

2 Q And you don't -- you wouldn't dispute that they
3 are accurate describing their own operation?

4 A No, not describing their business. But I didn't
5 hear everybody who testified about 640 say that either.

6 Q Okay. And I take it you yourself are not
7 responsible for actually operating any of your cheese
8 plants?

9 A I am not.

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

11 JUDGE HUNT: Mr. English was next.

12 BY MR. ENGLISH:

13 Q Charles English.

14 Looking at Exhibit 47.

15 A Yes.

16 Q Just to clear up a tiny bit of confusion, if I
17 may, I hope.

18 A Clear up?

19 Q I hope I clear up some confusion here.

20 A Okay.

21 Q You have a column called "Proposal."

22 A Yes.

23 Q And next to National Milk you have a one without a
24 comma and then you have six, comma, 14, 21 --

25 A That was just the first one in the last, line

1 number one.

2 Q Line number one.

3 A Yes.

4 Q So it's also line two for IDFA?

5 A Yes.

6 Q And line three for MPI?

7 A Yes.

8 Q That's not intended to imply that those were --

9 A It is not.

10 Q -- proposals that --

11 A It is not.

12 Q -- you are supporting or IDFA is support, correct?

13 A You are correct.

14 Q Moreover, if you look at your line for proposal
15 three and four, which is IDFA --

16 A Yes.

17 Q -- have you not included much more than what is
18 actually included in proposals three and four in your
19 analysis?

20 A I think, between the members of the IDFA group
21 there have been proposals of NASS minus six cents, the
22 barrels down to one cent, the whey and cheese allowances, I
23 think those were all in Dr. Yonkers' --

24 Q But isn't it true that proposal number three is
25 NASS minus six cents on Classes II, III and IV?

1 A Yes.

2 Q And proposal number four is NASS minus 6 on Class
3 I?

4 A So the combined --

5 A So the combined of those two would only be the
6 NASS, the butter issue on one, two, three and four, and all
7 these other issues regarding the barrels, the whey and the
8 cheese --

9 A Yes.

10 Q -- would be found somewhere else in the hearing
11 notice?

12 A Okay. Yes.

13 Q Okay.

14 A But when they all got to the same effect and they
15 all would measure the same way. But if your question is did
16 I mislabel as to proposal number three and number four, then
17 you are probably correct.

18 Q And can you tell me what the -- what you did with
19 respect to butterfat or for any of these classes? Did you
20 make the same adjustment as Ledman made?

21 A No, I did not. I did not break out price effects
22 on skim and fat. These are all the -- using the formulas,
23 they come back to a milk price, and those were the prices
24 that I used.

25 Q Fine. And you said that you looked at Ms.

1 Ledman's exhibit --

2 A Yes.

3 Q -- with respect to proposal three and eight?

4 A Yes.

5 Q And you did not see anything that you disagreed
6 with in terms of the methodology?

7 A That's right. Her -- no, did not disagree with
8 her methodology, and her magnitude, in general, for the --
9 the limited of that proposal, I agreed with.

10 Q Fine. Thank you.

11 A You're welcome.

12 Q With respect to the plants that you have told us
13 about participating in the RBCS and the California survey --

14 A Yes.

15 Q -- would I be correct that the Corona, California
16 plant participated only in the California survey?

17 A Correct.

18 Q Now, I don't want to get into confidential
19 information. I'm very sensitive as you are as well. But
20 can you tell me whether that plant and the information you
21 submitted for it, with respect to it, whether that plant had
22 higher, the same or lower costs than the other two plants
23 that submitted block?

24 A No, I don't want to get into that.

25 Q That's fine.

1 Would you agree that some of the costs that are
2 requested of the California plant in terms of categories are
3 different --

4 A Yes, I would agree.

5 Q -- from RBCS? You would agree with that?

6 A Yes, I would agree.

7 Q Now, among other entities that I represent here, I
8 represent Master Dairies, and Master Dairies has a number of
9 members, including Merrigold and Crowley Foods.

10 Are you familiar with those entities?

11 A I'm familiar with those entities, but you didn't
12 list -- Mr. Tinkavald didn't list who they were --

13 Q No, okay.

14 A -- so I can't tell you they are Master Dairies or
15 not.

16 Q Okay, fine. I will represent for you at the
17 moment that they are members.

18 A For the moment, I'll believe you.

19 Q Okay.

20 (Laughter.)

21 Well, for the moment, I'll believe your answer.

22 If Merrigold is a net -- Merrigold has a Class II
23 operation in Rochester, Minnesota, correct?

24 A That is correct.

25 Q And it would not be unlikely that as a result of

1 that operation they are net buyer of cream for use in their
2 ice cream, correct?

3 A That could be true.

4 Q So looking at page 9 of your testimony when you
5 reference the need for an adjustment to the Class IV
6 butterfat price, you said, "The purchased cream must be
7 handled twice, thus incurring extra cost that must be
8 compensated somewhere in the system."

9 You would agree with me that to the extent that
10 Merrigold is a net buyer of cream that they are buying a
11 product that has been handled twice?

12 A Yes.

13 MR. ENGLISH: Those are all my questions. Thank
14 you.

15 Q Mr. Galarneau.

16 BY MR. GALARNEAU:

17 Q Just a really quick question here. Clay Galarneau
18 with Michigan Milk.

19 You have a make allowance for why at .14?

20 A 1478.

21 Q 1478?

22 A Yes.

23 Q Given the whey markets up and down for the last
24 couple of years, do you believe it would be possible for the
25 whey price to actually be lower than the make allowance?

1 A That would be a possibility. Recent history, it
2 has not got that low, but that could happen.

3 Q And if that did happen, would you feel that the
4 whey portion of the milk price ought to have a negative
5 impact on the Class III value?

6 A My personal preference would be that that -- in
7 the instances where that happens, that that computation be
8 taken into account in the producer price differential.
9 There seems to be fewer -- there seems to be -- one of the
10 most difficult things to try to explain is why a regulated
11 price is negative, and I have yet to find a successful way
12 to do that. So if I had a choice in the matter, if that
13 were to come to be, that would be my preference.

14 Q As opposed to including something like a snubber
15 in the price calculation?

16 A Snubbers. I haven't given that a lot of thought.
17 In the Chicago area, Chicago regional order where they had,
18 you know, components, that was the case. The case was --
19 you know, if the price went to zero, it stopped there. That
20 made dealing with those issues somewhat easier. I wouldn't
21 say that I would oppose that but I haven't given that as an
22 alternative thought.

23 MR. GALARNEAU: All right. Thank you.

24 JUDGE HUNT: Mr. Olsen.

25 BY MR. OLSEN:

1 Q Mr. Hollon, Brad Olsen with Leprino Foods Company;
2 a few questions.

3 I'm looking at page 2 and you reference the
4 federal order policy where -- well, the federal order policy
5 in the past is aimed for reasoned minimum and expect the
6 market to operate above that minimum level.

7 Q Yes.

8 Q That's your expectation is that it establishes the
9 minimum and then the market through over order premiums and
10 the like will take care of itself above that?

11 A As long as you say "reason" minimums, I would
12 agree. If you will add that word to your -- there is some
13 levels of price even today that are pretty low that dairy
14 farmers are having a pretty hard time dealing with. But in
15 general, our policy is that federal orders operate at
16 minimum levels, reasoned minimum levels, and then
17 competitive as you described, over order premiums, business
18 practice operate above that.

19 Q Sure. And I'm not trying to change your testimony
20 at all.

21 A Okay, that's fine.

22 Q I want to make sure I understand it.

23 So we've got the reasoned minimums and then that
24 establishes this minimum level, and then the market, if you
25 will, operates above that --

1 A Yes.

2 Q -- minimum level --

3 A Yes.

4 Q -- so established?

5 A Yes.

6 Q Okay. And if I look at Exhibit 47.

7 A Okay.

8 Q And I look at the dollar amounts over here on the
9 right side here.

10 A Yes.

11 Q Okay. That appears to be reflective of -- at
12 least with respect to the negative -- well, I guess with
13 respect to all three of them -- the minimum numbers. That
14 would be your minimum number multiplied by the 162 billion?

15 A It would be the weighed all class price multiplied
16 by the pounds of milk. The weighted average, in the second
17 case the 35.1 cents is 42 percent times 24 plus 10 percent
18 times 26 plus 39 times 51.

19 Is that what your expectation is?

20 Q No, you are doing the math faster than I can do
21 it, but that's fine. Let me get just to the one point here.

22 A Okay.

23 Q When you are talking about the effect on 1999
24 prices, you're talking about the minimum prices
25 established --

1 A Yes.

2 Q -- through the regulated system?

3 A Yes. Yes, that's correct.

4 Q So when you do the dollar calculation, that's
5 taking those minimum prices and multiplying it by a whole
6 lot of milk?

7 A Yes. It's taking those minimums, moving them
8 lower by an average of 35 cents, and then multiplying it
9 times 162 billion pounds of milk, yes.

10 Q Right. Okay.

11 And so those minimums don't take into account what
12 we talked about a few minutes ago about over order premiums?

13 A No. No, they do not.

14 Q Okay.

15 A They do not.

16 Q And if those numbers were in there, the over order
17 premiums, I believe you earlier testified that in your
18 experience over order premiums exist throughout the Federal
19 Order System?

20 A Yes. But remember they would be in both -- they
21 would be in both analysis. They would be -- they are there
22 now, assume they would be there after, so it would have no
23 effect on this number. They would be in both cases.

24 Q No, I understand that the over order premiums are
25 there.

1 A If there was a dollar before under this
2 assumption, whether or not it's true or not, there would be
3 a dollar afterwards. If there was nothing before, there
4 would be nothing after. So that the net effect in either
5 case would be the negative 570 million for this example
6 whether there were premiums or not.

7 Q Not if the over order premiums increased?

8 A That's true.

9 Q Okay. So if we had a market level and it's --
10 this is going to be interesting on the record, right?

11 I've got a market level that's like about six
12 feet, okay? I've got a minimum -- I've got a minimum level
13 that's let's say at four feet.

14 A Yes.

15 Q If I now take the minimum level and I drop it to
16 three feet --

17 A Yes.

18 Q -- and the market hasn't changed.

19 A Yes.

20 Q It's still six feet.

21 A Yes.

22 Q Okay.

23 A In your -- I haven't -- in your assumptions, in
24 your analysis, that is correct. If you just look over the
25 last, you know, couple of years, that hasn't always worked

1 that way.

2 Q No, I understand.

3 A Okay.

4 Q I'm asking you to assume my six foot, four foot
5 deal here.

6 A Yes. Yes.

7 Q I'm still at six feet, right?

8 A Yes.

9 Q So my over order premiums now -- I've got more
10 over order premium.

11 A Yes. If everything held constant, yes.

12 Q And then there would be no dollar impact at that
13 point?

14 A Correct.

15 Q Okay, and I appreciate your helping me on the math
16 concepts here.

17 And so over order premiums, I say over order
18 premiums, that would also include say profit sharing
19 arrangements that might exist between --

20 A Yes.

21 Q -- a processor and a co-op?

22 A Yes.

23 Q And in negotiating contracts, and I'm not asking
24 for specifics here, it's fair to say that DFA has contracts
25 that involve over order premiums as well as profit sharing

1 arrangements?

2 A Yes.

3 Q And just to link it up with the six-foot analogy
4 here, that would be over order premiums and profit sharing
5 would be included, if you will, the difference between the
6 minimum, whether it's at four foot or three foot, and the
7 six-foot total price?

8 A I'm not sure if a net analogy on the profit
9 sharing piece, that just because the regulated price
10 dropped, all of that would carry through.

11 Q Okay. No, that's fair, but profit sharing is
12 certainly something that's over and above the minimum?

13 A Yes. Yes.

14 Q Okay. And as an economist, because I believe that
15 you -- I'm sorry?

16 A I said when you finish, I was requesting a break.

17 JUDGE HUNT: He needs a break.

18 MR. OLSEN: Okay. Now I feel all rushed.

19 THE WITNESS: Then as far as I'm concerned, we can
20 break now for five minutes. How is that?

21 JUDGE HUNT: Okay, we'll take a break for five
22 minutes.

23 THE WITNESS: Thank you.

24 JUDGE HUNT: Make it very quick because we'll be
25 breaking for lunch soon.

1 (Whereupon, a recess was taken.)

2 JUDGE HUNT: Okay, we can continue.

3 BY MR. OLSEN:

4 Q Okay, Mr. Hollon, I was only able to come up with
5 one more question, but I do feel compelled to ask it since
6 we took that break. Very quickly.

7 Okay, now I'm on page 8, and this is in my
8 continuing quest to understand the Van Slyke Formula.

9 A You may be asking the wrong person.

10 Q Okay. Well, that's fair. If you don't know the
11 answer to that, I won't feel so bad.

12 But in the second line there, that comments on the
13 cheese formula, it says, "The Van Slyke Formula states that
14 93 percent of the butterfat in milk is expected to be
15 retained," et cetera.

16 A Yes.

17 Q My understanding is that's a variable that's sort
18 of you -- you put into the Van Slyke Formula and then it's
19 traditionally been, you know, 90 to 93 percent.

20 A I think that Mike Brown is still scheduled to go,
21 and I promise you he can explain as much of that -- I don't
22 know all the nuances of that, so I would rather you asked
23 Mike, and he would probably be glad to explain it to you.

24 MR. OLSEN: Fair enough. I have no further
25 questions. Thank you.

1 JUDGE HUNT: Mr. Coughlin.

2 BY MR. COUGHLIN:

3 Q Elvin, my question is sort of going to go to some
4 of these impact analysis.

5 A Yes.

6 Q Do you remember the impact analysis that USDA put
7 out with the final rule?

8 A Yes.

9 Q What did it show in that impact analysis was going
10 to be, USDA looked at some of the Class III price, for
11 example? Do you remember the number that they showed?

12 A Is it 47 cents? Is that the --

13 Q Yes, I thought it was rather prophetic that your
14 exhibit was labeled as a 47 -- was Exhibit No. 47 cents.

15 A Okay.

16 Q But I think it demonstrates that, you know, a
17 number of us do analysis.

18 A Yes.

19 Q USDA did an analysis. They looked back to a
20 previous period of time. They concluded, I think -- do you
21 agree that they concluded that the cheese price over a past
22 period of time or the milk Class III price over the past
23 period of time was going to -- would have declined by 47
24 cents a hundredweight?

25 A Yes, that was their conclusion based on --

1 Q Don't you think that's primarily the reason we're
2 all here at this hearing today, because producers looked at
3 that and they saw a potential reduction in price at that
4 level?

5 A That is correct.

6 Q So I don't even think we would be having this
7 hearing -- do you agree -- we wouldn't probably be having
8 this hearing if that number had not been in that impact
9 analysis?

10 A Yes.

11 MR. COUGHLIN: Thank you.

12 JUDGE HUNT: And Mr. Rosenbaum.

13 BY MR. ROSENBAUM:

14 Q I want to ask you a question about the methodology
15 you used on Exhibit 47.

16 A Okay.

17 Q Which is your summary of impacts.

18 Did you -- in coming up with those numbers, did
19 you use the real butterfat contained in the milk going into
20 each of these classes?

21 A I didn't attempt to break down any category about
22 butterfat or nonfat solids. The pricing formulas are they
23 are announced each month in the federal order, I mean, those
24 things can easily be transferred over to a spreadsheet, and
25 so you take a series of butter, powder cheese, nonfat dry

1 milk prices. You run them through the formulas that they
2 exist, The produce prices, and you calculate those month.

3 Q Well, let me ask it maybe a little differently.

4 Were you assuming 3.5 percent butterfat milk --

5 A Yes.

6 Q -- each of these calculations?

7 A Yes. Yes.

8 Q So that if -- Ms. Ledman put in a document,
9 Exhibit 40, which said at least in the first two months of
10 this year for Class IV milk the butterfat was 6.67 percent,
11 all right?

12 A I didn't attempt to go back like she did and break
13 out skim pounds and butterfat pounds. I did not attempt to
14 do that.

15 Q But, for example, the impact of lowering the
16 butter price by six cents and calculating the butterfat
17 value would be larger for Class IV than is shown on your
18 document; is that right?

19 A Well, the application of the formula was, again,
20 you know, take those formulas and come back to a milk price,
21 and that milk price that the formulas come back to were the
22 prices that I used.

23 Q Yes, but the impact of each of the changes may
24 vary. I mean, they are not the same for each class of milk,
25 correct?

1 A I don't show them the same for each class of milk.

2 Q Well, but what I mean is if you're assuming the
3 Class I milk is 3.5 percent, when in fact it's 1.98 percent,
4 then the change in the butterfat component -- a proposal to
5 change that will in fact have a different impact in the
6 ultimate dollars than is shown on your Exhibit 47; isn't
7 that right?

8 A I don't think that makes an impact difference. I
9 mean, today, you know, we announce prices. For example, the
10 Class I price is announced at X and this Class I skim price
11 is this, Class I butter price is that, I followed that same
12 methodology.

13 Q But the pool is calculated based on butterfat and
14 a skim price, et cetera, correct?

15 A It does, but they also come back with, like a
16 statistical uniform blend, which is the comparison based on
17 all that data.

18 Q Yes, but they announce that for comparison
19 purposes, but that's not how --

20 A It doesn't mean it's not correct though.

21 Q Well, I'm sure it's mathematically correct, but m
22 point is that if you are going to drop the price of the
23 butterfat component for Class IV only, for example, which is
24 your proposal, and if the milk going into Class IV is in
25 fact. 6.67 percent butterfat, not 3.5 percent, isn't the

1 impact larger than you would be reflecting here?

2 A Again, I followed the -- the way the prices
3 announcements are put together, I don't think that that's
4 correct.

5 Q Well, for purposes of calculating the pool, the MA
6 does not -- hold on one second.

7 (Pause.)

8 BY MR. ROSENBAUM:

9 Q Well, in calculating the money that goes into the
10 pool, the MA takes the pounds of butterfat or solids not
11 fat, et cetera, and multiplies it times the prices that have
12 been -- the minimum prices for each of those, correct?

13 A Mm-hmm.

14 Q That's how he goes about deciding the total
15 dollars in the pool, correct?

16 A But at the same time there are those processed
17 through the formulas come back to a per hundredweight price,
18 and you can use those prices for analysis similar to these.
19 They have a Class I price, a Class II price, a Class III
20 price and blend price.

21 Q Well, I know ultimately they will announce one of
22 them, but let me give a simple example, all right?

23 Let's assume that the milk going into Class IV has
24 seven percent butterfat, okay? I'm just going to make it
25 easy because it's twice 3.5, okay?

1 A We can make an example and -- yeah, we can switch
2 places if you would like.

3 Q Well --

4 A You can --

5 Q No, I just want to understand it. I want to see
6 how your exhibit works.

7 A Well, I explained to you how I put it together.

8 Q All right, and --

9 A I told you it intimately piece by piece.

10 Q Then I'll just ask you a question that's not tied
11 to your exhibit if that's a problem.

12 MR. BESHORE: Your Honor.

13 JUDGE HUNT: Mr. Beshore.

14 MR. BESHORE: I think we've got as far as we can
15 go with that. He told him how it's calculated. It's not
16 calculated the way Mr. Rosenbaum's witness did some
17 calculations. But, you know, so what? I mean, are we going
18 to have -- at this stage --

19 JUDGE HUNT: I'll let him fly by one more time.

20 BY MR. ROSENBAUM:

21 Q If there is a proposal that would affect the
22 butterfat in Class IV only, and if the impact of that is to
23 reduce the minimum price for butterfat in Class IV by five
24 cents, you're not telling me the impact in actual dollars
25 cheeses the same irrespective of whether the butterfat

1 component in Class IV is 3.5 percent or seven percent, are
2 you?

3 A Not sure. I told you when we started that I
4 attempted to duplicate in general what Mary did, and got
5 reasonably similar answers. So at this point I would say
6 that, you know, while they weren't done exactly, and I
7 didn't attempt to do exactly what she did, our answers were
8 not far apart. So I think that's about as close as I can
9 get to where you're going.

10 MR. ROSENBAUM: All right.

11 JUDGE HUNT: Next questioner? Yes, Mr. Grandage.

12 BY MR. GRANDAGE:

13 Q Hello, Mr. Hollon.

14 A Good morning. No, good afternoon.

15 Q Afternoon, after lunch almost.

16 A Yeah, really. In fact, if you'll make it short,
17 I might buy yours.

18 Q Very good. I just had a couple of comments.

19 You mention in some of the testimony and
20 questions, a question came up about anhydrous milk fat and
21 you didn't really have any good answers.

22 A Now careful.

23 Q And made a comment that you thought it belonged,
24 probably, in Class III?

25 A Yes, I did make that comment. I agree.

1 Q And I guess I would just point to the fact that
2 under the DEIP program it is subsidized on an equal basis
3 with butter.

4 A Okay.

5 Q There are customers that use it, that it does
6 have, it is a residual product. I think it's just a
7 storable --

8 JUDGE HUNT: Are you asking questions or making
9 statements, Mr. Grandage?

10 THE WITNESS: We have to swap seats.

11 JUDGE HUNT: If you are going to testify later, if
12 you would like to make those comments --

13 MR. GRANDAGE: Okay. Understood.

14 JUDGE HUNT: -- you're welcome to do it.

15 MR. GRANDAGE: Okay.

16 MR. GRANDAGE:

17 Q I have a question concerning your support on the
18 NASS. I understand you have made a qualification that if
19 the reporting is mandatory with auditing. But I was
20 wondering if you would comment on the possibility of
21 circulatory effect of using a NASS price where in effect,
22 for example, if an increase in a packaging item cost would
23 be passed through on a price and be reported in a NASS price
24 would come back to increase the base raw material cost, and
25 thus the pass-through of the increase in the packaging cost

1 would be negated.

2 A It's possible that that could happen.

3 MR. GRANDAGE: That's all I have.

4 THE WITNESS: Okay.

5 MR. GRANDAGE: Thank you.

6 JUDGE HUNT: Anyone else? Mr. Beshore.

7 MR. BESHORE: I have just one question on
8 redirect, and I want to move the admission of Exhibits 45
9 through 48 also.

10 JUDGE HUNT: Does anyone object to 45, 46, 47, 48?

11 (No response.)

12 JUDGE HUNT: Hearing no objections, those exhibits
13 are admitted.

14 (The documents referred to,
15 previously identified as
16 Exhibit Nos. 45, 46, 47 and
17 48, were received in
18 evidence.)

19 REDIRECT EXAMINATION

20 BY MR. BESHORE:

21 Q The only question I have, Mr. Hollon, Mr. --
22 someone -- Rosenbaum probably, asked you some questions
23 about the impact of a make allowance, cheese make allowance
24 on Agri-Mark.

25 A Yes.

1 Q Wellington is not here, we can pick on him. That
2 was lower than what Mr. Wellington stated his costs were.
3 And the question was, you know, basically under that
4 situation isn't that plant operating at a loss.

5 My question to you is don't do -- aren't we
6 missing a necessary ingredient -- a necessary component of
7 that calculation, and that is, the selling price of the
8 cheese at that plant? Only if you assume that the average
9 NASS -- that it's at the average NASS price and all of it's
10 at the average NASS price --

11 A That's true.

12 Q -- can you compare the make allowance to the plant
13 costs?

14 A To the extent they are above and below, and we
15 were just talking about those products for which a NASS
16 definition fits, they could be above the average and have
17 some gain or below the average and have some loss.

18 MR. BESHORE: Okay, thank you.

19 JUDGE HUNT: Anyone else?

20 THE WITNESS: I wanted to make one other -- oh, go
21 ahead.

22 JUDGE HUNT: Yes, Mr. Schafer. I'm sorry. Oh,
23 Ms. Brenner. Oh, okay.

24 RE CROSS-EXAMINATION

25 BY MR. SCHAFFER:

1 Q Mr. Hollon, I'm going back to Exhibit 47 for a
2 minute. The question I had was when you calculated your
3 Class I values in here to calculate your differences --

4 A Yes.

5 Q -- did you take, for instance, the revised
6 formulas for Class III and IV and use those then for Class
7 I?

8 So for instance if you had changed the make
9 allowance in the Class IV nonfat solids --

10 A Mm-hmm.

11 Q -- that is the same formula that would have been
12 used in --

13 A Yes.

14 Q -- Class I computation?

15 A Yeah, I did.

16 Q Is that what you would expect a result of any
17 changes to these formulas to have happened to Class I and
18 Class II?

19 A Yes, I would expect that the Department would do
20 it that way.

21 MR. SCHAFER: Thank you.

22 BY MS. BRENNER:

23 Q You indicated that DFA supports use of the NASS
24 survey. Does it participate as fully as possible?

25 A Yes, ma'am. When we participate, we participate

1 in a whey, in butter, in cheese and in powder, some
2 products to greater level, depending on how we fit the
3 product definition.

4 Q And you said that, "If a proposal with regard to
5 cost of production with sound mechanical concepts can be
6 advanced that is able to overcome the objections raised in
7 earlier hearings, we would consider whether or not to
8 support it."

9 Have you heard any sound mechanical concepts
10 relative to that at this hearing.

11 A I have not.

12 Q And finally, you seem to assume that if the
13 Department or if the Secretary adopted a reduction in the
14 Class IV butterfat price, that that would not be carried
15 through to maintain the same relationship as currently
16 exists between the Class IV and Class II --

17 A That is true.

18 Q -- or Class IV and Class I prices?

19 A That is true.

20 Q And wouldn't -- well, do you feel that you have
21 made an argument or what argument would you make to change
22 that relationship between IV and II, for instance?

23 A The arguments for limiting the change in price
24 only to IV were based primarily on the cost incurred at the
25 Class IV level, and the 70 cents figure would, or, you know,

1 that Class IV - Class II make allowance -- not make
2 allowance but differential, we don't see where that would
3 change and we're not supporting that change.

4 So if there were proposals to say make it wider or
5 make it -- make it narrower, and we were not supporting
6 that.

7 MS. BRENNER: Okay, thank you.

8 JUDGE HUNT: Anyone else? All right, Mr. Beshore.

9 MR. BESHORE: Just one follow up.

10 FURTHER REDIRECT EXAMINATION

11 BY MR. BESHORE:

12 Q In terms of Class IV versus Class II, isn't Class
13 IV also the only class in which the products processed are
14 priced off the price series that establishes that price?

15 A Yes, that's correct.

16 Q Okay, so that's a distinction between Class IV and
17 the other classes also?

18 A True.

19 MR. BESHORE: Thank you.

20 JUDGE HUNT: Anyone else?

21 THE WITNESS: I wanted to add one comment.

22 JUDGE HUNT: Very good.

23 THE WITNESS: There was a question during the week
24 about the word "oversight."

25 JUDGE HUNT: Go ahead, Mr. Hollon.

1 THE WITNESS: And I just wanted to point out that
2 in addition to yesterday's discussion of the BFP Committee
3 report, there was a recommended decision, there was a final
4 rule, there were -- I personally attended in at least
5 different market administrators' offices, demo, show and
6 tells, road shows about the implementation and resulting
7 effects of the recommended decision and the final rule.
8 Everyone of those included the AA butter price as a price
9 input. In many cases there was extensive points pointed out
10 to all the attendees that that was going to be if the final
11 rule were adopted

12 In addition, there were articles written by
13 consultants, some of whom have appeared on the stand
14 already, about that effect. There were articles in trade
15 journals about that. And to say that was an oversight, I
16 would say is probably a comical conclusion.

17 JUDGE HUNT: Mr. English.

18 FURTHER RECROSS-EXAMINATION

19 BY MR. ENGLISH:

20 Q None the less, you're here today proposing that
21 exact six cents change for Class IV, correct?

22 A Yes.

23 Q Thank you.

24 A But the oversight was not -- to say that that was
25 an oversight is wrong.

1 Q But you concluded there is a six-cent problem,
2 correct?

3 A In the Class IV area.

4 JUDGE HUNT: Enough said, enough said on that
5 point.

6 Anything else on any other points in Mr. Hollon's
7 testimony?

8 (No response.)

9 JUDGE HUNT: All right, then we'll take a break
10 for lunch and be back at 2:00 sharp.

11 (Whereupon, at 12:50 p.m., the hearing the above-
12 entitled matter was recessed, to resume at 2:00 p.m., this
13 same day, Friday, May 12, 2000.)

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4 A F T E R N O O N S E S S I O N

5 (2:00 p.m.)

6 JUDGE HUNT: Good afternoon.

7 MR. SCHANBACK: Good afternoon.

8 Whereupon,

9 WARREN SCHANBACK

10 having been duly sworn, was called as a witness

11 and was examined and testified as follows:

12 JUDGE HUNT: The hearing has resumed.

13 Would you state and spell your name for the

14 record, sir?

15 THE WITNESS: Yes. Warren Schanback,

16 S-C-H-A-N-B-A-C-K.

17 DIRECT EXAMINATION

18 BY MR. ROSENBAUM:

19 Q Mr. Schanback, do you have a written statement for
20 today?

21 A Yes, I do.

22 Q Could you please read it?

23 A I have read, heard and support the testimony of
24 Dr. Yonkers from IDFA. In addition, I have comments to make
25 about the issues from the perspective of a largely Class II

1 and non-shutter Class IV manufacturer that I wish to share
2 with the Department.

3 In total, I have heard nothing at this hearing that
4 would lead me to believe that there is any need to adjust
5 pricing that would not be more effectively and efficiently
6 addressed by natural market forces.

7 The current federal market order regulations are
8 the result of many years of adjusting a static set of rules
9 to align them with constantly changing market forces. In
10 fact, each time a change is made is a disruptive market
11 responses dairy farmers, cooperative and handlers adjust to
12 the new regulations.

13 If these market forces are allowed to play out in
14 their natural progression with additional government
15 tampering, the results would be more equitable to all
16 involved.

17 However, faced with the choice of adopting the
18 proposals made by IDFA, or even more deleterious proposals
19 by others, I am clearly on the side of making only the
20 changes proposed by IDFA.

21 We support Proposals 3, 4, 12, 20, 31 and
22 obviously 32. We oppose Proposals 1, 2, 5 through 19,
23 inclusive, 22 through 30, inclusive.

24 Class II pricing should not be changed at this
25 time -- I'm sorry -- Class III pricing should not be

1 changed, Class II pricing shouldn't be changed either.

2 Something that seems to have received very little
3 attention is this hearing is the fact that cheddar cheese is
4 not the only product made from milk classified in Class III.
5 At our plant we produce some of these other products. The
6 effect of some of the proposals to which we object would be
7 to increase the cost of Class III milk.

8 The increased cost of milk could not be recovered
9 from the marketplace in the form of a higher priced for the
10 finished products without a current corresponding demand
11 response.

12 Some would argue that because we are currently
13 paying over order premiums the effect would be that we would
14 pay less to our dairy farmers in the form of premiums
15 because we are paying more in the base milk price. The
16 reality of this situation is that I cannot pay less to
17 producers in the short run and still attract a supply of
18 milk adequate to produce these products. This increased
19 cost of milk comes directly from what little profits I am
20 currently making.

21 However, over time milk production will response
22 to the higher prices being paid, increasing the supply of
23 milk and lowering over order premiums so that we will arrive
24 at a price very similar to where we are today

25 All of these issues will affect Friendship Dairies

1 to some degree but none so much as Proposal 8, which adjusts
2 the price of Class IV butterfat without making corresponding
3 changes to Class II butterfat. Any seller of a product
4 should and must seek out the highest profit on that product
5 if they are to remain in business. Profit is the difference
6 between the cost of that product and the revenue created
7 when selling the product.

8 If proposal 8 were adopted, the difference between
9 the cost of butterfat used in Class IV and Class II would
10 increase dramatically from \$0.007 to \$0.067 per pound.
11 Class IV manufacturers would be the preferred purchaser of
12 cream on the open market because the return to the seller
13 would be greater.

14 In order for me to be able to meet my butterfat
15 needs, I would have to ante up the difference or seek other
16 sources of milk fat, such as butter oil or anhydrous milk.

17 In response to the Department's request that
18 someone shed some light on the issue that proprietary plants
19 could de-pool to equalize margins with cooperative plants,
20 we contend that this completely ignores the reality that we
21 must pay a competitive price in order to attract an adequate
22 milk supply. Since we cannot recover the difference between
23 the Class II price and the blend price at our plant
24 location, we would not be able to remain in business.

25 Furthermore, this ignores the basic principle for

1 creating the pool in the first place, which is to evenly
2 distribute the proceeds received from the sale of milk in
3 Class I and Class II.

4 Finally, there is the issue of a recommended
5 decision. It is our opinion that a recommended decision be
6 issued upon which we may comment so that we are not back
7 here next year at this time discussing issues that were not
8 properly addressed.

9 This concludes my written testimony.

10 Q Could you please indicate for the record what
11 position it is you hold at the dairy?

12 A Yes, I'm executive vice president, and it's a
13 family business, third generation.

14 MR. ROSENBAUM: Mr. Schanback is available for
15 cross-examination.

16 JUDGE HUNT: Mr. Beshore.

17 CROSS-EXAMINATION

18 BY MR. BESHORE:

19 Q Good afternoon, Warren.

20 A Good afternoon, Marvin.

21 Q If you've got a -- if you've got some cottage
22 cheese, that's one of your products, right?

23 A That is correct.

24 Q Okay, if you have cottage cheese to sell and you
25 have two buyers, two possible buyers, and one offers you

1 more than the other, is that your preferred customer, the
2 higher price?

3 A Considering --

4 Q All other things being equal.

5 A All other things being equal, yes, it would be.

6 Q Okay. Those are the guys you seek out when you're
7 marketing your cottage cheese?

8 A All other things being equal, yes.

9 Q Okay. That being the case, can you explain to me
10 further the sentence in your testimony on page 2 which says
11 that, "If Proposal 8 is adopted and reduces the price of
12 Class IV butterfat, that Class IV manufacturers would be the
13 preferred customer of cream on the open market because the
14 return to the seller would be greater"?

15 A Yes. the cream generated from some type of
16 operation, let's say a fluid milk bottling facility produces
17 excess cream, the price that the handler -- the original,
18 the originating manufacturer pays for that cream sold on the
19 open market. The cost of it is based upon the end use in
20 which that cream is used. Class IV products, butter, would
21 cost the originating handler less money as a cost of the
22 cream.

23 On the other hand, if that product were going to
24 be used in Class II product, the cost -- the obligation to
25 the pool that the originating handler would have would be

1 higher.

2 So if everything were equal as far as the selling
3 price, the actual cost of the originating handler would be
4 less if the end use were a Class IV product.

5 Q Okay. Assuming the selling price is the same --
6 in other words, in this case instead of assuming that, as we
7 did in, you know, the hypothetical in terms of cottage
8 cheese, that the selling prices are different one buyer
9 versus the other, you're assuming that the sales price of
10 the cream to the butter plant is the same as the price of
11 cream of the ice cream plant, correct, that they're going to
12 pay the same price?

13 A Repeat the question.

14 Q Okay, I think you told -- what you said was that
15 the butter manufacturer becomes the preferred customer for
16 the hypothetical fluid handler here because he's going to
17 pay the same price as the ice cream plant would pay for the
18 cream, and the order would make the selling handler's cost
19 less, correct?

20 A That is correct.

21 Q If on the other hand the buyers pay a price
22 equivalent to their use value under the order, the lower
23 return is not going to be preferred to the seller of cream.
24 Would you not agree?

25 A You lost me again, but if what you are saying is

1 is that -- well, actually what I am referring to is the fact
2 that in order for the selling handler to be able to come out
3 with same margin of profit, I would have to pay more for
4 that cream. And because I would have to pay more for that
5 cream, it opens up the world of other opportunities where I
6 may source my fat, that it might be more competitive than
7 paying the higher price for that cream.

8 MR. BESHORE: Okay, thank you.

9 JUDGE HUNT: Yes, Mr. Rosenbaum.

10 DIRECT EXAMINATION (Resumes)

11 BY MR. ROSENBAUM:

12 Q I want to go over that example because it's an
13 issue that maybe hasn't been addressed quite as directly as
14 you have addressed it even though we are on day five of the
15 hearings.

16 Class I handlers are fluid handlers, correct?

17 A Correct.

18 Q And we all know that the milk that they get is
19 something in excess of 3.5 percent milk fat, correct?

20 A correct.

21 Q But their products only average maybe two percent
22 milk fat in today's world where most people buy skim milk or
23 one percent milk, correct?

24 A Correct.

25 Q So they end up with excess milk fat that they want

1 to dispose of, correct?

2 A Correct.

3 Q As a Class II handler making ice cream, you want
4 that fat because you use it to make your products, correct?

5 A Well, I don't manufacture ice cream, but I
6 manufacture sour cream, so yes, I am an end user of a
7 greater amount of fat.

8 Q Okay. Sour cream being a Class II product,
9 correct?

10 A That is correct.

11 Q Okay. It doesn't matter in my example whether
12 sour cream or ice cream.

13 Now, today, if that Class I handler sells the
14 excess fat to you, he accounts to the pool for that as a
15 Class II product, correct?

16 A That is correct if it's used in Class II.

17 Q And he doesn't have to pay the Class I price for
18 that even though he's a Class I handler. He pays the Class
19 II price for that because he's turned it over to you and
20 you're the first one who has actually made something from
21 it, correct?

22 A That is correct.

23 Q If on the other hand that Class I handler today
24 sells that cream to a butter manufacturer to make better
25 with, which is Class IV, then he accounts to the pool for

1 that product as a Class IV product, correct?

2 A That is correct.

3 Q Now, today the butterfat that he's selling either
4 to you, a Class II handler, or to a butter handler, which is
5 Class IV, the price is the same, correct, from terms of a
6 minimum price, right?

7 A Correct.

8 Q So a Class I handler today is indifferent in terms
9 of his obligation to the pool whether he sells the excess
10 butterfat to you or to a butter manufacturer, correct?

11 A That is as I understand it, yes.

12 Q Okay, now, the proposal of Land O'Lakes and others
13 would be to lower the butterfat price for Class IV, correct?

14 A Correct.

15 Q But not to lower it for any other class, right?

16 A Correct.

17 Q Now, what that means is that if that proposal were
18 adopted the Class I handler if he sold the excess butterfat
19 to you would have to account to the pool, or put it
20 differently, pay more money to the pool than if he had sold
21 that butterfat to a Class IV, correct?

22 A Absolutely correct.

23 Q Indeed, he would be paying six cents more into the
24 pool selling 100 pounds of butterfat to you than if he sold
25 that same 100 pounds of butterfat to a Class IV handler,

1 correct?

2 A That is correct.

3 Q And so the large Class I handlers of the world,
4 the Dean Food, Sweisses, whomever, are obviously going to
5 prefer to sell that to the Class IV handler, correct?

6 A Correct.

7 Q And your view is that the only way you could
8 adjust for that, to get that butterfat at all is to jack up
9 your price that you would be offering to the Class I
10 handler, correct?

11 A Unless I sourced it from some other fat supply.

12 Q But those would be the two choices that you would
13 experience, correct?

14 A Yes, that is correct.

15 Q Okay, so that when people show these charts that
16 say that Class II price is unchanged between the current
17 proposal -- current rule, rather, and a situation where the
18 six cents had been dropped on Class IV only, that has
19 nothing to do with the real world effect on a Class II
20 handler; isn't that right?

21 A That is correct. It puts us at a great -- it
22 would put us at a great disadvantage.

23 Q And that is why your view is that if the butterfat
24 price gets dropped for Class IV, it needs to come down for
25 Class II as well?

1 A That is correct.

2 MR. ROSENBAUM: Thank you.

3 JUDGE HUNT: Anyone else? Mr. Yale.

4 CROSS-EXAMINATION (Resumes)

5 BY MR. YALE:

6 Q My understanding is you want butterfat prices the
7 same all the way around in the system?

8 A Actually, as stated in my prepared statement, I'd
9 like the entire system to remain as it is currently. I
10 would like the results of this hearing to be no change
11 whatsoever to the current federal market order regulations.

12 Q Okay. Do you buy cream?

13 A Yes, I do.

14 Q And who do you buy it from? Not names but do you
15 buy it from processing plants?

16 A I actually buy it from the cheapest source
17 possible, and that varies, depending on the time of year,
18 distance involved.

19 Q Is that priced as any formula such as using the
20 CME as an index?

21 A It's typically priced on a multiple, yes.

22 Q Of the CME? Grade AA?

23 A Grade AA, yes.

24 MR. YALE: All right. I don't have any other
25 questions.

1 JUDGE HUNT: Anyone else? Yes, Mr. Grandage.

2 BY MR. GRANDAGE:

3 Q I'm questioning along the same lines.

4 You just mentioned that you buy that cream from
5 the cheapest source, whatever it is, based on a multiple --

6 A That is correct.

7 Q -- on the CME market?

8 A Correct.

9 Q What kind of a range in multiple do you end up
10 paying?

11 A It varies at different times of the year.

12 Q So how do you determine what the maximum cents per
13 pound you can afford to pay for pound of fat in that cream?

14 A Well, over the long term I have to figure my
15 competitive price against other manufacturers of the end
16 product. Let's say in this case sour cream. It's something
17 that in the short term I may be able to pay a premium
18 because I have to keep my end product flowing to my
19 customers.

20 Should I have a gap, should I tell a customer I
21 can't supply you with enough sour cream, that would probably
22 be the last time I ever got an order from that customer. So
23 the continuity of service to the end user or to my customer
24 is crucial.

25 However, over the long term I would have to

1 change, if I were to continue to purchase cream at an
2 increased cost, I would have to pass along that price
3 increase to my end customer.

4 Q Okay.

5 A If I were hire than my competition, I would lose
6 that business eventually.

7 Q If your competition is in the same order that you
8 are or working under the federal orders, the competitive
9 situation that he would expect to see would be the same as
10 you as far as that cream price, correct?

11 A Not necessarily, and --

12 Q So he would be selling sour cream or cream cheese
13 or cottage cheese, excuse me, and he would be able to buy
14 his cream cheaper because -- and you would have to pay the
15 extra six cents?

16 A He may not even have to pay for that cream. That
17 may be something that he is separating out of producer milk.

18 Q Which means he's still liable for the final usage.

19 A That's correct.

20 Q The utilization. So in the end it does not make
21 any difference of the Class II price is six cents higher
22 against another Class II producer utilization, the price is
23 the same for all of you. The competition, the playing field
24 between you and your competitors are even, and you do say
25 you have the ability to recalculate your finished product

1 price to adjust for those costs, correct?

2 A No, I wouldn't say that that's correct.

3 Again, as many of the economists have testified, a
4 great deal depends on where you apply your cost. Some of my
5 competition may choose to apply their cost to let's say in
6 this case the low fat skim milk or the low fat milk that
7 they are selling in their bottling operation.

8 So this difference only really comes into play
9 when you get to the nature -- competitively it only comes
10 into play when you have to go out and purchase cream as
11 fresh cream. You know, if they were able to manufacture
12 their Class II products out of butter, let's say, that had
13 been in storage, under the current circumstances everything
14 would balance out; their cost of -- I think it's been called
15 rewetting it, although I don't necessarily believe that you
16 always have to rewet butter if you're making sour cream --
17 their costs would tend to even out.

18 But if I were seeking fresh cream which typically
19 is what we favor because it is easier to handle, it is
20 easier to get on a short-term basis under the current market
21 order regulations, we would be at a disadvantage.

22 Q When you say "easier to handle," don't you really
23 mean less costly to handle than butter?

24 A Under the current order regulations, it is less
25 costly to handle than butter. Under the proposed

1 regulations, I'm not sure that that relationship would hold
2 true.

3 Q But you do agree that in your utilization, in your
4 situation you sell your finished product based on what your
5 costs are, plus your margin, and you hope to be competitive
6 with --

7 A No, no. No, that's not true at all. My end
8 product sales price is mainly determined by the marketplace.
9 My cost --

10 Q The marketplace being?

11 A -- and my profit are determined by the other
12 factors to which you are referring.

13 Marketplace being what my competition --

14 Q Competition.

15 A -- is selling.

16 Q Who is selling the same class.

17 A Or willing to sell for.

18 Q Who is selling the same class product that you are
19 now?

20 A Selling the same product, yeah.

21 Q Which means that you're at the same butterfat cost
22 basis.

23 A You are -- you are making a big assumption that
24 the competition that I'm facing is from a regulated handler,
25 and that's not necessarily the case. I do compete on Class

1 II products with unregulated handlers.

2 MR. GRANDAGE: Okay. Thank you.

3 JUDGE HUNT: Anyone else? Mr. Beshore.

4 BY MR. BESHORE:

5 Q What's the shelf life of your sour cream?

6 A It is increasing all the time due to technological
7 advances. The shelf life of our sour cream is currently 49
8 days.

9 Q How long do you keep it before you ship it out?

10 A Hopefully less than 49 days.

11 (Laughter.)

12 Q I hope so.

13 In practice, how long do you --

14 A In practice, it varies, Marvin. Again, our
15 manufacturing capacity is only so great so going into the
16 heavy sour cream consumption periods we would keep it
17 longer. We would have to keep an inventory of it.

18 In addition, based on what we expect pricing to do
19 in the following month, we may shift some of that product
20 into either an earlier or later month as far as production
21 is concerned to take advantage of the price difference.

22 Q What's your next largest product in terms of use
23 of cream?

24 A Our next biggest product. Farmer cheese.

25 Q What's the shelf life of the Farmer's cheese?

1 A Fifty-four days.

2 Q Okay. Do you make cream cheese?

3 A No, we do not.

4 Q What's the shelf life of the cottage cheese?

5 A The shelf life of cottage cheese is currently
6 running about 40 days.

7 Q Are those three products, sour cream, Farmer's
8 cheese and cottage cheese, your three largest lines?

9 A Yes.

10 MR. BESHORE: Thank you.

11 JUDGE HUNT: Mr. Rosenbaum.

12 REDIRECT EXAMINATION

13 BY MR. ROSENBAUM:

14 Q In addition to facing competition from unregulated
15 handlers, do you face competition from cooperative-produced
16 products?

17 A Yes, we do.

18 MR. ROSENBAUM: Thank you.

19 JUDGE HUNT: Thank you very much, mr. Schanback.

20 THE WITNESS: Thank you.

21 (Witness excused.)

22 JUDGE HUNT: And Mr. Brown now.

23 You had a long wait.

24 MR. BROWN: Yes.

25 JUDGE HUNT: Very patient man.

1 MR. BROWN: That's all right.

2 Whereupon,

3 MICHAEL BROWN

4 having been duly sworn, was called as a witness
5 and was examined and testified as follows:

6 THE WITNESS: Before I begin, I would like to
7 point out a couple -- I'm sorry. My name is Michael Brown.
8 I am general manager of National All-Jersey, Incorporated,
9 also known as NAJ, located at 6486 East Main Street,
10 Reynoldsburg, Ohio, 43068.

11 I've worked in the areas of dairy economics and
12 milk pricing policy for over 13 years. Prior to my six
13 years at National All-Jersey, I was employed in the areas of
14 dairy marketing and economic policy for Agnomics Research,
15 the Wisconsin Federation of Cooperative, and National Milk
16 Producers Federation.

17 I have three small changes to my testimony, just
18 technical area I want to point out before I begin because
19 one of them is so major I could get fired if it got on the
20 record, so I want to point it out.

21 (Laughter.)

22 At the top of page 4, the very first line it says,
23 "Subtracted from sum," it should be "the sum". Under point
24 two further down that paragraph on the last line it says,
25 "...receiving a lower net price per pound of milk." It

1 should say, "...lower net price per pound protein."

2 On page 4, there is a point about two thirds down
3 the page where I list three factors. The second factor,
4 last line where it says "per pound of milk," it should say
5 "per pound protein."

6 And then on the final page, the last paragraph,
7 fourth line, last words says, "NAJ does not". It should say
8 "NAJ does," and that's the one that could get me terminated
9 so please note the change.

10 It's been a long week. I'm going try to enjoy
11 this.

12 I am presenting my testimony on behalf of National
13 All-Jersey, Inc.'s 820 members, as well as the 2300 plus
14 members of NAJ's sister organization, the American Jersey
15 Cattle Association.

16 NAJ is a national dairy producer organization that
17 assists its members in marketing their milk through the
18 development of nonregulated milk pricing and premium
19 programs and by representing the membership on legislative
20 and regulatory issues involving milk marketing regulation
21 and policy.

22 NAJ also provides technical and planning
23 assistance to plants on issues involving milk pricing and
24 provides market outlooks and milk pricing education
25 information to its membership. For the last 22 years, NAJ

1 has focused most of its resources on end product and
2 component pricing issues. We have also funded research on
3 cheese and milk component issues at many land grant
4 universities.

5 NAJ does not support any significant changes to
6 the overall structure of the Class III and IV price formulas
7 at this time. While the proposals being heard at this
8 hearing express specific concerns over specific cheese or
9 specific yield factors and the manufacturing allowances, the
10 general structure of the current pricing system for Class
11 III and Class IV milk is being accepted by industry. This
12 is evidenced by the lack of specific proposals from industry
13 to make significant changes to the general yield structure
14 included in the current Class III and IV component price
15 calculations.

16 The industry is just beginning to understand the
17 new price rules and have spent a significant amount of money
18 adapting their plant producer accounting programs to
19 facilitate the changes. While some adjustments to the Class
20 III and IV formulas' yield factors and manufacturing
21 allowances are reasonable, significant changes to the Class
22 III and IV pricing structure, which has been in effect for
23 less than five months, are not warranted at this time.

24 We would argue that it is too early to make major
25 changes to the price formulas beyond consideration of the

1 relatively minor adjustments to yield factors or
2 manufacturing allowances proposed by the other participants
3 in this hearing. This argument is supported by the fact
4 that none of the proposals related to butterfat for pricing,
5 Proposals 1 through 8, protein pricing for Proposals 9
6 through 18, other solids pricing, Proposals 19 through 22,
7 or nonfat solids pricing, Proposals 20 through 28, suggest
8 major changes in the yield factors for these milk products.

9 NAJ believes the role of product price formulas is
10 to provide a reasonable representation of the value of milk
11 for products within a specified class. While it is
12 impossible to develop one formula that will perfectly fit
13 the yield relationships for all products and all plants
14 within a specific milk class, NAJ believes the component
15 formulas currently used for Class III and IV milk provide a
16 good approximation for the relative yield value for milk
17 fat, protein and other solids in Class III and milk fat and
18 solids nonfat in Class IV. We thus support the general
19 framework used to calculate prices for the Class III and IV
20 milk components.

21 NAJ specifically endorses that USDA continue to
22 assign the casein loss and cheese making to the protein
23 yield factor as is current practice. A 1.405 true protein
24 yield factor equal to 1.32 on a crude protein basis is used
25 in all current Class III protein formulas -- used in the

1 current Class III protein formula, excuse me. The 1.32
2 crude protein factor had previously been adopted in seven
3 federal milk marking orders prior to the implementation of
4 the consolidated federal milk marketing orders on January 1,
5 2000.

6 The 1.32 factor is a correct crude protein yield
7 factor to use with the above formula assumptions because it
8 reflects the contribution of protein to cheddar cheese yield
9 after consideration of casein loss in the cheese vat.

10 Using the same assumptions and assuming true
11 protein test averages, .019 pounds per hundredweight below
12 crude protein, the true protein factor is 1.40. The 1.32
13 protein yield factor was determined from the relationship
14 between protein and the then slight Cheese Yield Formula is
15 78 percent casein recovery, nine percent additional solids
16 recovery, the 1.09 factor, and 38 percent moisture.

17 The following discussion is based on crude
18 protein, reflecting the original work in developing the
19 factor.

20 The Van Slyke Formula suggests that 0.1 pounds of
21 casein per hundredweight milk is not recovered into the
22 cheese. In some way, this loss must be reflected in the
23 yield factors for the components that make up that cheese.
24 Since this casein loss factor is a constant per
25 hundredweight milk, it can be expressed on a hundredweight

1 basis.

2 To determine these factors, the Van Slyke is
3 partitioned into parts. Butterfat contribution to yield,
4 protein contribution to yield and casein loss per
5 hundredweight.

6 When the equation is reduced to determine the
7 factors, the yield coefficients are 1.5823 per pound
8 butterfat, 1.3713 per pound crude protein, and minus 0.1758
9 per hundredweight milk. In other words, if the 1.3713 crude
10 protein factor is used to determine yield, a factor of minus
11 0.1758 per hundredweight milk must be subtracted from the
12 sum of the fat and protein contributions to cheese yield per
13 hundredweight to reach the Van Slyke cheese yield.

14 Using the 1.3713 crude protein factor without
15 subtracting this constant gives a consistent overestimated
16 cheese yield of 0.1758 pounds per hundredweight.

17 The 1.32 crude protein factor was initially
18 proposed and adopted in the southern Michigan and five upper
19 Midwest orders prior to federal order reforms. This factor
20 was determined by assigning the 0.1 pounds of casein loss
21 per hundredweight milk to the crude protein portion of milk.
22 Instead of assigning this loss to hundredweight milk, it is
23 in effect assigned to the protein portion in order to
24 determine the crude protein yield factor. Assigning this
25 loss directly to crude protein results in component yield

1 factors for cheese yield of 1.5823 for butterfat, the same
2 as before, and 1.3164 for crude protein.

3 Because casein loss is assigned to protein, there
4 is no negative hundredweight factor as is the case when the
5 casein loss is assigned to the milk portion of the equation.

6 While neither of these two sets of factors will
7 provide a satisfactory estimate -- will provide a
8 satisfactory estimate of cheese yield, NAJ supports using
9 the protein factor in the current Class III protein formula
10 that includes casein loss in cheese for several reasons.

11 Number one, it assigns no negative value for milk,
12 for hundredweight milk as would be necessary if the higher
13 factor of 1.37 is used correctly. I would add, most of us
14 know from recent years having negative anything in the milk
15 price is a really tough one to explain.

16 Number two, it accomplishes the goal of pricing
17 each product component at the same price. If the higher
18 protein yield factor and corresponding negative
19 hundredweight milk factor are used, milk with a lower
20 protein content is actually receiving a lower net price per
21 pound due to concentration of protein in milk with higher
22 protein content.

23 Number three, it still results in nearly identical
24 cheese yield estimates to the Van Slyke Cheddar Cheese Yield
25 Formula.

1 Sir, at this time I'd like to tentative submit two
2 exhibits for consideration.

3 JUDGE HUNT: All right. The first one, could you
4 identify it, and we'll mark this as proposed Exhibit 49.

5 THE WITNESS: Okay, proposed Exhibit 49 is titled
6 Calculating Component Values From the Modified Van Slyke
7 Cheese Yield Formula.

8 (The document referred to was
9 marked for identification as
10 Exhibit No. 49.)

11 JUDGE HUNT: Okay.

12 THE WITNESS: And Exhibit 50 would be Calculating
13 Component Values for Butterfat, True Protein and Milk from
14 the Modified Van Slyke Cheese Yield Formula.

15 (The document referred to was
16 marked for identification as
17 Exhibit No. 50.)

18 JUDGE HUNT: Okay.

19 THE WITNESS: I would like to continue with my
20 testimony.

21 The first exhibit, Calculating Component Values
22 from the Modified Van Slyke Cheese Yield Formula, explains
23 the mathematics of determining component factors for
24 determining cheese yield for milk components. It discusses
25 how different ways of handling casein loss in the Van Slyke

1 Cheese Yield Formula can provide a reasonable estimate for
2 cheese yield.

3 The second exhibit, Component Values from the
4 Modified Van Slyke Using True Protein calculates the yield
5 factors discussed in the first exhibit, but on a true
6 protein basis. These factors are perhaps more relevant to
7 the current price formulas.

8 National All-Jersey also supports the method
9 currently used to assign the added value of fat in cheese to
10 protein in the Class III formula. NAJ certainly understands
11 that the volatility of milk component prices does cause some
12 shifts in the milk value from one component to another at
13 times.

14 While component price volatility in the market is
15 difficult for both processors and producers to manager, it
16 is a part of current dairy markets and the signals and price
17 changes for milk components, as well as milk as a whole,
18 should be sent to both producers and processors. This is
19 especially true for Class II and III processors who often
20 use a blend of milk ingredients in raw milk in their product
21 manufacturing.

22 Today, almost all modern cheese plants, especially
23 non-cheddar plants, standardize for their protein percent
24 ration on the vat milk. This standardization is
25 accomplished through the addition of dairy fat and protein

1 from several sources, including cream, nonfat dry milk and
2 condensed skim milk, among others. These plants buy and
3 sometimes sell these inputs from standardizing milk for vat
4 use. These decision are based on the relationship of the
5 cheese price to the price of milk, fat and protein from
6 other sources, including raw milk and dairy ingredient
7 sources.

8 When cheese has a certain value, only so much can
9 be paid for the ingredients that make that cheese. The
10 total cost of fat and protein in cheese vat cannot exceed
11 the value of the cheese manufactured, less operating costs.
12 Thus, when butterfat prices are high relative to cheese and
13 nonfat milk solids, the plant will sometimes sell butterfat
14 rather than purchase nonfat solids.

15 The plant will sell this fat based on the butter
16 value, not the cheese value. The reality is that producer
17 butterfat competes with processor butterfat, usually in the
18 form of cream, for their share of the cheese vat. The
19 current practice of pricing Class III fat based on the
20 butter value is not being challenged in any other proposals
21 relating to the pricing of butterfat, one through eight, or
22 protein pricing, Proposals 9 through 18.

23 NAJ does recognize that small adjustments to yield
24 factors and manufacturing allowances may be needed in order
25 for the Federal Milk Marketing Order Program to best provide

1 for the orderly marketing of milk and to best determine the
2 regulated minimum prices the milk components priced in these
3 classes.

4 NAJ does not have the data available to comment on
5 the level of make allowances that are appropriate for
6 determining these component prices. However, NAJ strongly
7 encourages USDA to continue to evaluate manufacturing costs
8 and use that information when reviewing what the appropriate
9 manufacturing allowances should be. However, since all
10 plants operate differently and produce a wide range of
11 different products, it is very important that the yield
12 formulas and the associated manufacturing allowances provide
13 both an adequate margin, allowing plants to operate while
14 providing a reasonable minimum component and milk values for
15 producers.

16 If formalized cost survey data were available, any
17 necessary adjustments in the future could be handled through
18 adjustments in the manufacturing allowances.

19 In Proposal 32, USDA asked for comments on how
20 butterfat would be paid to producers -- that should be if
21 fat prices varied from class to class.

22 NAJ strongly recommends that USDA continue to use
23 the Class III component prices as the base component prices
24 for producer milk. Use of the current Class III components
25 provides a relatively simple method to determine the basis

1 for forward contracting as these component values to follow
2 the cheese, butter and Class III milk futures markets.

3 Blending fat component values could make it more
4 difficult for producers to estimate the component value of
5 the milk price in advance of final payment. This is
6 particularly important to our membership as our milk
7 contains significantly higher solids levels than market
8 average milk.

9 Thus, if changes were made to the Class III
10 component price formulas, we still support using the new
11 Class III component values for producer payment as they will
12 still best reflect the Class III component and milk price.

13 Also in Proposal 32 USDA asked for comments
14 whether emergency conditions exists that would warrant
15 admission of a recommended decision. NAJ would encourage
16 USDA to provide a recommended decision for industry
17 consideration. If time does not allow for comment on that
18 decision before the January 1st deadline imposed by
19 Congress, NAJ would support publication of an interim final
20 rule with opportunity for industry to comment on that rule.

21 In summary, National All-Jersey encourages USDA to
22 consider the evidence to determine what the proper make
23 allowances should be under the Federal Order Program. We
24 also encourage USDA to limit any changes to the current
25 Class III and yield formulas to technical corrections based

1 on hearing evidence and do not support a major change in the
2 Class III price formulas at this time.

3 Finally, NAJ does support continued use of the
4 Class III component prices for producer component prices.
5 If changes are made to the Class III handler component
6 prices, those changes should also be reflected in the
7 producer component prices.

8 JUDGE HUNT: Ready for questions?

9 THE WITNESS: Yes.

10 JUDGE HUNT: All right. Mr. Rosenbaum.

11 CROSS-EXAMINATION

12 BY MR. ROSENBAUM:

13 Q Mr. Brown, I take it that you've had some previous
14 participation in federal order hearings that addressed the
15 question of yield factors; is that fair to say?

16 A That is correct.

17 Q And you mention the fact that a 1.405 true protein
18 yield factor is the same as a 1.32 on a crude protein basis,
19 correct?

20 A That is also correct.

21 Q And you testified that the 1.32 crude protein
22 factor had been adopted in seven federal marketing orders
23 prior to implementation of the current rule on January 1,
24 2000?

25 A Yes.

1 Q And is it your understanding that the rule now in
2 effect continues the previously existing yield factor except
3 that it's switched from a crude protein basis to a true
4 protein basis?

5 A That has been my understanding, yes.

6 Q Okay. And were you involved in the federal order
7 hearings where the 1.32 crude protein factor was adopted?

8 A Yes.

9 Q And your view is that has been simply carried over
10 to the new rule except to the extent that we have now
11 switched from crude protein to true protein?

12 A From my understanding, that is correct.

13 Q Okay. Now, you're aware that there has been some
14 questioning as to why the assumption is in the current rule
15 as to the percent of casein in crude protein, correct?

16 A That is correct. The assumption used in
17 determining the factor is correct, yes.

18 Q There has been some question as to what the
19 assumption was --

20 A Right.

21 Q -- as to the percent of casein in crude protein
22 for purposes of the yield factor in the current rule,
23 correct?

24 A That is correct.

25 Q But given the fact that under your understanding

1 the yield factors are unchanged, your answer to that
2 question would be what it is under the new rule is the same
3 as it was under the seven orders before the new rule went
4 into effect, correct?

5 A That is correct.

6 Can I elaborate on that a little bit because there
7 is a mathematical coincidence that makes the assumption easy
8 to -- well, not necessarily easy to understand but explains,
9 and it is interesting.

10 If you assign the casein loss to protein instead
11 of to hundredweights of milk, if you take that minus .175
12 factor, which means you take 3.2 pounds of crude protein
13 which is generally considered average protein test in milk
14 and assign that across that, you come up with the 1.32
15 factor.

16 Also, you will discover if you simplify the
17 equation that you come up with a relationship that's 75
18 percent of the protein in milk ends up in cheese, not that
19 75 percent of the protein in milk is casein.

20 The other -- the other challenge or coincidence is
21 that if you don't do that, if you do not assign the .0175
22 casein loss per hundredweight factor to the protein, you
23 keep it on the milk, and you assume a 75 percent casein
24 ratio, you'll come up with the 1.32 factor.

25 So you can -- depending -- I guess I would

1 summarize it is this. At 75 percent casein the marginal
2 contribution of protein to yield is 1.32. At 78 percent
3 casein the total contribution, again adjusting for that
4 casein loss, is 1.32. So it's almost a coincidence that the
5 two numbers are that way, and I think it's made it more
6 confusing for everyone, including me.

7 Q Okay, I will saunter on.

8 The question I was leading up to when you've
9 elaborated on why, I think, you -- in an way, you are
10 justifying the answer to the question I had asked the
11 question.

12 A Okay.

13 Q Which is, what is your understanding as to the
14 assumption in the current rule regarding the percent of
15 casing in crude protein?

16 A Using my math, because there is no per
17 hundredweight yield loss adjustment, I assume that it's 78
18 percent.

19 Q Okay. And that's your belief as to what the
20 current rule now provides, correct?

21 A I believe that mathematically that's it provides.

22 Q Okay. And I'm relating this all, as you probably
23 recognize, back to Dr. Barbano's testimony --

24 A Right.

25 Q -- were he thought that currently the assumption

1 about the percent of casein in crude protein was .75 and it
2 should be raised to .78.

3 A Right.

4 Q But your view is it's already at .78, correct?

5 A It is at .78, in my estimation; absolutely.

6 Q And your Exhibit, I guess it is 49.

7 A Right.

8 Q Takes us through the math in part --

9 A Actually, probably in whole.

10 Q Okay.

11 A It's pretty detailed.

12 (Laughter.)

13 Q It is -- Exhibit 79 is the definitive --

14 A Forty-nine.

15 Q Excuse me. Exhibit 49 is the definitive work so
16 far as you know on how one demonstrates that the number is
17 in fact already .78?

18 A It's very thorough.

19 MR. ROSENBAUM: Okay, thank you.

20 JUDGE HUNT: Mr. Yale?

21 BY MR. YALE:

22 Q Mr. Brown, one of your jobs and functions with
23 National All-Jersey is to assist the members of your
24 organization to obtain the full value of their components in
25 their milk, is it not?

1 adjustments will give you roughly the same yield, depending
2 what you adjust.

3 Q But to make myself clear though --

4 A Okay.

5 Q -- the focus on these formulas has always been on
6 those numbers, on what's in the vat, right?

7 A Yeah, there is no -- there is no loss -- there is
8 no loss of milk attached to the formula.

9 Q The assumption is, is that what shows up in that
10 farmer's bulk tank is going to go to that vat and that these
11 formulas are right then with no discount, right?

12 A Yeah, it's pricing every pound of milk weighed at
13 the farm.

14 Q Okay. And approximately how many plants have you
15 negotiated these premiums?

16 A Oh, boy, I can't even count them. Dozens.

17 Q And how years have you been involved in this?

18 A Directly, for six; indirectly, for eight.

19 Q All right. And you've never had to deal with that
20 issue of loss from the farm tank to the --

21 A No.

22 Q In applying these formulas?

23 A Not in applying a formula.

24 MR. YALE: That's all my questions. Thank you.

25 JUDGE HUNT: Yes, Mr. Coughlin.

1 BY MR. COUGHLIN:

2 Q Mike, I just have one.

3 Were you here earlier today when one of our
4 member's representatives, Clay Galanrnea of Michigan Milk
5 testified?

6 A Unfortunately, I was not, but I have read his
7 testimony.

8 Q Have you read his testimony?

9 A Yes.

10 Q And his proposal to simplify the formula?

11 A Yes.

12 Q What's your opinion on that? I take it -- I mean,
13 I think of you as the expert on the area because you have
14 probably worked with these formulas more than any of us
15 here.

16 A I have not had the chance to sit down and run a
17 mathematical proof of it, but from what I can see all it
18 does is basically simplify the formula and it gives you the
19 same values.

20 Q Is it a simpler way to come to the same --

21 A Yes.

22 Q If it does come to the same answer, is it a
23 simpler way that could be more easily understood by people?

24 A Yes, it is.

25 MR. COUGHLIN: Thank you.

1 THE WITNESS: I might add that we have plants that
2 do simplify the cheese yield formula when they pay their
3 producers --

4 JUDGE HUNT: Yes, ma'am.

5 THE WITNESS: -- in a similar way.

6 JUDGE HUNT: I'm sorry. You had something to add,
7 Mr. Brown?

8 THE WITNESS: No, that's it. That's okay.,
9 That's it.

10 SUE TAYLOR: Sue Taylor from Leprino Foods. Now
11 we're really getting dangerous when I take the mike up here.

12 THE WITNESS: It's okay. I know your history.

13 BY MS. TAYLOR:

14 Q Mr. Brown, Mr. Yale asked you a question about
15 whether plants typically, using the cheese yield formula,
16 would first acknowledge a loss between the farm and plant
17 before calculating the value of the milk. And as I
18 understand it, you answered that question no?

19 A Yeah, that is correct.

20 Q Could you tell me whether the plants that are
21 using those cheese yield formulas are adding a whey cream
22 value?

23 A Generally not, no.

24 Q In that case since they are using a cheese yield
25 formula, can it be assumed one minus fat retention factor in

1 the Van Slyke yield would be fat that they are not paying
2 for?

3 A They are not directly paying for it. I think
4 it's -- they are not directly paying for it. Again, if I
5 may elaborate.

6 We have to remember that a cheese yield is a proxy
7 for that milk's relative work. And if you have milk that's
8 three percent fat or you have milk that's five percent fat,
9 ten percent of that, according to the modified Van Slyke,
10 doesn't make it into the cheese. It makes it into the whey
11 cream, but they do not pay directly for it.

12 But they still have to be competitive in the
13 market. Remember these are over market premiums. They
14 still have to be competitive whatever the regulated price is
15 plus what the market bears. But you're right, they do not
16 directly pay for that fat.

17 Q So in some ways that might be their way of
18 accounting for that loss, or an offsetting relative to the
19 current system.

20 A I can't -- I can't honestly say that that's the
21 case. No one has ever directly said that. I don't pay for
22 that because there is a loss there. It's more of an issue
23 of when we evaluate producers' options for milk price, we
24 convert it into price of milk per pound cheese, even if it's
25 a protein premium per point, and we don't look -- I never

1 look, I never adjust for casein -- for loss of fat in whey.

2 MS. TAYLOR: Okay, thank you.

3 JUDGE HUNT: I see no hands. Then I thank you
4 very much.

5 THE WITNESS: We need to --

6 JUDGE HUNT: Oh, I'm sorry. You want 49 and 50 as
7 part of the record.

8 THE WITNESS: Yes, I would.

9 JUDGE HUNT: Any objections to 49 and 50 being
10 part of the record?

11 (No response.)

12 JUDGE HUNT: No objections. Then 49 and 50 will
13 be made part of the record in this proceeding.

14 THE WITNESS: Thank you.

15 JUDGE HUNT: Thank you, Mr. Brown.

16 (Witness excused.)

17 (The documents referred to,
18 previously identified as
19 Exhibit Nos. 49 and 50, were
20 received in evidence.)

21 JUDGE HUNT: And Mr. Schad then?

22 Yes, ma'am?

23 MS. WHITESIDES: Good afternoon, I'm Ashley
24 Whitesides, and I represent --

25 JUDGE HUNT: Excuse me. Your last name?

1 MS. WHITESIDES: Whitesides.

2 JUDGE HUNT: Whiteside, okay.

3 MS. WHITESIDES: And I represent Hershey Foods
4 Corporation.

5 Mr. Schad has graciously agreed to let Audrey
6 Throne testify ahead of him --

7 JUDGE HUNT: All right.

8 MS. WHITESIDES: -- since she has some time
9 constraints today.

10 JUDGE HUNT: Good afternoon.

11 MS. THRONE: Good afternoon.

12 Whereupon,

13 AUDREY F. THRONE

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

16 JUDGE HUNT: And would you state and spell your
17 name, please? Thank you.

18 THE WITNESS: My name cheeses Audrey Throne.
19 That's spelled A-U-D-R-E-Y, T-H-R-O-N-E.

20 MS. WHITESIDES: Your Honor, we have passed out
21 copies of her written testimony, and we would like to
22 identify it as the next consecutive exhibit number. I think
23 we are on 51.

24 JUDGE HUNT: Yes, you're right, 51.

25 (The document referred to was

1 marked for identification as
2 Exhibit No. 51.)

3 MS. WHITESIDES: Please proceed with your
4 testimony.

5 THE WITNESS: Good afternoon. My name is Audrey
6 Throne and I am testifying today on behalf of Hershey Foods
7 Corporation regarding Hershey's position on the various
8 proposals which have been submitted to reconsider the Class
9 III and Class IV milk pricing formulas in the final rule.

10 I have been employed by Hershey for 20 years, and
11 my present position is manager of dairy ingredients. My
12 responsibilities include buying all of the milk and dairy
13 ingredients that Hershey Foods uses in making its products
14 in North America.

15 I grew up on a dairy farm in Pennsylvania and my
16 entire career at Hershey Foods has been in milk sanitation
17 and procurement.

18 Hershey Foods is the leading North American
19 manufacturer of quality chocolate, confectionery and
20 chocolate-related grocery products. In addition, we export
21 Hershey's branded products to more than 90 countries
22 worldwide. In 1999, Hershey's total sales were \$3.9
23 billion.

24 Our principal brands include Hershey's Milk
25 Chocolate and Milk Chocolate with Almonds Bars, Hershey's

1 Kisses Chocolates and Hershey's Hugs Chocolates, Kit-Kat
2 Wafer Bar, Reeses Peanut Butter Cups, Jolly Rancher Candy,
3 Payday Peanut Caramel Bar, Twizzlers Candy, Whoppers Malted
4 Milk Balls, and York Peppermint Patties, to name just a few.

5 Hershey Foods Corporation was founded by Milton
6 Hershey in 1894, and he located his manufacturing plant in
7 the heart of Pennsylvania's dairy country where he could
8 obtain the large supplies of fresh milk needed for making
9 his method of high quality milk chocolate.

10 Today, Hershey Foods Corporation operates more
11 than a dozen confectionery plants throughout the United
12 States, Canada and Mexico. We still use primarily fresh
13 fluid milk in making our products, such as Hershey's Milk
14 Chocolate Bars, Hershey's Kisses Chocolates, and Hershey's
15 Milk Chocolate Bars with Almonds. These products have a
16 distinctive flavor and texture that the American public has
17 recognized and enjoyed for many decades. And one important
18 reason for that distinctive Hershey favor is that Mr.
19 Hershey's methods call for fresh fluid milk.

20 As I said before, my responsibilities include
21 buying the fresh fluid milk that Hershey Foods uses in its
22 milk chocolates and other products, as well as all other
23 dairy ingredients used in our manufacturing operations.

24 In 1999, Hershey Foods bought more than 1.5
25 million pounds of fresh fluid milk every day.

1 The price relationship between Class IV milk on
2 the one hand and Class II milk on the other is significant
3 for the future of the dairy industry in this country.
4 Several of the proposals for adjusting the Class IV price
5 would have the ripple effect of increasing the price of
6 Class II milk. USDA should avoid any step that would
7 increase the Class II price or increase the price difference
8 between Class II and Class IV milk.

9 The trend already is for food manufacturers to
10 reduce their use of Class II milk, and any increase in the
11 price difference between Class II and Class IV milk will
12 accelerate the trend. This trend harms dairy farmers.

13 Class II food manufacturers are reducing their
14 reliance on traditional domestic fluid milk by reformulating
15 products to eliminate the dairy component, substituting
16 nondairy fats, using imported dairy ingredients and
17 relocating manufacturing operations in foreign countries.

18 For example, imports of milk protein and of
19 anhydrous milk fat, which are alternative dairy ingredients,
20 have risen dramatically in recent years. These imports have
21 replaced some domestic Class II milk because they are less
22 expensive.

23 Moreover, once a manufacturer changes its
24 processes or formulations to eliminate Class II milk, it is
25 extremely difficult and expensive to reverse that change.

1 For these reasons, Hershey submits that if USDA
2 reduces the price of fat, it should do so for all classes.
3 USDA should not discriminate in favor of Class IV by
4 reducing the price of fat for that class alone.

5 In addition, the make allowance for Class IV
6 should not be decreased and the yield factor for nonfat dry
7 milk should not be changed.

8 Hershey also submits that USDA should issue a
9 recommended decision for public comment before adopting a
10 final rule. In requiring this rulemaking, Congress did not
11 state that there were emergency conditions in the market
12 that would justify dispensing with a recommended decision
13 and public comment.

14 To the contrary, the congressional objection to
15 the final rule USDA adopted in 1999 was based on what
16 Congress perceived as inadequate public comment.

17 The price of butterfat should be the same for all
18 classes. Several parties propose that the price of
19 butterfat be reduced by six cents per pound, and that's
20 Proposals 3, 4, 5, and 8. These proposals differ, however,
21 on whether this reduction should be applied uniformly to all
22 classes or whether the reduction should benefit Class IV
23 alone.

24 Hershey submits that if conditions in the market
25 warrant a six-cent reduction in the price of butterfat this

1 reduction must be applied across the board. There is no
2 rational justification for reducing the price in one class
3 while leaving it unchanged in other classes.

4 There are at least four reasons against reducing
5 the price of butterfat in Class IV alone.

6 First of all, reducing the price of fat in Class
7 IV alone will provide an artificial incentive to use more
8 cream to produce butter. The market should determine the
9 use of fat because the market can and the market will
10 allocate fat to the most efficient use. Reducing the price
11 of fat in Class IV but not in Classes II or III will provide
12 an artificial incentive to use more cream to produce better.

13 By calling this incentive artificial, I mean only
14 that the free market would not provide this incentive on its
15 own.

16 All classes of milk compete for the same fat. The
17 price that sellers of excess cream are obligated to pay for
18 that butterfat is determined by the first use of the excess
19 butterfat sold. Therefore, if you reduce the Class IV
20 butterfat price six cents per pound and leave butterfat
21 prices in other classes unchanged, it means that sellers of
22 excess cream will have a six-cent per pound lower obligation
23 if that butterfat is sold for use in Class IV products.

24 As a result, users in other classes will have to
25 pay six cents more per pound of milk fat to attract that fat

1 away from Class IV users.

2 Class IV manufacturers will always be the
3 preferred outlet for sellers of milk fat because their
4 obligation for that butterfat will be lower. Favoring Class
5 IV will cause Class II manufacturers to use butter or other
6 ingredients.

7 Many Class II products compete on grocery store
8 shelves with food products made from Class IV milk. If USDA
9 makes fat used in Class II more expensive than the identical
10 fat used in Class IV, then butter and other ingredients will
11 become more economical than fresh cream for use in Class II
12 products.

13 Class III-A pricing, when it was introduced in
14 1993, had the same effect on the use of skim milk.

15 Class II manufacturers will then be forced to use
16 those substitutes to remain competitive. While there are
17 FDA standards of identity for many Class II products, those
18 standards often permit the use of ingredients such as
19 butter, and many products made from Class II milk or cream
20 are not subject to any standard of identity.

21 Additionally, products such as anhydrous milk fat
22 can be imported for less. For example, import statistics
23 from the Census Bureau indicate that the quantity of AMF
24 imported into the United States increased from only 110, and
25 that should have been thousand kilograms, or more simply,

1 tons, so increased from only 110 tons of AMF in 1995 to more
2 than 10,500 tons in 1999. Obviously, this reveals a
3 significant increase in the importation of alternative dairy
4 ingredients.

5 To the extent that substitutes for cream are not
6 available to Class II manufacturers, then a reduction for
7 Class IV alone places them at a competitive disadvantage.

8 Both the International Dairy Foods Association and
9 the National Milk Producers Federation have conducted an
10 economic analysis of the effect on Class II prices of
11 reducing the price of fat in Class IV by six cents per pound
12 without any reduction in other classes. These analyses show
13 that this one class reduction would increase the difference
14 between Class II and Class IV by 21 cents per hundredweight.

15 Thus, the current differential, which is fixed at
16 70 cents, would in effect be increased to more than 90
17 cents. I believe that these analyses to be correct.

18 This dramatic increase in the difference between
19 Class II and Class IV would place Class II manufacturers at
20 a substantial competitive disadvantage.

21 As I noted above, one effect will be to force
22 Class II manufacturers who compete with products made with
23 Class IV milk to seek cheaper alternatives. Where cheaper
24 substitutes are not available, however, the Class II
25 manufacturers will be placed at a substantial and unfair

1 cost disadvantage. This is especially a concern for my
2 company because many of our competitors use skim milk and
3 fat made from Class IV milk rather than Class II fluid milk.
4 A difference of 91 cents per hundredweight would put Hershey
5 at a cost disadvantage relative to its competitors of at
6 least \$4 million per year.

7 Favoring Class IV alone could force the Class II
8 price above the blend price in some orders, with the result
9 that Class II users will depool.

10 Based on my practical experience with milk prices,
11 I believe it is likely that a reduction in the fat price
12 that is limited to Class IV would cause the Class II price
13 in some orders to be greater than the producer blend price.
14 In this situation many Class II users would have a strong
15 incentive to depool their milk and thus take advantage of
16 the lower blend price.

17 Indeed, the current 70-cent differential is
18 already having exactly this effect in some orders, and
19 increasing the Class II price further relative to the Class
20 IV price will accelerate the trend toward depooling.

21 The current make allowance for Class IV should not
22 be decreased. In its Notice of Hearing, USDA gave its
23 assessment that reducing the make allowance for nonfat dry
24 milk would have the effect of increasing the price of Class
25 I and Class II milk. This price increase would reduce the

1 volume of milk used in those classes and consequently
2 increase the volume of milk used in Class III and Class IV.

3 I agree with USDA's assessment. It seems to me
4 that it would be irrational to force more milk into uses
5 that USDA considers surplus at the expense of consumer-
6 driven products such as fluid milk and food products.

7 In addition, as discussed earlier, increasing the
8 price of Class II milk will force manufacturers to use less
9 expensive substitutes, including some imported products.
10 Moreover, any increase in the price difference between Class
11 II and Class IV milk, even if the increase is inadvertent,
12 will place Class II manufacturers at a substantial
13 competitive disadvantage.

14 Market forces correct any effect of a make
15 allowance that is too large through the mechanism of
16 negotiated over order premiums. Thus, any claim that the
17 make allowance should be decreased should be rejected by
18 USDA because free market forces will force buyers to pay
19 premiums.

20 On the other hand, if the make allowance is too
21 small, then production of nonfat dry milk will move to
22 cooperative plants that are not subject to minimum price
23 regulation or to plants outside the Federal Order System.

24 The yield factor should not be changed from the
25 current 1.02. Several proposals have been made to reduce

1 the yield factor for nonfat dry milk. They are Proposals
2 26, 27 and 28. The rationale for these proposals appears to
3 be that the amount of nonfat dry milk produced from skim
4 milk will be greater than the amount of nonfat solids in the
5 skim milk because of the moisture that remains in the nonfat
6 dry milk even after drying.

7 The flaw in this rationale is that there are
8 unavoidable losses of milk from the farm to the drying plant
9 and within the plant itself. Thus, not every pound of
10 nonfat solids is recoverable in the form of nonfat dry milk.
11 Moreover, some nonfat solids go into cream during the
12 separation process and therefore are not captured in the
13 nonfat dry milk.

14 USDA recognized these losses in adopting the 1.02
15 yield factor. USDA should reject the proposals to change
16 the current yield factor.

17 USDA should publish a recommended decision for
18 public comment. USDA should not omit a recommended decision
19 for public comment during this rulemaking.

20 First, while Congress called for an emergency
21 rulemaking, it did not intend for USDA to bypass the
22 recommended decision phase which was designed to ensure that
23 rules, such as the milk pricing formulas, reflect not only
24 the agency's expertise, but also public opinion. Congress
25 obviously recognized the importance of obtaining public

1 comment on these milk formulas because it insisted USDA
2 return to further rulemaking because the final rule did not
3 adequately reflect public comment from the initial
4 rulemaking.

5 Second, there are no emergency marketing
6 conditions that exist to warrant the omission of the
7 recommended decision and public comment phase. There is no
8 emergency milk marketing situation that would warrant
9 omitting the public comment period on the secretary's
10 proposal.

11 Hershey and other interested parties are entitled
12 to an opportunity to comment on the secretary's recommended
13 decision. Considering the importance of milk pricing, USDA
14 should, at the very least, allow interested parties a
15 minimum number of days to comment on the proposal.

16 In conclusion, Hershey favors allowing milk prices
17 to be set by the free market, not by regulation. USDA
18 should reject any proposal for the price of Class IV that
19 will have the ripple effect of increasing Class II prices or
20 that would increase the price difference between Class II
21 and Class IV milk. Such proposals will ultimately harm
22 dairy producers by driving manufacturers away from Class II
23 milk and forcing them to adopt substitute ingredients, some
24 of which will be imported. Such proposals will also place
25 Class II manufacturers at a substantial competitive

1 disadvantage.

2 In addition, Hershey believes it is important for
3 USDA to allow public comment on a recommended decision in
4 this proceeding.

5 Respectfully submitted.

6 MS. WHITESIDES: Your Honor, we would like to move
7 for Exhibit 51 to be admitted into the record as evidence.

8 JUDGE HUNT: Does anyone object to 51?

9 (No response.)

10 JUDGE HUNT: There being no objections, Exhibit 51
11 will be received into evidence.

12 (The document referred to,
13 previously identified as
14 Exhibit No 51, was received in
15 evidence.)

16 MS. WHITESIDES: The witness is available for
17 further questions.

18 JUDGE HUNT: Yes, Mr. Yale.

19 CROSS-EXAMINATION

20 BY MR. YALE:

21 Q My first question is where are the exhibits of the
22 Hershey Candy Bars and the others?

23 A As you will recall when we arrived on Sunday, it
24 was 96 degrees. Makes it a little though.

25 Q I would have licked the wrappers.

1 (Laughter.)

2 You mentioned in your testimony this issue of farm
3 shrinkage and that must be a consideration in that 1.02
4 factor in the nonfat dry milk.

5 Do you recall your statement to that effect?

6 A Yes, I do.

7 Q Have you read the final decision in regarding
8 setting the 1.02?

9 A Yes.

10 Q Does it say in there that it's accounting for
11 shrinkage from the farm to the processing?

12 A I think that it addressed, and this is really from
13 recollection, that it addressed the lower value of
14 buttermilk is my recollection.

15 Q I think you're right. I mean, for buttermilk
16 powder. But it never addressed -- you cannot identify
17 anywhere where it addressed the issue of shrinkage being a
18 factor in these yields, right?

19 A I don't recall.

20 Q Do you have any statistics -- Hershey buys raw
21 milk from producers as well, does it not?

22 A We do.

23 Q Yes.

24 A No, not from producers. I'm sorry.

25 Q Not from -- from cooperatives?

1 A We buy from cooperatives.

2 Q From cooperatives.

3 You don't have your own independent supply
4 anymore?

5 A We do not.

6 Q You used to?

7 A Yes, that's correct.

8 Q Okay. And do you have any statistics on loss from
9 farm test -- from farm weights to what is actually used
10 there at the plant?

11 A When we had our own producers and we had our own
12 calibration units, we strove to achieve about a quarter
13 percent loss from farm to plant.

14 MR. YALE: That's all my questions. Thank you,
15 Your Honor.

16 JUDGE HUNT: All right, Mr. Yale.

17 Mr. Coughlin.

18 BY MR. COUGHLIN:

19 Q Audrey, Ed Coughlin from the National Milk
20 Producers Federation.

21 You are talking on the very last page of your
22 testimony and earlier in the testimony about substituting
23 ingredients, some of which will be imported, and I think
24 earlier in the testimony you mentioned anhydrous milk fat.

25 Are you familiar with the general agreement on

1 tariffs and trades and what that does?

2 A I am.

3 Q Does that basically provide for some additional
4 imports of dairy products into the United States with low
5 tariffs?

6 A It generally provides tariff rate quotas for the
7 imports of certain quantities at relatively low duty rates,
8 and then it provides for additional imports at higher duty
9 rates.

10 Q Right.

11 A I believe the borders are open but you must pay.

12 Q Yes. I just want to explore the economic
13 viability of anhydrous milk fat. At the bottom of page 7 of
14 your testimony you talk about that anhydrous milk fat
15 imported into the United States increased from only 110 tons
16 in '95 to more than 10,500 tons in 1999.

17 In your recollection, if you go back to 1995, did
18 the government at that point in time under the Price Support
19 Program still have stocks of butter?

20 A Yes, there were still some stocks in 1995.

21 Q And what's happened since that time?

22 A They had become depleted.

23 Q And so we've had, if you will, I mean, the
24 butterfat demand market today and you know, over -- and last
25 year, has it been a situation where -- have we had adequate

1 supplies of butterfat in the United States being produced?

2 A I believe we've had adequate supplies, but
3 certainly they have been at higher prices.

4 Q Okay. Has the U.S. been an exporter of butterfat?

5 A Yes, the U.S. has exported some butterfat.

6 Q Large quantities?

7 A I don't know the exact quantities that were
8 exported.

9 Q What happened in the U.S., did the butter prices
10 get up to close to \$2 a pound?

11 A They got up closer to \$3 a pound.

12 Q And what happened at that point in time with
13 respect to the -- were there any exports of butter?

14 A My recollection is that in early 1998, there were
15 exports of butter. It was in the latter part of 1998, when
16 prices went to \$2.81.

17 Q And did we then begin importing butter and
18 anhydrous milk fat?

19 A There was then butter and anhydrous milk fat that
20 was imported.

21 Q And why did butter begin to flow into the United
22 States then?

23 A The product flowed into the United States because
24 at the world price for butter and anhydrous milk fat, plus
25 the over-the-top tariffs, it was economical compared to

1 domestic product.

2 Q Is it at today's butterfat levels, is it economic
3 to import product and pay the duties that you would pay on
4 it?

5 A Not today.

6 MR. COUGHLIN: Thank you.

7 JUDGE HUNT: Mr. Beshore.

8 BY MR. BESHORE:

9 Q Audrey, does Hershey use anhydrous milk fat in any
10 of its product formulations?

11 A We do.

12 Q Do you source it domestically?

13 A We do.

14 Q Have you sourced it with imports also?

15 A We have.

16 Q Do you acquire it from domestic producers in the
17 Northeast or other parts of the country?

18 A There is a very limited number of producers in the
19 country. I think most of them are located in the Midwest.

20 Q Do you use it all the time or only to replace
21 butterfat because of cost factors, cost criteria?

22 A We currently using AMF all the time.

23 Q So it provides an important ingredient in some of
24 your products, I take it?

25 A That's correct.

1 Q Do you at Hershey, a plant in Hershey, do you
2 regularly buy cream or sell cream or do you standardize with
3 dry solids?

4 A Within our system, we do buy some cream.

5 Q Okay, who do you -- do you acquire cream from
6 fluid handlers generally?

7 A Yes.

8 Q Okay. I'm trying to understand the arguments with
9 respect to the impact that Proposal 8, which would reduce
10 the price of butterfat in butter, would have on Class II
11 users, including Hershey.

12 First of all, your absolute price under the orders
13 would not change; isn't that correct?

14 A The absolute price would not change.

15 Q Right. You would -- the price would remain if
16 Proposal 8 were adopted at a price based off the NASS
17 butter, butter price less a make allowance; that component
18 value, correct?

19 A For farm milk.

20 Q For farm milk?

21 A Yes.

22 Q Okay. What percentage of your use of butterfat at
23 the plant at Hershey is farm milk as opposed to cream?

24 A I don't know the comparison as opposed to cream.
25 I would say generally overall farm milk as a percent of fat

1 usage is maybe half.

2 Q Okay. So if you're purchasing 1.5 million pounds
3 a day, I think your testimony indicated farm milk. Am I
4 right about that, on average?

5 A Mm-hmm.

6 Q And that only provides about half your cream --
7 half your butterfat?

8 A That's correct.

9 Q Are you also using a lot of butter in making candy
10 at Hershey?

11 A We use various forms of fat, whether it be cream,
12 butter and anhydrous milk fat, whole milk powder.

13 Q Okay. So if you are using all those ingredients
14 now, I assume they are being used -- may I assume that they
15 are being used because that's what the recipe calls for,
16 what Milton Hershey's recipe called for, basically?

17 A Mr. Hershey's original recipe called for nothing
18 but fresh milk.

19 Q Okay. Okay, but you are using those ingredients
20 now because in the ratios you do primarily because that's
21 the ratios you want to use in those products, I assume.

22 A At this point in time, yes. As to why we went to
23 those products, I don't have all of the history on that ,
24 but certainly we've made the decision not to produce that
25 chocolate from fresh milk.

1 Q Well, you're producing at lot of chocolate from
2 fresh milk, correct?

3 A We are.

4 Q Okay. And you're standardizing with additional --
5 are you also bringing in dry solids?

6 A We use dry solids to make chocolate.

7 Q Okay. Approximately what portion of your dry
8 solids is fresh milk versus other sources?

9 A I think the best answer I can give you is that
10 it's probably also about half.

11 Q Okay. Now, is it your contention that the
12 absolute price for the cream that you purchase surplus to
13 the fluid milk plants, that the absolute price of that cream
14 will increase if the absolutely price of cream for butter
15 goes down?

16 A I believe that the market may vary at times during
17 the year, but that one of two things must happen or some
18 combination of those two, and one is that either the cream
19 in the Class IV will go down or the cream in Class II will
20 go up or some combination of the two, depending on the
21 market forces at the time, whether there are surpluses of
22 fat or whether there are shortages of fat.

23 I think someone testified earlier today that the
24 Class I people couldn't recover -- I guess it was Bob
25 Wellington -- that they had been unable to recover that six

1 cents during this early part of the year, but that the
2 general feeling is that as we get into the later part of the
3 year when cream supplies get tight and they will make up for
4 it.

5 Q Would it be your experience, as has been alluded
6 to by others -- I don't even know who -- that in the market
7 for cream basically the buttermaker buys the last load of
8 cream?

9 A I guess I've always thought of butter and nonfat
10 dry milk as the market of last resort.

11 Q In both skim and butterfat? Is that a yes?

12 A Yes.

13 MR. BESHORE: Thank you. That's all I have.
14 Thanks.

15 JUDGE HUNT: Mr. Vetne.

16 BY MR. VETNE:

17 Q By market of last resort, in response to the last
18 question, was it your intention to imply a place where the
19 seller gets the least return or a place that can always do
20 something with the milk even though other buyers might not
21 have anything to do with it?

22 A It should certainly be the market where butter
23 will go if there is no other demand for it since it
24 automatically has a market, and the government will purchase
25 the excess if there is any.

1 Q Okay. And is one of the concerns of Hershey with
2 respect to some of these proposals is that, although it
3 might also go there last, it may also be a market in which
4 the economic return is greater which in turn affects the
5 cost, not your ability, but the cost to you and others to
6 pull that milk away from Class IV?

7 A That's correct.

8 Q In response to questions from Ed Coughlin on
9 imported anhydrous, you keep track of that, I understand?

10 A I do.

11 Q Okay. Anhydrous imports end of 1998, early 1999,
12 when butter prices skyrocketed, were those extra imports at
13 the second more expensive tier of import duties?

14 A Yes. There is -- there was a graduated scale that
15 increased each year as to the volume that could come in
16 under the TRQ, and I don't remember those exact volumes.
17 But if there was say 10 or 12 million pounds that came in
18 under the TRQ, everything above that volume was at the
19 higher duty rates.

20 Q Okay. And the TRQ in English words is?

21 A I'm sorry. Tariff Freight Quota.

22 Q Tariff Freight Quota.

23 Okay. So economic conditions in 1999 were such
24 that even the more expensive imports could be cost
25 effectively marketed to the United States and offered to

1 buyers in 1998-99, correct?

2 A That's correct.

3 Q Okay. The amount that's eligible for the more
4 favorable duty, I think you referred to that as an expanding
5 amount?

6 A It increased each year during the GATT agreement
7 until the year 2000, and then I believe from this point
8 forward it is steady.

9 Q It's steady, it's at a fixed volume?

10 A At a fixed volume.

11 Q And is that fixed volume one of the questions that
12 is at issue in, or should have been at issue in Seattle or
13 will be at issue in trade talks that are going to take place
14 in the near future?

15 A I'm assuming that the discussion of all imports
16 and subsidies worldwide on dairy are up for discussion in
17 those meetings.

18 Q Okay. Would you agree with me that the direction
19 that has been taken in the past at least is to open markets
20 from country to country by reducing duties and non-tariff
21 barriers on international trade?

22 A I would agree that that's the direction that
23 certainly the United States has been moving towards, and
24 some other countries.

25 Q And if what's good for our trading partners is

1 what we preach, then that same direction would result in
2 more dairy ingredients, such as anhydrous milk fat coming in
3 under a more favorable duty rate?

4 A I believe it could.

5 Q You've referred to use of whole milk powder as one
6 of your sources of fat and solids. Do you acquire whole
7 milk powder both from local manufacturers as well as
8 manufacturers within the United States distant from your
9 plant?

10 A We do.

11 Q And that would include, for example, California
12 whole milk powder as well as powder from Detrick, which is
13 next door to you?

14 A Yes, that would include California powder as well
15 as local powder.

16 Q Okay. Do you on occasion acquire whole milk
17 powder that is made to your specifications as to the fat and
18 skim solids content or do you buy mostly generic whole milk
19 powder that's -- whatever the whole milk went into it is the
20 powder that comes out of it?

21 A Our specification is basically what I would
22 consider to be the accepted specification for whole milk
23 powder. Whether you can take raw milk and just simply dry
24 it and it precisely meets that specification, it probably
25 does not at all times of the year.

1 Q Okay. If you are able and willing to testify, can
2 you give us some indication of the market price based on
3 your purchase experience of whole milk powder in relation to
4 the market price for powder in NFDM and a fat equivalent
5 product meeting the fat portion of that need?

6 A Generally, we are able to purchase whole milk
7 powder at a slightly favorable price to the combination of
8 nonfat and a fat source.

9 MR. VETNE: Okay, that's all I have. Thank you.

10 JUDGE HUNT: Mr. Coughlin.

11 BY MR. COUGHLIN:

12 Q Audrey, Mr. Vetne brought me back here because --
13 do you know what the over quoted tariff rate is
14 approximately on butterfat that comes into the United
15 States?

16 A It just went down in January, and I don't know the
17 exact rate, but it's somewhere around 88 to 95 cents,
18 somewhere in that range, and it will vary based on the price
19 of the product you are bringing in.

20 Q So per pound -- per pound of butter, you would pay
21 that much for each pound of butter that you brought into the
22 United States?

23 A I'm sorry. I was giving you an AMF number.

24 Q Okay.

25 A I don't know the butter number.

1 Q Okay, on the AMF number, we haven't had any -- AMF
2 is 98 percent fat or thereabouts, isn't it?

3 A 99.9.

4 Q 99.9, so it's practically pure fat.

5 would the over quota tariff rate on butter be
6 roughly proportional to that in terms of -- is it probably
7 somewhere in the neighborhood of 60 to 70 cents per pound,
8 in that range?

9 A I'll say between 60 and 80, I believe. I don't
10 recall what it is anymore.

11 Q Okay. Are you familiar with international market
12 prices for dairy products?

13 A Roughly.

14 Q If somebody told you to go out and irrespective of
15 over quota tariffs to buy the cheapest source of milk fat,
16 would it be in this country or would it be somewhere else in
17 the world?

18 A It would be somewhere else in the world.

19 Oh, I'm sorry. Are you saying including quotas?

20 Q No, without the quota.

21 A Certainly somewhere else.

22 Q So that which moves into this country, within the
23 TRQ, is the cheapest source?

24 A Yes.

25 Q Okay. And that once you go up to that limit and

1 you go over that, you're going to pay somewhere, let's -- we
2 probably could agree -- somewhere above 60 cents per pound
3 on a butter equivalent basis to bring that product into the
4 country?

5 A We're talking AMF?

6 Q Well, on AMF you gave me a higher price than that,
7 but on a butterfat -- on AMF you're going to pay somewhere
8 70 to 80 cents a pound I think you indicated.

9 A The AMF is more economical to bring in at the top
10 tier tariff than the -- or at the top tier duty than the
11 butter.

12 Q But at what level would butter prices in this
13 country have to get approximately before it's economical to
14 bring AMF into this country?

15 A Somewhere between \$1.30 and \$1.35.

16 MR. COUGHLIN: Okay, thank you.

17 JUDGE HUNT: Anyone else have questions for Ms.
18 Throne? Ms. Brenner.

19 BY MS. BRENNER:

20 Q You indicated that Hershey would like an
21 opportunity for comment on our recommended decision. If the
22 time frame doesn't prove very advantageous for issuing a
23 recommended decision, would a tentative final decision with
24 an opportunity for comment after it goes into effect, and
25 then perhaps a change on that be acceptable?

1 A Our first preference would be a recommended
2 decision. Certainly we would prefer the situation you just
3 described as preferred to just a final hearing with no time
4 for comment.

5 MS. BRENNER: Okay, thank you.

6 JUDGE HUNT: Mr. Cooper.

7 BY MR. COOPER:

8 Q Yes, Ms. Throne, I think you indicated, in
9 response to Mr. Beshore or perhaps it was Mr. Vetne, that
10 you used -- you used whole milk powder at times in making
11 your milk chocolate; is that correct?

12 A We do.

13 Q And is that a regular use as distinction from odd
14 occasion?

15 A No. We regularly use whole milk powder.

16 Q And how about nonfat dry milk powder?

17 A We regularly use that.

18 Q And do you use anhydrous milk fat in making
19 chocolate?

20 A We do.

21 Q Milk chocolate or?

22 A Yes.

23 Q I was wondering, you have to have some milk in
24 there, don't you --

25 A Yes.

1 Q -- to label it "milk chocolate"?

2 A The standard requires a certain amount of milk and
3 fat and solids to be in chocolate.

4 Q Do you also -- have you also used sweetened
5 condensed milk?

6 A We use -- in the process of making chocolate we do
7 sweeten the milk. So if you call that sweetened condensed
8 milk, I would say yes. We buy sweetened condensed milk from
9 outside sources, but it's not used in chocolate. It's used
10 in other confectionery products.

11 Q Oh, okay. There has been testimony in past
12 hearings that you bought sweetened condensed milk. That
13 wasn't used in the chocolate, that was used in other
14 products?

15 A It goes into other confectionery products; things
16 like caramels or bakery type products.

17 MR. COOPER: Okay, I have no further questions.

18 JUDGE HUNT: Mr. Grandage.

19 BY MR. GRANDAGE:

20 Q On page 6 of your testimony, going back to the six
21 cents butterfat price, you make a comment that, "As a
22 result, users in other classes will have to pay six cents
23 more per pound of the fat."

24 Is that true across classes? In other words, each
25 class would be paying the same price, so a competitor would

1 be paying the same increased price that you would?

2 A If they are buying Class II cream, I would assume
3 that they would be paying the same price or close to the
4 same price.

5 Q You mentioned also that with the six cents off of
6 the Class IV price, but not off of the other classes, that
7 the Class IV market would become the market of first choice.

8 Wouldn't that then, if market conditions were
9 such, that would produce an excess in butter and thus
10 actually lower all of the fat prices for milk in all the
11 classes?

12 A What I meant by saying that is at a given market
13 price for cream the Class IV market would be the market of
14 choice because it would create the greatest net margin for
15 the seller.

16 Now, if the other buyers, such as the Class II
17 buyers, would ante up the money to attract that cream away
18 from the Class IV market, then the seller would be willing
19 to sell to the Class II or Class III users.

20 Q To your knowledge, does that happen now?

21 A I believe it probably does.

22 MR. GRANDAGE: Thank you.

23 JUDGE HUNT: Anyone else? Mr. Rosenbaum.

24 BY MR. ROSENBAUM:

25 Q Following up on that particular inquiry, you are a

1 Class II handler that buys cream from Class I handlers,
2 correct?

3 A Yes.

4 Q When they sell you that cream they have to pay
5 money to the pool to go out to farmers, correct? They, the
6 cheese handler has to, correct?

7 A Yes, they must.

8 Q And the minimum price they have to pay in the pool
9 is the Class II price, correct?

10 A That is correct.

11 Q And the Class II price for butterfat, right?

12 A Yes.

13 Q Because that's what we are talking about,
14 butterfat.

15 And today alternative that Class I handler can
16 sell that fat to a Class IV handler, correct?

17 A I'm sorry. Could you repeat that?

18 Q Alternatively that Class I handler can dispose of
19 its excess fat to a Class IV handler, correct?

20 A Yes, they can.

21 Q And today they dispose of that -- excuse me. When
22 they do that they pay the Class IV price for that fat,
23 correct?

24 A That is correct.

25 Q They meaning the Class I handler pays into the

1 pool the Class IV price for that fat, correct?

2 A Yes.

3 Q Which is the same as the Class II price for fat
4 today, correct?

5 A With the exception of .007 per pound in Class II.

6 Q Okay. All right. And if the butter price is
7 dropped by six cents for Class IV but not for Class II, what
8 does that .007 go up to?

9 A It becomes 6.7 cents per pound.

10 Q Okay, so it goes from a difference of less than a
11 penny to almost seven cents, correct?

12 A That's correct.

13 Q All right. And so a Class I handler would be
14 quite irrational to sell -- well, right now a Class I
15 handler is essentially indifferent as to whether he sells
16 that cream to you, a Class II handler, or to a Class IV
17 handler, correct?

18 A That's correct.

19 Q But he would be quite foolish if this change goes
20 into effect to sell the excess butterfat to you at the same
21 price he would sell it to a Class IV handler, correct?

22 A That is correct.

23 Q Because every pound he sells to you he has to pay
24 the pool six cents more than he would have if he had sold it
25 to a Class IV handler, correct?

1 A That is correct.

2 Q Okay. And so you as a Class II handler could only
3 presumably induce a Class I handler to sell that excess
4 butterfat to you instead of the Class IV handler by paying
5 the extra six cents, correct?

6 A That is correct.

7 Q And that's the cost of -- that's the ultimate
8 implication of the proposal to drop the six cents for only
9 Class IV, correct?

10 A I believe it is.

11 MR. ROSENBAUM: Okay, thank you.

12 JUDGE HUNT: Anyone else?

13 (No response.)

14 JUDGE HUNT: All right, thank you very much, Ms.
15 Throne.

16 (Witness excused.)

17 JUDGE HUNT: And we'll take a 10-minute break.

18 (Whereupon, a recess was taken.)

19 JUDGE HUNT: We are back on the record. You are
20 sworn in, Mr. Schad, so you are still under oath.

21 Whereupon,

22 DENNIS SCHAD

23 having previously duly sworn, was recalled as a
24 witness and was examined and testified further as follows:

25 MR. BESHORE: We have copies of Mr. Schad's

1 statement for anyone that I didn't get them to so far.

2 Dennis, would you go ahead and give your prepared
3 statement?

4 THE WITNESS: Good afternoon. This is the
5 statement of Dennis Schad on behalf of the Association of
6 Dairy Cooperatives in the Northeast, known as ADCNE.

7 This statement is presented on behalf of the
8 Association of Dairy Cooperatives in the Northeast. The
9 association consists of the following member dairy
10 cooperatives: Agri-Mark, Dairylea, Dairy Farmers of
11 America, Land O'Lakes, Maryland and Virginia Milk Producers
12 Cooperative Association, O-AT-KA Cooperative, St. Albans
13 Cooperative Creamery and Upstate Farms Cooperative.

14 The members of ADCNE market in excess of 65
15 percent of the milk in Order 1, the federal order regulating
16 the milk marketing in the Northeast marketing area. Order
17 1, in turn, represents more than 20 percent of the milk in
18 the Federal Milk Marketing Order System.

19 ADCNE supports the positions of the National Milk
20 Producers Federation on the proposals in this hearing.
21 ADCNE has reviewed the hearing proposals independently with
22 particular reference to the marketing conditions in the
23 Northeast and believes that the consensus positions advanced
24 by the National Milk Producers Federation represent
25 constructive, positive positions on the issues in this

1 hearing which are in the best interests of the dairy farmers
2 of the Northeast.

3 Agri-Mark has presented as separate position with
4 respect to one or more of the hearing proposals. We offer
5 the following additional testimony in support of the
6 National Milk Producer Federation positions.

7 Make allowances: ADCNE supports the National Milk
8 Producer Federation's testimony with respect to the
9 calculation of manufacturing allowances for Class III and IV
10 products. I want to underscore just a few of the important
11 points with respect to setting the manufacturing allowance.

12 First, it should be based on data from actual
13 plant operations which have been documented through the RBCS
14 study, the State of California information, and hearing
15 testimony from individual plant operators.

16 Secondly, it should include on a weighted average
17 basis data from California manufacturing operations as well
18 as plants in the Federal Order System because California
19 plants are major competitors of all the manufactured dairy
20 product markets.

21 Third, it should be set at a level which includes
22 an allowance for marketing expense and return on capital
23 which are necessary costs of plant maintenance.

24 Finally, it should be set at a level that is
25 sufficiently generous to assure the availability of plant

1 capacity to handle the Class III and IV reserve supplies of
2 milk.

3 We believe that the National Milk Producer
4 Federation methodology appropriately reflects these factors
5 and should be utilized by the Department.

6 Product prices: ADCNE supports the continued use
7 of NASS prices in Class III and IV formulas. We also
8 support the adoption of legislation which would make the
9 NASS price reporting mandatory and provide for verification
10 procedures. However, until that legislation is in place we
11 understand that the Department is unable to make those
12 improvements to the NASS price series. Nevertheless, the
13 NASS prices remain the broadest based prices available for
14 use in the federal order price formulas and they should be
15 continued to be so used.

16 Opposition to changes in Class I and Class II
17 prices: Several proposals in the hearing notice would
18 attempt to change the formulas for Class I and/or Class II
19 prices through this hearing.

20 We object to these proposals being given
21 consideration at this hearing which by statute was mandated
22 to reconsider Class III and Class IV price formulas.

23 Class IV butterfat price: ADCNE supports the
24 change in the Class IV butterfat price as proposed by the
25 National Milk Producers Federation, Land O'Lakes and others.

1 This change in pricing of butterfat used to produce Class IV
2 products, primarily butter, is necessary to restore the
3 historical relationship of Class IV butterfat cost to end
4 product prices.

5 We want to emphasize that this change in Class IV
6 pricing will not directly affect the base price used to
7 establish Class I prices thus its impact on dairy farmer
8 income will be minimal. We want to note in this regard that
9 the change in the manufacturing allowance for butter
10 supported by National Milk Producers Federation will
11 increase the Class IV price by reducing the present make
12 allowance.

13 Yield factors and related issues: ADCNE supports
14 the National Milk Producer Federation position with respect
15 to yield factors which should be utilized in the formula for
16 cheese and nonfat dry milk.

17 In conclusion, in summary, ADCNE requests that the
18 Department adopt the positions on the hearing issues as
19 presented by Mr. Coughlin on behalf of the National Milk
20 Producers Federation. These are positions which represent a
21 consensus of the producer side of the dairy industry from
22 all regions of the country, and in particular, they are
23 supported by producers in the Northeast who are a member of
24 the ADCNE cooperatives.

25 Thank you for the opportunity to present our

1 views.

2 DIRECT EXAMINATION

3 BY MR. BESHORE:

4 Q Mr. Schad, the seven cooperatives, eight
5 cooperative organizations for which you are speaking have a
6 variety -- represent a variety of types of organizations and
7 operations in this large market in the Northeast, and I
8 wonder if you could just describe briefly what each
9 cooperative association does and the operations it has.

10 A Okay. Agri-Mark, Incorporated, a northeastern
11 cooperative, markets milk to third party buyers, also has a
12 butter powder plant as well as a cheese plant.

13 Dairylea Cooperative primarily markets milk to
14 third parties, but it is also a member of O-AT-KA which is a
15 butter powder operation, as well as a member and a joint
16 venture at Detrick, which again is a butter powder
17 operation.

18 Dairy Farmers of America, Elvin Hollon's described
19 their national operations, but in the Northeast they are
20 marketers to third parties, all classes, Classes I, II, III
21 and IV, and they are also a member of a joint venture called
22 Detrick, a butter powder plant.

23 Land O'Lakes operates -- again markets to third
24 parties Class I, II and III, also operates a butter powder
25 plant.

1 Maryland and Virginia Milk Producers Association,
2 like Land O'Lakes, markets to third parties and operates a
3 butter powder plant at Laurel, Maryland.

4 O-AT-KA is a cooperative of three cooperatives,
5 Upstate, Niagara and Dairylea. It's primarily a butter
6 powder plant but they have other operations there as well.

7 St. Albans Cooperative Creamery markets to third
8 parties and also operates a condensing and drying plant.

9 And Upstate is a cooperative in western New York.
10 They own bottling plants and also is a part owner in the O-
11 AT-KA system.

12 MR. BESHORE: Okay, thank you. Mr. Schad is
13 available for other questions.

14 JUDGE HUNT: Mr. Yale.

15 CROSS-EXAMINATION

16 BY MR. YALE:

17 Q Mr. Schad, you've just described the operations of
18 all these cooperatives, and I think one of your member
19 cooperatives, Agri-Mark, had a speaker today by the name of
20 Mr. Wellington. And he described the relationship of Agri-
21 Mark as a three-legged stool.

22 Do you remember that?

23 A I was out of the room when he --

24 Q You were out of the room.

25 Well, he said that there was producers -- they had

1 their producer side, and their processor side, and they had
2 to balance, and they were also member-owned so the producers
3 had to get profit out of their processor end, but at the
4 same time they needed its producers to get a fair price,
5 right.

6 And you're aware of that, right?

7 A I'm aware of the concept, yes.

8 Q And that is a challenge that your member
9 cooperatives face all the time as they make all their
10 business decisions, right? Is that correct?

11 A Yes.

12 Q Now, in the Northeast, there is a sizeable amount
13 of what we call independent milk; is that correct?

14 A That's correct.

15 Q And those producers all receive a blend price,
16 right?

17 A If they are pooled under the federal order, they
18 draw from the pool, and my -- the large majority of those
19 producers are pooled under the federal order, to my
20 knowledge.

21 Q Right. Which means they get the blended, the
22 federal order blended price, right?

23 A Correct.

24 Q So your cooperative members to compete in that
25 marketplace also have to pay a blend price, right, or close

1 to it, or in that range to be competitive, right?

2 A To be competitive, you have to pay a minimum of
3 blend price in the Northeast.

4 Q And your cooperatives are aware of the
5 implications of these make allowances, right, in terms of
6 what it will do to their ability to pay producers and the
7 blends and all that?

8 A Well, as -- yes.

9 Q And they are also aware of their processor side
10 and their capital side of how they have to be profitable,
11 right?

12 A That's correct.

13 Q So they have made -- in viewing all of those
14 issues, they have made a policy decision, haven't they?

15 A Yes.

16 Q That these rates are sufficient that they can meet
17 their goals as a processor, right?

18 A That's correct.

19 Q And as a producer-owned cooperative?

20 A That's correct.

21 Q And also as buying milk from producers, right?

22 A That's correct.

23 Q And that's much akin to the policy issue the
24 Department has to make, right?

25 A I would say so. Yes, sir.

1 Q Now, the people that don't have cooperatives, the
2 proprietary manufacturers don't have to address the issue of
3 the payments to the producers, do they? I mean, in terms of
4 their decision on what they wanted from their make
5 allowances in the same way that you as a cooperative have
6 to?

7 A Not in the same way.

8 Q They don't have to answer to the cooperatives
9 democratically as well as competitively, right?

10 A I would agree with that.

11 MR. YALE: All right. No other questions.

12 JUDGE HUNT: Yes, Mr. Rosenbaum.

13 BY MR. ROSENBAUM:

14 Q You've listed a number of cooperatives who are
15 part of your association of dairy cooperatives in the
16 Northeast, correct?

17 A Yes, sir.

18 Q Am I right that Agri-Mark is by far the biggest
19 cheese manufacturer in that group?

20 A It probably is the only manufacturer -- again, we
21 have national cooperatives included here. But if we just
22 look at the Northeast operations of the national
23 cooperatives, your answer is yes.

24 Q And they have dissented from your view as to what
25 the make allowance should be for cheese?

1 A Yes.

2 Q So they have looked at your proposals, and to use
3 Mr. Yale's terminology, made the considered decision that
4 your proposal does not provide an adequate make allowance?

5 A I think you can infer that from Agri-Mark's
6 actions.

7 MR. ROSENBAUM: Thank you.

8 JUDGE HUNT: Anyone else?

9 (No response.)

10 JUDGE HUNT: Thank you very much, Mr. Schad.

11 THE WITNESS: Thank you.

12 (witness excused.)

13 JUDGE HUNT: And I guess, Ms. Taylor.

14 Good afternoon.

15 MS. TAYLOR: Good afternoon.

16 Whereupon,

17 SUE M. TAYLOR

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

20 JUDGE HUNT: And would you state and spell your
21 name, please?

22 THE WITNESS: My name is Sue Taylor, S-U-E,
23 T-A-Y-L-O-R.

24 MR. OLSEN: Ms. Taylor, I think we've circulated
25 copies of this for the reporter and on the back table there.

1 In the interest of time what I'm going to ask you to do is
2 just talk very briefly about your -- you know, you are
3 currently doing for Leprino Foods Company. We will let your
4 introduction and expertise page sort of stand in the record
5 as if read and sort of move on to the next section on page
6 2.

7 We will like to have this introduced as an
8 exhibit, Your Honor.

9 JUDGE HUNT: All right, that's 52.

10 MR. OLSEN: Fifty-two.

11 (The document referred to was
12 marked for identification as
13 Exhibit No. 52.)

14 MR. OLSEN: That said, Ms. Taylor, why don't you
15 go ahead and begin the brief description of who you are and
16 why you are testifying, and then skip right to the point.

17 THE WITNESS: Okay, thank you.

18 I'm Sue Taylor, Director of Dairy Policy and
19 Procurement for Leprino Foods Company headquartered in
20 Denver, Colorado. Our business address is 1830 West 38th
21 Avenue, Denver, Colorado, 80211.

22 Leprino operates 11 plants manufacturing
23 mozzarella cheese and whey products domestically, and in
24 marketing them internationally. Those plants are located in
25 New York, Michigan, Nebraska, Colorado and New Mexico, in

1 terms of the plants that are operated within the Federal
2 Order System. We also operate two plants in the State of
3 California, one in Tracy and one in LaMore, California.

4 My responsibilities at Leprino as Director of
5 Dairy Policy and Procurement fall in the category that most
6 people term dairy economists role, policy issues as well as
7 raw milk procurement.

8 My prior history includes similar roles starting
9 in 1989 with Sorrento Cheese Company, and I did have a
10 consulting business between 1992 and 1994, and I've been
11 with Leprino since 1995.

12 I'd like to proceed them to page 2, and
13 congressional misperceptions.

14 Before proceeding, I would like to note that we
15 believe the congressional mandate for this hearing was based
16 on misconceptions, and accordingly, a change from the
17 current Class III milk price formula is unnecessary at this
18 time.

19 The political impetus that mandates USDA to
20 conduct this hearing was based upon a mistaken belief that
21 the current Class III price formula would decrease the Class
22 III price on average 47 cents per hundredweight relative to
23 the basic formula price that was in use prior to January
24 2000.

25 However, in analysis of the data for the 16-month

1 time period of September '98 through December '99, for which
2 data was available to calculate the new Class III price,
3 shows that the new price formula would have been revenue
4 neutral to the BFP at 35 butterfat, and in fact would have
5 resulted in a price that average 16 cents per hundredweight
6 higher than the BFP at full test if assuming .19 pounds of
7 non-protein nitrogen per hundredweight.

8 In fact, we believe the new price formula will
9 have an even greater uplifting effect since the cheddar
10 block and barrel price spread on the CME was 4.57 cents
11 during that time period, which is in excess of what can be
12 expected under normal market conditions and is far in excess
13 of the 1.94 cents average spread that existed during the
14 four months since the implementation of the final rule.

15 The 2.63-cent difference between the block and
16 barrel price spread during the two time periods equates to
17 an additional increase in the Class III milk price of 17
18 cents per hundredweight.

19 Clearly, the impetus for this hearing was based on
20 erroneous perceptions and it is critical that the decision
21 from this hearing not have the effect of further increasing
22 minimum regulated Class III prices.

23 The role of regulated pricing: Regulated milk
24 prices inherently influence the structure of the U.S. dairy
25 industry. In today's domestic and international

1 environments, it is more critical than ever that this
2 influence be minimized so that markets rather than
3 government regulation determine where and how milk is
4 produced and processed.

5 Although the events in Seattle last fall delayed
6 further dairy trade liberalization and Congress extended the
7 Dairy Price Support Program through year end, long trade
8 liberalization and elimination of the support program are
9 both likely realities in the not too distant future.

10 Allowable subsidized export volume through the
11 DEIP Program has already significantly reduced -- been
12 reduced by the WTO agreement implemented in 1995. The
13 changes in the support program and international trade both
14 support that to the extent that there is a range of
15 justifiable milk price levels for a particular manufacturing
16 complex, a price level on the lower end of the range should
17 be adopted in the regulated system. This will allow the
18 market to provide a greater portion of the price signal to
19 producers.

20 As Dr. Stephenson suggests, there is little risk
21 in setting the regulated price too low since the market
22 compensates through the development of premiums. However,
23 there is substantial risk in setting the regulated price too
24 high. Over regulating prices results in disorderly
25 marketing by encouraging additional milk production that the

1 market does not have a ready outlet for while decreasing
2 demand at the processor level.

3 Additionally, the setting of regulated prices at
4 too high a level discourages investment in innovative
5 technology the industry requires to develop commercially
6 viable new products that will absorb the milk that is
7 currently cleared through the price support program in the
8 DEIP.

9 The importance of setting the regulated price at a
10 level that is not intrusive on the market is also increased
11 when the regulated price is based on an end product price
12 formula and product price formulas contrast with survey-
13 based milk prices in their rigidity.

14 Since finished product prices are directly
15 captured in the milk price, any adjustments made to the
16 sales price to adjust for competitive or cost issues
17 unrelated to milk will be reflected in the milk price.

18 Therefore, if a regulated price is established by
19 an end product price formula, it is important to set that
20 regulated price at a level that allows other market forces
21 to work and adjustments to occur outside the regulated
22 system.

23 The University BFP Committee commissioned to
24 advise USDA during the federal milk marketing order reform
25 process echoed the need to view regulated pricing as market

1 clearing minimums and stating that, "Minimum pricing reduces
2 the need for the secretary to fine tune the price of milk to
3 reflect local or regional uniqueness in a market setting
4 that is national in scope. Regional price differentials for
5 manufactured products which may vary seasonally and over
6 time can be set by market forces where over order premiums
7 are warranted."

8 Issues: Leprino supports National Cheese
9 Institute's proposal on Class III pricing, including setting
10 the make allowance at no less than weighted average of the
11 CDFA and Association Services cost studies, expanding the
12 National Ag Statistics Service survey and cheese price used
13 in the Class III formula to include 640-pound blocks,
14 replacing the three-cent adjuster on barrels to the
15 difference in cost for manufacturing between barrels and 40-
16 pound blocks, and making the NASS product price survey
17 mandatory and audited.

18 This proposal is based on sound economics with
19 elements that have been developed and are supported by
20 objective analysis. Additionally, the resulting overall
21 level determined by the NCI formulas is appropriate in the
22 context of our current dairy environment.

23 Although much of the discussion at this hearing
24 focused on specific factors in the price formulas, it is
25 important also to evaluate the formulas from the overall

1 price levels in the context of the role of regulated
2 pricing.

3 Commodity prices, price data sources: USDA should
4 continue to use NASS price surveys to collect finished
5 product price data for the purposes of the Class III and IV
6 price formulas. One advantage of price surveys over
7 exchange prices is that they represent a significantly
8 larger volume of transactions than the exchanges. The
9 survey also reflects fluctuations in premiums and discounts
10 relative to the exchange that are reflective of overall
11 nationwide supply and demand conditions.

12 The further strengthen the survey, however,
13 participation should be mandatory and results should be
14 auditable. Mandatory reporting would facilitate the
15 addition of 640-pound blocks to the data set.

16 One risk of using a national price from the NASS
17 survey is it's overvaluation of finished products in some
18 parts of the country, specifically in the West.

19 Given the balance of supply and demand in various
20 parts of the country, one expects the hard manufactured
21 product price surface to increase from West to East. This
22 price surface does exist in practice and has been verified
23 by the various retail price surveys of butter, nonfat dry
24 milk and cheese conducted by the NASS and the Agricultural
25 Marketing Service.

1 Additionally, this price surface is supported by
2 the spacial modeling completed by Cornell University. The
3 BFP University Committee states that, "It is quite
4 reasonable to anticipate that manufactured product prices
5 will be different geographically and related to the location
6 of population demand centers, production supply centers and
7 transportation costs. This has been confirmed empirically
8 by the price surface for milk used for manufacturing
9 developed by the Cornell Study team. These maps indicated
10 higher manufacturing milk values moving from the west coast
11 to the east."

12 Setting a minimum milk price based on a finished
13 product price that is higher than can be attained in
14 regulated areas of the West is of concern. However, the
15 benefits of using a broader data set outweigh the risks. So
16 long as the balance of the factors in the milk pricing
17 formula are not set at intrusive levels, the potential
18 damage of setting milk prices based on national product
19 price averages are limited.

20 Cheese forms. We support the addition of 640-
21 pound block prices to the NASS survey cheddar cheese price
22 that drives the Class III protein price. Expanding the
23 cheddar price by adding the 640-pound block series adds
24 statistical validity to the survey and thus the regulated
25 price.

1 Mandatory participation in the price, as advocated
2 above, will remedy the nonparticipation problem experienced
3 when NASS previously collected 640-pound price data. Other
4 NCI members will testify to specific quantities of NCI -- or
5 of 640-pound blocks that are produced in the marketplace.
6 It is our belief that this volume is significant and its
7 addition would result in a more representative survey
8 result.

9 Price adjustments for form: The price adjustment
10 applied to the barrel and 640-pound block price should be
11 reflective of the difference in the cost of producing those
12 forms relative to 40-pound cheddar blocks. We have been
13 told that the cost differential for barrels is between one-
14 half and three-quarter cents. Specifically, the three-cent
15 price adjustment currently added to the monthly weighted
16 average barrel price should be replaced by an adjustment
17 that is reflective of the difference in cost between blocks
18 and barrels.

19 The three-cent adjuster was advocated during the
20 informal rulemaking process because of the lack of
21 manufacturing cost data. The three-cent adjuster is
22 consistent with the difference between block and barrel
23 purchase price adjustment in the support program and can be
24 historically justified based on market relationships between
25 block and 39 percent moisture adjusted barrel prices.

1 As Dr. Yonkers testified, however, the three-cent
2 price spread actually accounts for two things.

3 The first contributor to the three-cent historic
4 block barrel price spread is the difference in manufacturing
5 cost between block and barrels which I have already noted is
6 less than a penny.

7 The second and larger contributor to the three-
8 cent price spread is related to the fact that block
9 producers, in order to remain within the legal
10 specifications for cheddar, produce current blocks at a
11 moisture content that averages approximately 38 percent.
12 They are not directly compensated for the reduced yield
13 associated with this lower moisture level since cheddar
14 block prices are not adjusted to the actual moisture content
15 in the marketplace.

16 In contrast, cheddar barrels are typically
17 produced at lower moisture levels, but are priced in the
18 marketplace based on dry matter. In other words, barrels
19 are sold on a price per pound dry matter calculated by
20 dividing the 39 percent moisture adjusted price on the CME
21 by 61 percent dry matter. Therefore, barrel pricing
22 effectively credits the cheesemaker for every additional
23 pound of dry matter above 61 percent. The vary with the
24 point of moisture for which the barrelmaker is compensated
25 but for which the blockmaker is not compensated is directly

1 calculated by either extending the yield difference by the
2 price or by reviewing effective barrel prices at 38 and 39
3 percent.

4 Using the modified Van Slyke Yield Formula,
5 assuming 90 percent fat retention and 78 percent casein and
6 crude protein, results in a hundredweight yield of 10.019 at
7 38 percent moisture and 10.183 at 39 percent moisture.

8 The value of the .064 pounds of yield for which
9 the barrelmaker is compensated but for which the blockmaker
10 is not can be calculated by multiplying the .0164 by the
11 cheese price. This equates to 21.03 cents per hundredweight
12 of milk, or 2.13 cents per pound cheese at the average
13 cheddar barrel price from the 1999 through -- I'm sorry --
14 1990 to '99 period of a \$1.3009.

15 The moisture adjustment formula for barrel cheddar
16 can also be used to estimate the impact of the barrel yield
17 credit for dry matters above 61 percent. Although the
18 formula is stated in many forms, the easiest way for me to
19 think of it is cheese price per pound cheese at 39 percent
20 moisture divided by .61 pounds dry matter times the actual
21 dry matter in the barrels.

22 The difference in the moisture of corrected barrel
23 price between 38 percent and 39 percent moisture is
24 consistent with the above methodology; that is, the
25 difference equates to 21.03 cents per hundredweight of milk

1 or 2.13 cents per pound cheese at the average cheddar barrel
2 price from '90 through '99 of \$1.3009.

3 Cheesemakers with capacity in both blocks and
4 barrels are incented to shift production to barrels any time
5 the spread between the 40-pound block and the 39 percent
6 moisture adjusted barrel price is less than the combination
7 of their processing cost difference in the moisture adjuster
8 available on barrels on the foregone yield at their average
9 block moisture.

10 Conversely, any time the market price spread
11 excess the combination of their processing cost difference
12 in the moisture adjuster cheddarmakers are incented to shift
13 production to blocks.

14 Therefore, over the long term an absent or
15 irregularity incentive to distort the price for one form of
16 production over the other, the price relationship between
17 these two forms will equilibrate at a level that reflects a
18 combination of the difference in cost and difference in
19 yield value.

20 Other witnesses have noticed the inconsistency
21 between adjusting the barrel price to a 39 percent moisture
22 price while grossing up its milk value assuming the lower
23 yield associated with 38 percent moisture cheddar. While
24 the surface this appears to be a flaw in the current system,
25 it is not a flaw when considered in combination with a

1 three-cent barrel add-on. In essence, under the current
2 rule the couple cents cheese price is reduced between 38
3 percent moisture and 39 percent is added back as part of the
4 three cents.

5 Although the current method of reducing the barrel
6 price to a 39 moisture price equivalent in combination with
7 the addition of three cents to the barrel price is generally
8 sound, it is less precise than using the 38 percent adjusted
9 barrel price in combination with a reduction of the three-
10 cent addition to a number that is reflective of the
11 differences in manufacturing cost alone.

12 It is critical that if USDA either changes the
13 barrel price reference to a 38 percent equivalent or adjusts
14 the barrel yield to a 39 percent moisture yield, the three-
15 cent add-on to the barrel price must be reduced to eliminate
16 the doubling of the impact of the moisture adjustment.

17 Product yields: Product yields should be based on
18 yields that can be reasonably attained under standard plant
19 conditions. It is important to recognize that federal milk
20 marketing orders set minimum prices for milk measured at
21 producer weights and tests at the farm.

22 The losses of milk volume and components that
23 occur between the farm bulk tank and the plant, coupled with
24 the losses that occur throughout the plant in even the most
25 efficient processes, make the adoption of a theoretical

1 maximum yield inappropriate.

2 Component losses between farms and plants occur in
3 two forms: One, components lost in proportion to the
4 general volume losses; and two, fat loss due to its
5 propensity to cling to surfaces, including the farm bulk
6 tank transmissions hoses and the walls of the bulk truck
7 tank.

8 The farm-to-plant losses, in my experience, vary
9 across the country and tend to be related to average farm
10 size, generally ranging from .015 percent in regions
11 dominated by large dairies and exceeding .25 percent in
12 regions dominated by small dairies.

13 Additionally, we typically see differences between
14 the producer tests upon which we pay and the fat test of our
15 milk received at the plant of around .015. For example, if
16 we had 3.685 percent test, the co-op would have 3.700
17 percent test on a long-term average basis.

18 We generally experience farm-to-plant losses that
19 average near six cents per hundredweight. Additionally,
20 milk components are lost even in the best managed cheese
21 plants in the transmission between vessels and due to
22 necessary cleaning protocols and related activities.

23 The Ecolab Database of 51 cheese plants shows an
24 average of 2.35 percent of the plant's biological oxygen
25 demand intake is present in the plant affluent.

1 Importantly, the Ecolab expert noted that the percentage
2 loss of -- that should be 2.35 percent understates the
3 overall milk component loss through the plant because it
4 does not account for high BOD waste streams that are
5 diverted before discharge to the waste water treatment
6 systems; in other words, diverted to animal feed land
7 application or other disposal methods.

8 Our own plant experience shows that we cannot
9 account for 2.5 to three percent of the butterfat that
10 enters the vat. These losses must be recognized in setting
11 yields.

12 The cheddar yield factors incorporated in the
13 final rule originated in the decision to implement multiple
14 component pricing in the southern Michigan order. Testimony
15 provided by National All-Jersey at that hearing to support
16 the use of the 1.32 factor used an advance like yield
17 formula modified by C. A. Ernstrom of Utah State University.

18 The basic formula used was, and we've seen that
19 formula enough that I won't work through it again.

20 The process used to calculate the yield
21 contribution of the individual components requires that the
22 fat component be zero to establish the protein contribution,
23 that the protein component be zero to establish the fat
24 contribution. A 38 percent moisture content in the finished
25 cheese is assumed.

1 This methodology has the effect of determining the
2 average yield of a pound of protein and fat. Methodologies
3 that have been discussed at this hearing establish yields
4 based on an incremental yield analysis are inappropriate for
5 use in the multiple component pricing system because federal
6 milk marketing orders are pricing all the protein in milk at
7 the yield rather than the incremental protein relative to an
8 average level.

9 The incremental analysis approach results in a
10 higher yield assumption than the average protein yield
11 approach because effectively the incremental approach
12 assumes that all of the casein loss occurs at the base
13 casein level and none occurs at the additional volumes of
14 protein. This assumption and the resulting methodology is
15 economically unsound and illogical. As such, it should be
16 discarded as an approach.

17 Protein yield: The protein yield assumption of
18 1.405 incorporated in the current formula is too high.
19 Using the midpoint of the 82.2 to 82.4 percent casein in
20 true protein that was cited Dr. Barbano is reflective of
21 national milk composition, in other words, 82.3 percent,
22 results in a yield per pound true protein of 1.388 rather
23 than the 1.405 that exists in the current formula at 3.01
24 true protein.

25 With typical farm-to-plant losses of .25 percent,

1 and plant losses in the two and a quarter percent range, the
2 yield drops to 1.367. This is far less than the 1.405
3 incorporated in the current price formula and it's more
4 reflective of reality.

5 Fat yield: The cheddar yield factor per pound fat
6 is 1.582 based on the above equation, and some proposals
7 being considered at this hearing would increase it to 1.60
8 or 1.61.

9 Advocates of raising the fat yield factor argue
10 that without plant fat retention sometimes exceed 90
11 percent. I understand that fat retention in cheddar cheese
12 plants is quoted in the range from 90 to 93 percent in
13 practice. However, these capture rates are measured as the
14 fat in the cheese relative to the fat that is present in the
15 vat at the start of cheese manufacturing and do not
16 recognize the many losses that occur both before and after
17 the vat.

18 As I've previously stated, fat losses between the
19 farm and the vat are even higher than those experienced for
20 the other components since butterfat clings to stainless
21 steel.

22 Therefore, it is particularly important to
23 recognize that the regulated milk price applies to farm
24 components, not components in a closed system once the milk
25 is in the vat.

1 Increasing the fat retention assumption will
2 establish the fat yield at a level above what is attainable
3 in many plants. Increasing this factor is also inconsistent
4 with the overall objective of setting minimum prices at
5 market clearing levels.

6 Fat-to-protein ratio: The incremental value of
7 fat in cheese relative to butter is overstated by the 1.28
8 ratio in the current Class III formula. In effect, the
9 equation assumes that for every pound of protein that is
10 priced under the order 1.28 pounds of raw milk fat has been
11 misvalued at the butter value of fat.

12 As has been noted by other witnesses, this exceed
13 the average fat-to-protein content of producer milk and
14 causes the Class III hundredweight value at full test and
15 stable cheese prices to drop as butter prices increase.

16 As another witness pointed out, this phenomenon
17 will continue on individual producer milk so long as the
18 incremental fat value is allocated to protein. However, the
19 distortions would be reduced by setting the 1.28 at a level
20 that is more consistent with producer tests.

21 Furthermore, the 1.28 factor effectively allocates
22 incremental value to raw milk that is associated with the
23 addition of cream, to the extent that cream addition occurs.

24 A review of federal milk marketing order
25 statistics from November 1998 through October 1999 reveals

1 that the average fat-to-true protein based on total Kjeldahl
2 Nitrogen minus .19, in other words total Kjeldahl Nitrogen
3 meaning total protein, relationship in producer milk in
4 those orders with published component data ranged from
5 1.1695 in the southwest Idaho-Oregon order to 1.2587 in the
6 Chicago regional order, and that's shown on Attachment A.

7 The monthly average ratio across these same orders
8 range from 1.2018 in September '99, to 1.2434 in March '99.
9 We also reviewed the data available for the first two months
10 of this year and found it to be consistent with the same
11 months of the prior year.

12 Based on this analysis, we recommend that the
13 Department reduce the current fat-to-protein ratio factor in
14 the Class III price formula from the current 1.28 to 1.19.
15 The 1.19 is based on my estimate of the ration in the new
16 western order. In reducing the 1.28 factor, the class
17 reformula will accommodate the raw milk composition of all
18 orders.

19 Whey fat overvaluation: Leprino opposes proposals
20 that add a whey cream revenue stream to the Class III price
21 formula unless those proposals are intended to provide a
22 credit to properly reflect the lower market value of whey
23 cream rather than sweet cream.

24 Contrary to the proponents' arguments, the Class
25 III price already values the volume of fat that is disposed

1 of as whey cream. The current system prices every pound of
2 butterfat measured at the farm currently relative to the
3 Grade AA butter value. The 90 percent capture rate of the
4 fat and cheese is reflected in the current formula through
5 the combination of the butterfat price charged at the AA
6 butter market value and the incremental cheese yield value
7 of the fat, which is reflected in the protein price. The
8 other 10 percent of the butterfat that is not captured in
9 the cheese is valued at the Grade AA value.

10 In order for the fat not captured in cheese to be
11 omitted from the price, one would need to reduce the
12 butterfat pounds priced at the butter value to only 90
13 percent of the butterfat volume.

14 Clearly, this does not make sense and USDA chose
15 to capture all Class III fat regardless of whether it's
16 captured in the cheese vat or is disposed of as discounted
17 whey cream at the Grade AA butter value.

18 Although some cheesemakers have overcome the
19 bacteria problems that previously led to cheese quality
20 problems when reintroducing whey cream to the vat, many
21 cheesemakers do not reintroduce the whey cream. Those
22 cheesemakers generally sell their whey cream at a discount
23 to the AA butter market upon which the Class III price is
24 based.

25 Whey cream historically was priced off the Grade B

1 butter market which historically traded at close to a 10-
2 cent discount from the AA market. Since the elimination of
3 Grade B butter trading at the CME, the historic market
4 discount has generally been reflected in the privately
5 negotiated cream price formulas.

6 In pricing all the fat at the AA value, the Class
7 III formula overvalues that portion of fat that is not
8 captured in cheese but is captured in the whey cream.

9 The California order to incorporate a whey cream
10 factor in the Class IV-B formula. However, it is important
11 to note that California uses a different methodology to
12 arrive at the Class IV price and does not overvalue whey
13 fat.

14 The California system bills to a hundredweight
15 value of milk at 365 fat and 8.78 SNF based on a combination
16 of the cheese yield value, and I'll, since you have it in
17 writing, omit that formula, and the whey cream recovered.
18 This value is then allocated first to the butterfat at the
19 AA butter value and the residual is allocated to SNF.
20 Effectively, the 10-cent discount on the butter price used
21 to reflect the whey cream value is reflected in the SNF
22 price.

23 The overvaluation of whey fat in the current
24 formula is another important reason why the butterfat cheese
25 yield factor should assume a lower rather than a higher

1 butterfat retention in cheddar.

2 Manufacturing allowances: Manufacturing
3 allowances are necessary components of any end product price
4 formula. Manufacturing allowances should accommodate the
5 cost exclusive of the raw milk price of acquiring raw milk
6 and converting it into finished product that has a market in
7 addition to plant operational costs, these costs, including
8 management interest cost of capital, and marketing costs,
9 among other things.

10 We support the use of the combined California
11 Department of Food and Agriculture and Association Services
12 survey results in establishing the make allowances in the
13 manufacturing classes.

14 The California Department of Food and Ag maintains
15 the most comprehensive current manufacturing cost data
16 available. CDFA employs an accounting staff whose primary
17 responsibility is collecting and analyzing cost information.
18 The resulting cost studies are based on audited data
19 compiled according to a consistent methodology.

20 Marketing costs are excluded from these cost
21 studies, but a conservative cost of capital is included,
22 calculated by multiplying each plant's net book value by the
23 prime interest rate.

24 CDFA's cost studies have been fine tuned through
25 many years of data collection and years to support policy

1 decisionmaking as to the appropriate level of make allowance
2 used in the end product price formulas used in California's
3 regulated system.

4 Although the methodology used in the CDFA studies
5 results in the most accurate cost studies currently
6 available, these costs are representative of California
7 plants only, and therefore may not be representative of the
8 broader geography regulated under the federal milk marketing
9 orders.

10 The CDFA data should be combined with the survey
11 results from the study conducted by Association Services.
12 The Association Services cost study captures data from a
13 broad geographic region outside of California and was
14 subject to review by economists with statistical background.

15 This survey is broader and the methodology is more
16 precise than that used in the benchmarking study conducted
17 by the Rural Business Cooperative Service within the USDA.
18 Additionally, it is more comprehensive in identifying costs
19 associated with converting raw milk into marketed finished
20 products.

21 Leprino participated in the sweet whey processing
22 cost study for the only two plants in which we produce sweet
23 whey. Those plants are our Waverly, New York and Allendale,
24 Michigan plants.

25 We believe that the process used to collect and

1 review the cost data was sound. The cost data was solicited
2 broadly from the industry regardless of ownership form. I
3 am directly aware of the follow-upon data provided as I
4 received two calls questioning cost categories that were
5 either outliers on the high or low side of specific
6 categories.

7 Since the RBCS study is specifically designed as a
8 plant benchmarking instrument, it excludes costs such as
9 milk procurement staff, administrative cost and interest
10 cost. It appears that the result of the CDFA and the
11 Association Services surveys are consistent with the results
12 of the RBCS survey once the RBCS survey is adjusted for
13 those cost categories that are excluded from the RBCS
14 survey.

15 The Association Services study is the only cost
16 study provided at this hearing that includes sweet whey
17 costs. The conclusion of the cost study is the weighted
18 average cost for processing whey is 15.92 cents, more than
19 two cents higher than the current nonfat dry milk make
20 allowance of 13.7 cents.

21 We believe that the cost difference between nonfat
22 dry milk and whey processing is actually greater. The
23 analysis of incremental energy and equipment cost provided
24 at this hearing by C. K. Vankat show an incremental cost of
25 2.6 cents before reflecting additional labor, maintenance

1 and other operating costs.

2 As was noted in Dr. Yonkers' testimony, the
3 weighted average cost of producing cheddar and whey under
4 these combined studies is 16.67 cents and 15.92 cents for
5 cheddar and sweet whey, respectively.

6 Setting the make allowance at the weighted average
7 inherently places half of the volume in a position of not
8 recovering costs. Therefore, USDA should consider setting
9 the make allowance at slightly above the weighted average,
10 consistent with the interest of setting the regulated prices
11 in a market clearing level.

12 Opposition to proposals to adjust fat pricing on
13 Class IV prices only: Several proposals are being
14 considered that will result in a change to fat pricing
15 either for Class IV milk or for multiple classes. We
16 strongly advocate that the relationship between fat prices
17 for various classes not be changed as a result of USDA's
18 decision.

19 Products currently in Class III, such as anhydrous
20 and cream cheese, compete with butter. Additionally, whey
21 cream does not get reclassified under the order. Adjusting
22 the butterfat price for Class IV without similarly adjusting
23 the butterfat price for Class III would lead to cheesemakers
24 needing to further discount whey cream in order to compete
25 with sweet cream.

1 Conclusion: End product pricing formulas are
2 complex and require an understanding of realistic yield and
3 processing cost structures. Although we believe the
4 Department did a commendable job in developing the final
5 rule Class III price formula, this opportunity to review and
6 fine tune the price formulas has been afforded us by
7 congressional mandate. There is ample technical support for
8 tweaking a number of factors in the price formula.

9 Leprino urges USDA to adopt NCI's proposal. The
10 NCI proposal is based on sound economics and recognizes the
11 need to establish regulated pricing that does not distort
12 markets. Additionally, the NCI proposal provides the
13 opportunity for innovation as the industry faces the
14 challenges of the transition to a more global marketplace
15 without price supports.

16 MR. OLSEN: Thank you, Ms. Taylor. A couple quick
17 items.

18 DIRECT EXAMINATION

19 BY MR. OLSEN:

20 Q There has been talk, I think probably more today
21 than any other time, about the concept of USDA issuing a
22 recommended decision.

23 Can you speak to that briefly?

24 A We would very much desire an opportunity to
25 respond to a recommended decision. We feel that it's an

1 important opportunity for the industry to further refine
2 their thoughts and respond. We think that it also was an
3 opportunity to provide some significant input during the
4 last rulemaking process, so we are seeking a recommended
5 decision.

6 Q Okay. And despite the length and the rapidity of
7 your reading here, I only noted one possible error and that
8 was on page 11, right above paragraph four in the last
9 paragraph. It says, "As was noted in Dr. Yonkers'
10 testimony, the weighted average cost of producing cheddar
11 and whey under these combined studies is \$0.1687," and you
12 may have misspoken, but it is one -- now I'm doing it --
13 0.1687, is that correct?

14 A That's correct.

15 MR. OLSEN: All right, we would ask that Ms.
16 Taylor's testimony, including the attached exhibit, an
17 Attachment A, be entered into evidence as Exhibit 52.

18 JUDGE HUNT: Any objections?

19 (No response.)

20 JUDGE HUNT: Hearing no objections, Exhibit 52
21 will be received in evidence.

22 (The document referred to,
23 previously identified as
24 Exhibit No. 52, was received
25 in evidence.)

1 MR. OLSEN: Thank you, Your Honor, and Ms. Taylor
2 is now available for cross-examination.

3 JUDGE HUNT: Mr. Yale.

4 MR. YALE: It would have been easier if I had
5 written it for you.

6 (Laughter.)

7 CROSS-EXAMINATION

8 BY MR. YALE:

9 Q Ms. Taylor, does Leprino produce any cheddar
10 cheese?

11 A We do not currently. We do have cheddar product
12 capacity in our Roswell, New Mexico plant, and previously we
13 had produced cheddar barrels. It's a balancing opportunity
14 when needed.

15 Q When is the last time you produced cheddar?

16 A I believe that it was January 1998. We were
17 included in the cheddar barrel survey, the NASS survey
18 initially for a period, I think, of a little less than a
19 year.

20 Q Did you participate in the NCI price production
21 cost that has been reported here, you know, for producing
22 cheddar?

23 A Not for producing cheddar. We did participate for
24 the production of whey. Since we don't have any production
25 of cheddar currently, it would be inappropriate for us to

1 participate in the cheddar survey.

2 Q Now, the mozzarella you produce, is this primarily
3 stuff that's sold in consumer packages that a consumer buys
4 at a store or is it part of another added value consumer
5 product?

6 A Our production is focused mostly at the fast food
7 level, the pizza industry, as well as food manufacturers,
8 the frozen entre folks that make the lasagnas and those
9 kinds of product as well. So ultimately they may end up in
10 consumer packages but we are not the folks who are putting
11 them in consumer packages.

12 Q Would you describe your primary product as a high
13 moisture, part skim mozzarella or how would you describe
14 your primary product?

15 A It's a frozen, shredded product.

16 Q Okay. What I mean in terms of the cheese, the
17 mozzarella cheese, how would it be described?

18 A In terms of composition, Ben, I'm not sure that I
19 can comment. I haven't focused on whether it's whole milk
20 or part skin, and actually that's one of the challenges with
21 defining mozzarella because you have such a range of
22 products across the industry.

23 Q Okay. We won't ask that question.

24 But does your moisture level of the cheese that
25 you produce generally exceed 50 percent?

1 A I can't tell you whether it does. It does tend to
2 be a higher moisture level than most of the mozzarellas that
3 are sold in the refrigerator case as grocery store primarily
4 because the cook conditions in the pizza industry are very
5 harsh, they are blast ovens that generally are zipping a
6 pizza through there in probably 10 or 15 minutes. And you
7 require a different profile for that cheese than you would
8 for a home oven.

9 Q So in a pound of the mozzarella that comes out of
10 your plant the ratio of solids to the pound of product is
11 lower than what we would even be talking about in cheddar,
12 right?

13 A Yes, it's a higher moistured cheese certainly than
14 cheddar.

15 Q Now, your testimony regarding the differences
16 between barrels and blocks, I mean, do you buy cheddar
17 cheese right now?

18 A We do.

19 Q In large volumes?

20 A It depends on what our customers are doing in
21 terms of pizza cheese plants. Some of our customers will do
22 six cheese promotions where it's a blend of six cheeses.
23 It's a pizza topping and we'll acquire all the cheeses that
24 are required for those blends. So depending on what our
25 particular customer's interests are at the time, those

1 volumes can be significant or at times they can be
2 insignificant.

3 Q The purchasing or selling of that cheddar cheese,
4 do you index that off the CME?

5 A Yes, we generally are indexing off of the CME.

6 Q What about the mozzarella?

7 A Yes.

8 MR. YALE: One second.

9 (Pause.)

10 MR. YALE: I also wanted to make sure that I
11 didn't get a signal during this presentation.

12 BY MR. YALE:

13 Q In your testimony you indicate that you lose about
14 a quarter of one percent in the markets where you have
15 smaller producers, less than that in the market where you
16 have larger producers in terms of what we sometimes call
17 farm shrink; is that correct?

18 A It sometimes exceeds a quarter percent. That's
19 how I've indicated it in my testimony.

20 Q Do you generally -- or wait a minute.

21 And then you also later on in here, I think,
22 quantify that in an amount of six cents a hundredweight; is
23 that right?

24 A That's correct.

25 Q All right. So you pay on the average \$24 per

1 hundredweight for the milk that you receive?

2 A No. This is by component the six-cent analysis
3 has been done.

4 Q So you're --

5 A If you look at the combination of the fat losses
6 and the volume losses, we roughly equate those to six cents
7 a hundredweight. Obviously, fat carries a much higher
8 value. And this analysis was done actually while we were
9 still on fat skim pricing at a particular location. And the
10 higher proportion of those losses were occurring on the fat
11 side.

12 Q So you are indicating your 25 percent loss, you
13 have a higher loss in fat than you do in the overall volume?

14 A Certainly, and I've indicated that in my
15 testimony.

16 Q And what's your ratio of fat loss? What's your
17 percentage of fat loss from farm to on test?

18 A Depending on the location, we tend to lose
19 somewhere in the neighborhood of .015 in terms of test, so
20 if it was a 3685 versus 3700 as opposed to .015 percent of
21 the fat. It's the difference in fat test.

22 Q And what's the methodology used to determine the
23 value of fat that you receive?

24 A We evaluate it relative to the prices paid.

25 Q Do you use a standard Babcock test or do you do

1 this electronically?

2 A Oh, I'm sorry. Infrared testing.

3 Q And just looking over in your testimony, on page 7
4 you've pointed out as being a .015, am I right?

5 A That's correct.

6 Q The formula -- you noticed, I can't remember the
7 page now, but I think about page 7 or so you state very
8 succinctly the fact that with the Van Slyke Formula you can
9 zero the protein and determine the value of butterfat and
10 vice versa, zero the butterfat and determine the protein,
11 right?

12 A Right.

13 Q And in the traditional valuations of cheese where
14 we don't worry about federal orders and we don't worry about
15 butterfat values, that's exactly what -- and that's
16 generally what's done, is that you determine -- you take the
17 cheese price, determine the amount of fat that goes in
18 there, and that's the fat value. And you determine the
19 amount of protein using this Van Slyke Formula and you go
20 against the cheese price, and that's the value of the
21 protein, right?

22 Do you want me to restate that?

23 A Yes.

24 Q Okay. The standard formula is cheese, the value
25 of cheese equals the value of protein plus the value of fat.

1 A And you're talking about --

2 Q On cheddar.

3 A -- competitive premium programs or?

4 Q No, I'm talking about cheddar, just the tradition
5 valuing of cheddar.

6 A I believe that the Van Slyke, modified Van Slyke
7 Yield Formula is used more commonly as a plant operational
8 evaluation tool. Unless a plant is also paying cheese yield
9 premiums, generally I don't believe that they extend them --
10 that formula by price.

11 Q Let me -- that wasn't where I am going and I
12 evidently misstated my question.

13 In the final rule the Department has decided to do
14 exactly what you suggest, and that is, if you know the value
15 of butterfat, you zero out the butterfat value out of the
16 cheese, and what's left over is protein.

17 A Mm-hmm.

18 Q Is that correct?

19 A Yes.

20 Q All right.

21 A Well, actually, I'm not certain. I would have to
22 back and look at the language as to whether they
23 characterized it as an incremental or looking at the
24 absolute level by zeroing it out. I don't recall precisely.

25 Q Well, go with me with the second and let's see if

1 this is correct; that the cheese equals -- the cheese, or
2 the protein price equals the amount of the protein, I think
3 in the end it's the amount of the protein plus the residual
4 difference between the Class IV butterfat price and the
5 Class III butterfat price.

6 Isn't that essentially what the final rule's
7 formula is?

8 A No. the Class IV and the Class III butterfat
9 prices are identical. And by doing that you would be adding
10 zero. My understanding is that the protein price is
11 comprised of the cheese value of protein and the incremental
12 fat value of protein, and the incremental fat value would be
13 defined by the cheese value of fat minus the butter value of
14 fat.

15 Q Would you state that again, please?

16 A Okay. The protein price is comprised of the
17 cheese value of protein plus the difference between the
18 cheese value of fat and the butter value of fat.

19 Q Okay. I agree with that. That was what I thought
20 I had just asked, but I asked it differently.

21 Now, if you look at the -- when we come to the use
22 of butterfat in the protein formula in the final rule, the
23 purpose of determining the value or the amount of fat
24 recovery is to determine not the value of butterfat in
25 cheese for purpose of the Federal Order Program, but the

1 value of the protein.

2 Is that not correct?

3 A I would not agree with that.

4 Q How does this change the value of butterfat in the
5 Federal Order Program?

6 A It does not change the price of butterfat in the
7 Class III formula. Your prior question I took to ask as far
8 as the intent of what you were doing there.

9 Q Okay.

10 A You're trying to reflect the full value of
11 butterfat in cheese by that adjuster.

12 Q So I want to restate because I want to make this
13 really clear to where we are going, is that to know what the
14 value of protein is in the final rule formula we subtract
15 out the Class IV butterfat value and what's left is the
16 protein value, right? In the end, isn't that what we do?

17 A The calculation subtracts out the Class IV
18 butterfat price, or which also happens to be the Class III
19 butterfat price.

20 Okay, what you have done is allocated a portion of
21 the butterfat value in cheese over to the protein component
22 in order to accommodate in the interest of having butterfat
23 valued equally in Class III and Class IV.

24 As Dr. Barbano elaborated, you could also
25 construct a system, if you wanted to, where you could put

1 that full value with the butterfat and cheese, that 1.582
2 yield, on to the butterfat component. We've chosen in this
3 system not to do that.

4 Q Right. And you say it depends, if the butterfat
5 value in the Class III and IV per pound is less than a value
6 of cheese per pound, then the allocation goes the other way,
7 is that we take money away from protein to add it to the
8 butterfat, right?

9 A That's correct.

10 Q Okay. But in the end this formula to determine
11 protein is we take the value of cheese per pound and we
12 subtract whatever amount of the butterfat that we determine
13 that's in a pound of cheese and we subtract that out at the
14 Class IV or Class III butterfat price, and what's left is
15 the value of the protein, right?

16 A No, you added in that incremental process of fat
17 so the protein price, it reflects both the protein -- the
18 cheddar value of protein and the incremental value of fat in
19 cheddar.

20 Q As we have sometimes discussed here, there is the
21 real world and the theoretical, and there is a world in
22 which we have to deal with the federal order.

23 The protein value I'm talking about is the protein
24 value that the Department determines that's going to be
25 charged under the federal program is the value of cheese for

1 one pound less the amount of fat that's in one pound of
2 cheese at the Class III and IV butterfat price, and what's
3 left is the value of protein in one pound of cheese, right?

4 A If you are asking me if I agree that the protein
5 price as calculated under the Federal Order System currently
6 strictly reflects the protein value, I would have to
7 disagree.

8 Q I'm not asking that. I'm asking how they come to
9 the protein value that they do.

10 A Okay. In that case, they take 1.405, multiply it
11 by the cheese price less a make allowance plus 1.582 times
12 the cheddar market less a make allowance, that quantity,
13 multiplied by 1.28.

14 Q And in the end in a very basic thing is that the
15 protein value that is determined for the purposes of the
16 federal order, I'm not saying whether it's the correct --
17 I'm not going to use the word "true" -- correct protein
18 value. I'm saying that the protein value in the Federal
19 Order Program is the value of cheese for one pound minus the
20 value under Class III and IV for whatever fats in a pound of
21 cheese, and what's left over is the protein value used in
22 the Federal Order Program; is that correct?

23 MR. OLSEN: Your Honor.

24 JUDGE HUNT: Mr. Olsen?

25 MR. OLSEN: I'm going to object. At this point

1 she's been asked, I don't know four or five, six times. Ms.
2 Taylor has answered it several times, and I would like that
3 objection noted.

4 JUDGE HUNT: Objection allowed. I'll allow him to
5 ask it one more time.

6 MR. YALE: Well, Your Honor, she has not answered
7 the question, and this is the fundamental issue in this
8 case.

9 JUDGE HUNT: I say you ask her, ask her again.

10 MR. YALE: Okay. All right.

11 THE WITNESS: I'm not trying to avoid your
12 question. I clearly don't understand what you are trying to
13 get to if I haven't answered your question.

14 MR. YALE: Well, just answer the question. Don't
15 worry about where I'm getting you. I'm --

16 MR. OLSEN: Well, Your Honor, I'm going to object
17 again.

18 JUDGE HUNT: I have said he could ask it one more
19 time and see if she can answer it.

20 MR. OLSEN: I have no problem with that.

21 JUDGE HUNT: If she can't answer it, then move on.

22 MR. YALE: Just one second.

23 (Pause.)

24 BY MR. YALE:

25 Q All right. The word "protein" that I'm using

1 here, value of protein deals with that value we're going to
2 use to calculate the Class III price in the Federal Order
3 Program.

4 A In other words, you're saying the price of protein
5 under the Federal Market Order System?

6 Q Absolutely right.

7 A Okay.

8 Q Okay. In its most basic form, the formula that is
9 used in the final rule takes the value of one pound of
10 cheese using whatever the series and all the calculations
11 and the make allowance and everything, it comes up to a
12 value of cheese, and it subtracts from that the amount of
13 butterfat that it has calculated that belongs in that pound
14 of cheese using the value that it has already established
15 for the butterfat price for Classes III and IV, and what's
16 left is the protein value.

17 A I'm with you up until your final addition to the
18 statement. I agree that the protein price takes the value
19 of a pound of cheese contributed from both the protein and
20 the fat component, and reduces it by the fat that's already
21 been priced at the butter market.

22 Q And there is a multiplier times that butterfat, I
23 mean, 1.28.

24 A Right.

25 Q I mean, I'm not trying to get that.

1 Now, what I am trying -- let's go to the next step
2 though, is that as the amount or the value of the
3 butterfat -- you agree with this -- is the amount of the
4 butterfat or the value of the butterfat in a pound of cheese
5 goes up the value of the protein goes down in the formula
6 under the Federal Order Program?

7 A No, that's not correct. If the value of a pound
8 of fat in cheese goes up, that implies that the cheese
9 market is going up, and therefore the protein price would be
10 going up.

11 Q All right, let's start over again.

12 JUDGE HUNT: No. She's given an answer. She
13 disagrees with you. You may not like the answer. You're
14 just trying to rephrase it.

15 MR. YALE: No. Well, I'm not -- Your Honor, this
16 is -- this question and line of question is worth tens or
17 hundreds or millions --

18 JUDGE HUNT: Well, she answered it. She disagreed
19 with you, but she gave you an answer.

20 MR. YALE: No, she didn't answer -- I understand
21 that maybe you don't understand some of the technicalities,
22 but it was not quite the answer to the question.

23 JUDGE HUNT: Well, she did answer the question.

24 MR. YALE: Okay.

25 JUDGE HUNT: Because I heard it.

1 BY MR. YALE:

2 Q All right, assume that the value of cheese under
3 NASS survey, CME, whatever, has been determined to be \$1.10.
4 We know that value.

5 A Okay.

6 Q And we know the value of butterfat or we're going
7 to look at the value of butter. But the value of cheese
8 does not change.

9 A Okay.

10 Q And you would agree during a month once we
11 determine the average value of cheese, it doesn't change,
12 right?

13 I mean, once the Department has determined last
14 month's value of the average NASS survey price for cheese
15 and all the adjustments, it's fixed, right?

16 A Right.

17 Q Okay. Now, assuming that the cheese doesn't
18 change but this month the butterfat price -- between two
19 months, the cheese price doesn't change, this month's
20 butterfat price goes up, what will happen to the protein
21 price?

22 A If the butterfat price goes up because the butter
23 market has gone up.

24 Q Right.

25 A Which would be the only way that it could go up.

1 Q Right.

2 A Then the protein price goes down.

3 Q Thank you. And the converse is also true, that if
4 the price of butterfat went down the value of protein went
5 up?

6 A The price of protein under the federal orders does
7 go up.

8 Q All right. Now, in the butterfat portion of the
9 cheese formula isn't it also true that, assuming all the
10 values are the same, that is, that the cheese price is the
11 same and the butterfat price is the same, that as you change
12 the -- and increase the butterfat yield, that you will
13 decrease -- wait a minute.

14 As you increase the butterfat yield in these
15 formulas, what will be the impact on the protein price?

16 A If you were to change that 1.582 factor to a
17 higher number, then the protein price would go up.

18 Q As compared to a cheddar plant, what do you buy
19 and use more of in the final mozzarella cheese, more protein
20 or more fat?

21 A Cheddar tends to be a fuller fat cheese. We tend
22 to have a lower fat level in our cheese.

23 Q Now, in your testimony -- let me just ask it to
24 you this way.

25 On page 8 in Part B of your testimony -- now,

1 you've already stated, I think, in your testimony, and I
2 agree with this, is that the plant pays -- if they get 100
3 pounds of milk at the hypothetical standard composition of
4 3.5 percent butterfat, they pay for 3.5 percent at the Class
5 III and Class IV butterfat price, right?

6 A Yes.

7 Q Regardless of what we do on the protein formula?
8 Irrespective of what we do on the protein formula, they are
9 going to pay the same price; is that right?

10 A At a given fat price and given fat volume, that's
11 the price they're going to pay.

12 Q Right. The only difference is is they may pay
13 more or less on the protein?

14 A If the inputs to the protein part of that formula
15 change, yes, that protein price will change.

16 Q Thus in Part B, what I want to make clear is, is
17 that you are talking about here is the changes in these
18 formulas will not change the value of the butterfat that's
19 paid for, it will only change the value of protein; is that
20 correct?

21 A It will not change the price --

22 Q The price.

23 A -- of butterfat. It will change the price of
24 protein as the formulas are currently constructed.

25 Q Right.

1 A The value of butterfat for cheese making is the
2 same regardless of what you are paying for the butterfat
3 price in Class III. The difference gets lobbed over to
4 protein.

5 Q So that if we make any changes in the cheese or
6 the protein formula -- I want to make sure this is clear --
7 we will not be affecting the value or the price of the
8 butterfat, right, under the current system?

9 A Can you restate that, please?

10 Q If we make changes to the protein formula under
11 the current system and no changes of reducing the butterfat
12 price in Class IV, just leave that part the same, we would
13 have no impact on the butterfat price, right?

14 A That's my understanding.

15 Q And thus on page 9 when you talk about the
16 overvaluing of the whey fat on page D, we're not talking
17 about valuing the whey fat to pay for fat, we're talking
18 about the value of protein, right?

19 A The whey fat effectively is being priced at the AA
20 market because it's -- a straight AA market. It's being
21 valued at the Class III fat price because that portion of
22 the fat that is captured in the protein is priced up as part
23 of the protein -- as part of the protein price.

24 Q But what we are talking about the whey recovery
25 here, it's purpose is to determine the value of the protein,

1 not the value of butterfat, right?

2 In this formula, the way it's been introduced,
3 it's to determine the value of protein, not the value of
4 butterfat, right?

5 MR. OLSEN: Your Honor, this is more argument from
6 Mr. Yale. The formula is there. The formula is what it is.

7 JUDGE HUNT: Go ahead and ask the question, Mr.
8 Yale.

9 BY MR. YALE:

10 Q The value of whey that is being proposed and the
11 capture of whey in these formulas, its purpose is to
12 determine the value of protein, not the value of butterfat;
13 is that correct?

14 A Are you asking me about whey or whey cream?

15 Q The whey cream. Thank you. I apologize.

16 The whey cream in the proposal to capture that in
17 this butterfat yield portion, its purpose is to deal with
18 the protein price, not the butterfat price?

19 A I believe that that's how it's been manifested in
20 the proposals.

21 Q And any implications from your testimony to the
22 contrary are misinterpretations; is that correct?

23 Any indications in your testimony that recapturing
24 the value of whey cream increases the butterfat value are --
25 we've misinterpreted your testimony?

1 A I don't believe that I've stated that the whey
2 cream component is intended -- if I did represent the
3 proposals inaccurately, then perhaps that's the case.

4 My point is that any proposal which adds whey
5 cream as an additional source of value, whether that value
6 is allocated to the butterfat component or allocated to the
7 protein component is unnecessary, and in fact in the current
8 formula whey fat is already overvalued.

9 Q And why do you say that?

10 A Because all fat is valued at a minimum of the AA
11 market. Whey fat is not sold off of the AA market; it's
12 sold at a discount. Generally, historically, it's been
13 about a 10-cent -- people use the AA minus 10 cents as a
14 pricing base.

15 Q And where in the current formula is whey cream
16 determined?

17 A It's captured as part of the incoming butter fat.
18 We pay for 100 percent of the butterfat.

19 MR. YALE: We've been there, Your Honor. I have
20 no further questions. Thank you.

21 JUDGE HUNT: Anyone else? Mr. Beshore.

22 BY MR. BESHORE:

23 Q Sue, somewhere in your testimony, I thought I had
24 it marked, you refer to incremental systems -- testimony in
25 the hearing which would advocate incremental pricing of

1 protein rather than the alternative, whatever that is.

2 Do you recall that?

3 A Yes.

4 Q Why I can't find what page it's on, probably
5 because it's five o'clock Friday afternoon here.

6 What testimony did you refer to -- were you
7 referring to in that -- methodologies, page 7 -- that have
8 been discussed at this hearing that establish yields based
9 on an incremental yield analysis are inappropriate for use
10 in multiple component pricing system because FMM owes their
11 pricing all to protein.

12 What methodologies or testimony are you referring
13 to there?

14 A I was referring to some of Dr. Barbano's testimony
15 which argued that the current system assumes a 75 percent
16 casein level in total protein rather than the 78 percent
17 casein level, which I believe that it does.

18 Q Okay. Is that the only portion of the 75 versus
19 78, is that the only portion of his testimony that you were
20 referring to, or the particular portion you were referring
21 to?

22 A He spent a fair amount of time endorsing the
23 incremental concept.

24 Q But is there anything else? Is the present
25 formula used in the final rule, some concept other than an

1 incremental concept?

2 A I believe it is. If you go back to the roots --
3 my understanding, and I have received some internal
4 documentation that converted the 132 factor up to the 1405
5 factor.

6 Q Internal to whom?

7 A Internal to USDA when I inquired how they got to
8 the 1405. They did not go back to the Van Slyke Yield
9 Formula and perform new calculations. They started out with
10 a 132 factor that had been adopted under the previous
11 multiple component pricing orders.

12 That 132 factor, in fact, was a rounded factor.
13 The original factor was 1316. I believe that also is
14 consistent with Mike Brown's testimony.

15 They then did a ratio assuming a .20 non-protein
16 nitrogen in crude protein which further boosted us up to
17 that 1.405 factor when you cannot calculate to the 1.405
18 using the Van Slyke, going back to the original formulas.

19 Q And what is it that makes that a total or an
20 average rather than incremental procedure?

21 A The numbers do not themselves. The
22 characterization of them in this hearing, and there was one
23 descriptor in the final rule that would lead you to believe
24 that perhaps it was incremental.

25 Okay, you can get to that 1.316 factor that was

1 originally in the Midwest orders and the Michigan order by
2 doing an incremental analysis if you assume 75 percent
3 casein and crude protein, or if you use, as the original
4 testimony was by National All-Jersey in those hearings the
5 78 percent casein in total protein assumption, you could
6 also get to that same factor.

7 Q You could get the 1.405 using either .75 or .78?

8 A No. You could get to the 1.316 --

9 Q Using either one?

10 A -- using either 75 percent, looking at it as an
11 incremental, or 78 percent, looking at it across the total
12 protein.

13 The difference, the reason why you can get there
14 both ways is looking at incrementally you are essentially
15 allocating all the casein loss to the base protein. That .1
16 factor in the numerator of the Van Slyke Yield Formula is
17 constant, and so as you move up a tenth of a point of
18 protein you're not increasing your loss under that
19 theoretical formula.

20 In real life what we are doing is we're pricing
21 all of the pounds of protein that were coming in, and I
22 would also argue that as you increase that protein you are
23 more like, and I think this came back to one of the cross-
24 examination questions of Dr. Barbano, whether the .1 factor
25 in the numerator was more appropriate or 94 percent or 96

1 percent, I don't recall the exact measure, but it was a
2 percentage, was more appropriate in the formula. And I
3 believe that Dr. Barbano answered that either one should
4 work. If you look at it on a percentage basis, you can look
5 at it incrementally and end up with the same result using 78
6 percent is what we did in our approach.

7 Q Okay. The fat-to-protein ration commentary that
8 you have made at the bottom of page 8 and the top of page 9
9 states -- begins with the statement that, "The incremental
10 value of fat and cheese relative to butter is overstated by
11 the 1.28 ratio," and you go on to talk about a 1.19 ratio.

12 Is it appropriate to be dealing with incremental
13 values of fat in this situation?

14 A The terminology probably is confusing, but in this
15 case my use of incremental means the calculation that's done
16 by reducing the cheese value of fat by the butter value of
17 fat that you have already paid for, this is not associated
18 with incremental yields. This is just -- the incremental
19 fat value that's rolled over to protein is the cheddar value
20 of a pot of fat less the butter value of a pound of fat.

21 Q Okay, so in the current formula that just
22 basically is used to figure out how much of the cheese is
23 fat for purposes of valuing protein?

24 A I'm not sure I would go quite that far. It's
25 trying to reflect the fact that in the fat price you're not

1 paying relative to the cheese value, and so it's allocating
2 that over to protein.

3 Q Like you have to figure out how much you're
4 allocating over, and you're saying only allocate 1.19.

5 A That number -- what I would suggest is that the
6 Department look at the information during the course of this
7 year. We're very early in the process of having the true
8 protein numbers, the actual true protein numbers, and maybe
9 that number is 1.19, maybe it's 1.20, but it seems to me
10 that it's logical that that factor not exceed the ratio of
11 fat to protein in producer milk because that's what we're
12 purchasing here.

13 Q Has Leprino ever made block cheddar?

14 A Oh, gosh. I think probably back in the sixties
15 from the stories I have heard.

16 Q Since you've been involved with them?

17 A No.

18 Q Okay. Were any of your other employment
19 experiences involved in production of block cheddar?

20 A I had a client when I had the consulting business
21 that produced some block cheddar

22 MR. BESHORE: Thank you. That's all.

23 JUDGE HUNT: Anyone else? Ms. Brenner.

24 BY MS. BRENNER:

25 Q On page 4, Ms. Taylor, where you're talking about

1 cheese forms and say that, "Mandatory participation in the
2 price survey, as advocated above, will remedy the
3 nonparticipation problem experienced when NASS previously
4 collected 640-pound price data," you're referring to before
5 they started collecting the other price data they were
6 collecting cheese prices and that included --

7 A Right. I believe it was started in May of '97 and
8 there was a period where they also published 640-pound data.

9 Q Okay. And the reason they dropped that was
10 because of lack of participation or?

11 A My sense is that it was lack of participation.
12 The volumes were not large. And if you looked at the price
13 series, it was somewhat illogical, I think, because of the
14 lack of participation.

15 Q And what do you mean by "illogical"? The prices
16 didn't look right or?

17 A You would expect the 640s to track the 40s. I
18 think most folks who are using 640s think of 40s as an
19 alternative, and so I would expect them to follow very
20 closely, and they were not in all cases doing that. In
21 fact, at times they appeared to get stuck.

22 Q And you're attributing the number of reporting of
23 640-pound blocks to lack of participation rather than the
24 lack of 640-pound blocks being traded or sold?

25 A I am, and that's, based, I guess, somewhat on

1 rumor but also on the gentleman from AMPI who testified the
2 other day. I understand that they at that time took the
3 position that that was a too intrusive survey and they did
4 not want to report, and it sounds like they do have a
5 significant volume of 640s themselves.

6 Q But I don't know that they are still not
7 reporting.

8 A Well, now they are not being asked to report
9 though because NASS has discontinued the 640s.

10 Q Okay. If we did end up putting 640-pound blocks
11 into the NASS survey and getting prices and that sort of
12 thing, we still could have a real nonparticipation problem
13 without mandatory reporting, and we don't have any prospects
14 in hand of having mandatory reporting.

15 A Yes. If the data series appears to be too weak,
16 it would not make sense to incorporate it. However, my
17 understanding is that there are some folks who are
18 attempting to provide some legislative impetus behind
19 mandatory reporting. And if that were to occur, I would
20 think that it would be very sound to incorporate the 640s
21 into the cheese price formula.

22 MS. BRENNER: Mr. Schaefer had a question.

23 JUDGE HUNT: Mr. Schaefer.

24 BY MR. SCHAEFER:

25 Q I think you stated at the beginning of your

1 testimony that you supported NCI's proposal?

2 A Yes.

3 Q And then when you went through the various parts
4 of the protein formula you had some differences. NCI, I
5 believe, kept the 1405, the 1582 and the 128. And you
6 indicated that those may not be appropriate.

7 Which set of numbers are you planning on having us
8 use here?

9 A I would hope that USDA would look at the technical
10 justification, and I believe that the numbers I used in the
11 text, in the body of my testimony are solidly justified and
12 therefore those are the ones that I would like you to
13 consider as to what we are advocating.

14 To be honest, at the time that NCI developed their
15 proposal, I'm not sure that any of us had had the -- had
16 taken the time to properly look at all the yield factors.

17 MR. SCHAEFER: Thank you.

18 JUDGE HUNT: Anyone else?

19 (No response.)

20 JUDGE HUNT: Thank you very much, Ms. Taylor.

21 (Witness excused.)

22 MR. COOPER: Your Honor.

23 JUDGE HUNT: Yes, Mr. Cooper?

24 MR. COOPER: Perhaps it would be appropriate,
25 given the last questions from Ms. Brenner, to take official

1 notice of that prior survey that was done by NASS. It was
2 called the NASS Cheddar Cheese Prices. It was a weekly
3 publication from March 1997 through September 1998. We
4 would like to have it officially noticed.

5 JUDGE HUNT: Thank you, Mr. Cooper.

6 Does anyone object to taking official notice of
7 that document.

8 (No response.)

9 JUDGE HUNT: Hearing no objections, notice is
10 taken.

11 And take a 10-minute break.

12 (Whereupon, a recess was taken.)

13 JUDGE HUNT: Okay, here is for your encore, Mr.
14 Yonkers. You are still under oath.

15 Whereupon,

16 ROBERT YONKERS

17 having previously duly sworn, was recalled as a
18 witness and was examined and testified further as follows:

19 THE WITNESS: Good.

20 DIRECT EXAMINATION

21 BY MR. ROSENBAUM:

22 Q Mr. Yonkers, you testified previously about cost
23 of manufacturing surveys that were conducted by the National
24 Cheese Institute with respect to both cheese and whey,
25 correct?

1 A That's correct.

2 Q And you were asked during that testimony if you
3 would provide a list of the companies that participated in
4 each of those surveys.

5 Do you have that information with you now?

6 A Yes, I do.

7 Q Could you please list the companies that
8 participated in the cheese cost of manufacturing survey?

9 A The cheddar cheese survey, the 10 firms that
10 participated were Glambia Foods, Alto Dairy, Jerome Cheese
11 Company, Yowega Milk Products, Telemuc County Creamery,
12 Sorrento Lactalos, Valley Queen Cheese, Kraft Foods,
13 Foremost Farms, and Land O'Lakes.

14 Q And could you please identify which of those
15 companies are cooperatives?

16 A To my knowledge, Alto Dairy, Telemuc County
17 Creamery, Foremost Farms and Land O'Lakes.

18 Q And I think that Mr. Wellington testified early on
19 behalf o Agri-Mark that they participated in the NCI survey
20 of cost of manufacturing for cheese but they got their
21 numbers in too late to be included in the calculations that
22 you have previously provided?

23 A Yes, the association that was doing our collecting
24 the data received theirs too late to call them back and
25 check any of the data, so therefore they were not included.

1 They couldn't get the summary done in time had they done
2 that.

3 Q And can you confirm that if the Agri-Mark data had
4 been included the weighted average cost of manufacturing
5 would have gone up?

6 A I can't conclude that because I didn't see their
7 data. But from what Dr. Wellington -- or Mr. Wellington
8 said in his testimony, he indicated that their average cost
9 was higher than the average cost that was the weighted
10 average in our survey, and that would have brought the
11 average up.

12 Q All right. Now, could you please identify the
13 companies that participated in the NCI survey of the cost of
14 manufacturing whey?

15 A Dry whey: Alto Dairy, Yowega Milk Products,
16 Leprino Technology, Serrento Lactolos, Kraft Dairy and Land
17 O'Lakes.

18 Q And could you identify which of those companies
19 are cooperatives?

20 A Alto Dairy and Land O'Lakes.

21 Q All right. Now, you were asked also to provide
22 the geographic distribution of the actual plants that
23 participated from among those companies.

24 Do you have that information?

25 A Yes, I do.

1 Q And could you provide that?

2 A On cheddar cheese from, and this is using the
3 NASS, I believe it's the dairy products regions. It's the
4 same one that Charlie Ling used earlier in his testimony.
5 For cheddar cheese, we had one plant in the North Atlantic,
6 six in the East North Central, three in the West North
7 Central and five in the West Region.

8 And the in the dry whey survey, we had two in the
9 North Atlantic, three in the East North Central, one in the
10 West North Central and one in the West.

11 Q The last request that was made that we provide a
12 copy of the letter from the National Cheese Institute that
13 accompanied the survey as it was sent out to companies
14 soliciting their participation.

15 Do you recall that?

16 A Yes, I recall that.

17 Q And the survey form itself is attached to your
18 testimony which has been entered into the record as Exhibit
19 14, I believe.

20 A I don't recall the exhibit number. But yes, it
21 was part of my testimony.

22 MR. ROSENBAUM: All right, I would ask, Your
23 Honor, that we mark as Exhibit 53 a copy of the letter that
24 accompanied that survey.

25 JUDGE HUNT: It's so marked 53.

1 (The document referred to was
2 marked for identification as
3 Exhibit No. 53.)

4 BY MR. ROSENBAUM:

5 Q Copies of Exhibit 53 are being distributed, and
6 can you simply confirm, Dr. Yonkers, that Exhibit 53 is in
7 fact the letter that went out under your signature that
8 distributed the survey to the companies soliciting their
9 participation?

10 A Yes, it is.

11 MR. ROSENBAUM: That's all I have, Your Honor.

12 JUDGE HUNT: All right. Any questions on the
13 information that Mr. Yonkers just provided?

14 Yes, Mr. Yale.

15 This, of course, just covers the points that he's
16 covered today.

17 MR. YALE: I understand that.

18 JUDGE HUNT: Not any previous --

19 MR. YALE: Trust me, I have no interest in going
20 there. I do have one area, though, that addresses some of
21 the larger issues.

22 CROSS-EXAMINATION

23 BY MR. YONKERS:

24 Q Of the list that you gave here, how many of those
25 testified at the hearing this week?

1 A Glambia Foods testified, Kraft Foods, Land O'Lakes
2 and Leprino.

3 Q And how many of those testified as to their actual
4 costs?

5 A I don't recall. I'd have to go back. I wasn't in
6 the room when all of them testified for the entire time.

7 Q During your testimony and cross-examination, did
8 you indicate to those present that the details or the people
9 behind these numbers would be there to testify about their
10 numbers, or give that indication?

11 A Could you restate that question again?

12 Q Well, I mean, it was my understanding that you're
13 going to have members of the -- or not members, I guess, so
14 much. I guess they are members of NCI, but participants in
15 the NCI survey that were going to discuss the values that
16 were behind the numbers that you had in your testimony.

17 A I think I indicated they were going to discuss
18 their participation in the survey and the procedures they
19 used to derived at -- what they choose to testify to as to
20 their specific numbers are up to them. I believe several of
21 them were asked and declined for proprietary reasons to do
22 so.

23 Q Okay. And of those that you mentioned, it looks
24 like about four names, five names, which of those do you
25 recall provided that information?

1 A I wasn't in the room for all their testimony, Ben.
2 I don't recall.

3 MR. YALE: I have no more questions, and when the
4 witnesses are done, I do have one thing I want to bring up.

5 JUDGE HUNT: After?

6 MR. YALE: After his questions are done, I have
7 another matter.

8 JUDGE HUNT: Oh, after he's finished?

9 MR. YALE: Yes.

10 JUDGE HUNT: Oh, I see. Okay.

11 Any other questions of Mr. Yonkers?

12 Mr. Rosenbaum?

13 MR. ROSENBAUM: I would just move Exhibit 53 into
14 evidence.

15 JUDGE HUNT: Any objections?

16 (No response.)

17 JUDGE HUNT: No objections. Then Exhibit 53 will
18 be received.

19 (The document referred to,
20 previously identified as
21 Exhibit No 53, was received in
22 evidence.)

23 JUDGE HUNT: Mr. Grandage. Excuse me.

24 MR. YALE: He can come down. I do have a
25 matter --

1 JUDGE HUNT: Well, no, he has a question.

2 MR. YALE: Oh, I'm sorry.

3 BY MR. GRANDAGE:

4 Q Bob, from the Association. Do you have any data
5 as to like what the average multiple paid for cream that's
6 purchased in the Class II?

7 A We don't collect any price data from our members.

8 MR. GRANDAGE: Okay.

9 JUDGE HUNT: Anyone else?

10 (No response.)

11 JUDGE HUNT: All right, thank you very much, Mr.
12 Yonkers.

13 (Witness excused.)

14 JUDGE HUNT: All right, Mr. Yale.

15 MR. YALE: Yes, Your Honor. On behalf of the
16 Select Milk Producers and the other proponents of Proposal 1
17 and others, we would move to strike the testimony of Mr.
18 Yonkers dealing with the NCI survey on the basis that it is
19 totally hearsay of hearsay and not backed by any
20 information.

21 The testimony that was presented on the NCI was,
22 was that this information was collected by an accounting
23 firm. There has been no witness from that accounting firm.

24 MR. ROSENBAUM: Your Honor, I'm sorry to object
25 but this is too late.

1 JUDGE HUNT: He hasn't finished his objection yet.

2 MR. ROSENBAUM: I know that.

3 JUDGE HUNT: Let him finish his objection.

4 MR. YALE: Very well, but I think that the time
5 now based on the information and promises made -- let me
6 finish this out -- the survey study was based upon the --
7 there was an accounting firm that collected this
8 information, summarized it. Mr. Yonkers merely reported
9 those numbers.

10 And during questions about testing those numbers,
11 he said we're going to have people who participated in this
12 survey are going to be here and you can ask them. And by
13 and large, nobody showed up with any information to back up
14 those numbers.

15 Now, what we have here is a promise of what's
16 going to be here to support this information. And as he
17 indicated, someone said it's proprietary, we can't tell you
18 about it.

19 And we now have a report of somebody else's thing
20 of unsworn testimony that goes to a critical issue here in
21 these make allowances.

22 And at the time, based upon the promises made,
23 there wasn't a need to object because we thought, you know,
24 this information was going to be there. But we have now
25 heard dozens of witnesses and it isn't there.

1 Now, Dr. Ling, he was able, he collected the
2 information. You could test him. DFA was there, they
3 presented that information directly. But we don't have that
4 closing of the loop so that we can test this information.
5 And I think it's fundamentally unfair to take this data and
6 based on this record and use it as a basis to determine
7 something so important to producers around the country.

8 JUDGE HUNT: All right, Mr. Rosenbaum.

9 MR. ROSENBAUM: Your Honor, I suspect that was an
10 argument addressed not toward you, but toward USDA and why
11 Mr. Yale doesn't like the data, and he can put that in his
12 post-hearing brief if he wants to. But let me just address
13 any possible claim that we promised something was going to
14 happen that didn't happen, absolutely false.

15 We said - first of all, Dr. Yonkers provided a
16 copy of the survey which he designed, explained exactly how
17 it was performed and compiled. There has been no question
18 raised whatsoever about the accuracy of the reporting
19 process. All Dr. Yonkers said was that, in response to some
20 specific questions, number one, that he would provide the
21 information that he just finished providing; and number two,
22 that if there were specific questions as to how companies
23 went about allocating their costs among the various
24 categories, there would be participants in the survey who
25 could answer those questions if Mr. Yale or Mr. Beshore or

1 anyone else had those questions.

2 We've had four or five people take the stand who
3 participated in the survey. Neither Mr. Yale nor Beshore
4 chose to ask those questions of those witnesses, which was
5 their choice. But the suggestion that by having failed to
6 ask questions which they claim they were interested in
7 asking of the participants the survey has lost credibility
8 is just absurd.

9 We have done exactly what we said we would do, and
10 that data is in the record. It needs to stay in the record.
11 It's the best evidence from our position of the cost of
12 manufacturing for cheese and whey.

13 JUDGE HUNT: Mr. Beshore.

14 MR. BESHORE: The only comment I want to make,
15 what Dr. Yonkers said, the transcript will speak for itself.
16 Questions that were asked witnesses, the record will speak
17 for itself.

18 But I think Mr. Rosenbaum has put his finger on
19 the very -- the very issue that arises with respect to this
20 information, and that is with the assertion that no one
21 questions or questioned the accuracy of the data compile,
22 that's the heart of the matter. There has been no possible
23 way in this hearing to have any inquiry with respect to the
24 accuracy or the source or anything else of the information
25 compiled because it was second, third or beyond person

1 removed anyone coming into this room.

2 JUDGE HUNT: Mr. English.

3 MR. ENGLISH: I certainly concur with Mr.
4 Rosenbaum as to the procedural aspects of this particular
5 objection at this time, but let me go beyond that to the
6 substantive question, Your Honor, because there are two
7 reasons why, even if Mr. Yale had risen for days ago with
8 respect to this objection, it would be invalid.

9 The first is that Dr. Yonkers is plainly an
10 expert. As an expert, he is entitled to rely upon studies
11 that he has reviewed that he has not personally performed,
12 nor delve into. That's the whole point of having expert
13 testimony is to talk about and have opinions on those kinds
14 of issues.

15 But for another reason, Your Honor, these kinds of
16 proceedings are not, and I repeat, not subject to the same
17 formal rules of Federal Rules of Evidence with respect to
18 hearsay.

19 Your Honor, according to the hearsay evidence of
20 proceedings before federal administrative agencies 6 ALR
21 Fed. at 76, at page 83, 1971, "The general rule is that in
22 the absence of a statute to the contrary, evidence is not
23 merely -- of the exclusionary provisions. Most of the
24 exclusionary provisions of the Federal Rules of Evidence,
25 especially the hearsay rule and its many exceptions were

1 promulgated to control fact finding by lay jurors.
2 Technical application of these rules directly in agency
3 adjudication is unnecessary, inappropriate, and
4 counterproductive."

5 Finally, Your Honor, the United States Supreme
6 Court in Interstate Commerce Commission v. Baird, as far
7 back as 1904, 194 U.S. 25, 1904, relaxed the rules of
8 hearsay in these kinds of proceedings.

9 I agree with Mr. Rosenbaum. The objection is too
10 late. But even if it were not late, it is not well taken.

11 MR. YALE: Your Honor, if I could --

12 JUDGE HUNT: No, unless there is something new.
13 It's just rebuttal.

14 MR. YALE: No, it's is absolutely new.

15 JUDGE HUNT: It's a new point.

16 MR. YALE: It's absolutely new.

17 I've got a plane to catch.

18 JUDGE HUNT: All right.

19 MR. YALE: I'm not going to waste Your Honor's
20 time.

21 JUDGE HUNT: State your point.

22 MR. YALE: In the letter that we just received
23 within the last half-hour, and it says this -- now if I can
24 find it. I had it here in a minute. "No individual plant
25 data will be available to anyone other than the survey

1 research company."

2 So Mr. Yonkers didn't have the data to talk about
3 or discuss or think about. he reported the data from a
4 party that never showed up at this hearing.

5 Now, this is a proceeding for producers as well as
6 plants. We had a group who put on a presentation to
7 describe a make allowance adjustment based upon the record.
8 They couldn't talk about it. We couldn't put in third party
9 I wasn't able to get in because I had the guy here to do it,
10 and I understand that ruling. But this is more hearsay than
11 that ever was because we don't even have the report, let
12 alone the ability to test it.

13 Thank you.

14 JUDGE HUNT: Thank you, Mr. Yale.

15 First of all, I do not find his motion to be
16 untimely. I think it's a motion timely made.

17 However, I will deny the motion and I will allow
18 the -- even though it may be hearsay -- I will allow the
19 testimony to remain in the record and allow the Department
20 to evaluate the weight that it wants to give to it.

21 All right, now, we have Mr. -- let's see, who do
22 we have done here? Oh, yes, Mr. Marshall.

23 (Pause.)

24 JUDGE HUNT: Raise your right hand, please.

25 Whereupon,

1 DOUGLAS MARSHALL

2 having been duly sworn, was called as a witness
3 and was examined and testified as follows:

4 JUDGE HUNT: And again, just state your name
5 please for the record?

6 THE WITNESS: Your Honor, my name is Douglas
7 Marshall, M-A-R-S-H-A-L-L.

8 I have distributed earlier in the week and again
9 today copies of a prepared statement and attached to that
10 statement are a series of what are called exhibits. I
11 understand that the next exhibit number is 54.

12 JUDGE HUNT: That's correct.

13 THE WITNESS: I would like to offer the
14 attachments that are denominated in my nomenclature as
15 Exhibit 1-A, 1-B, 2-A, 2-B, 3, 4-A, 4-B -- I'm sorry. 3-A,
16 3-B, 4-A, 4-B, and 5. I suggest they be offered and marked
17 together as Exhibit 54-1-2-3. If you would rather have them
18 sequentially numbered, that would be just fine as well.

19 JUDGE HUNT: We'll mark that A -- how many are
20 there?

21 THE WITNESS: There are five. They are marked as
22 Exhibits --

23 JUDGE HUNT: Okay, we will mark them all as 54-A,
24 B, C and D and E.

25 THE WITNESS: Well, it's more complicated than

1 that, Your Honor. We would need --

2 JUDGE HUNT: All right. They will be 54 with
3 accompanying exhibits.

4 THE WITNESS: All right. Okay.

5 (The document referred to was
6 marked for identification as
7 Exhibit No. 54.)

8 THE WITNESS: And I have six copies for the
9 record. They are attached to the statement. I do not ask
10 that the statement be entered as an exhibit because I'm
11 going to extemporize.

12 MR. COOPER: What did we end up with? All 54?

13 JUDGE HUNT: Yes, all 54, yes.

14 THE WITNESS: I am the senior vice president of
15 Northwest Dairy Association headquartered in Seattle,
16 Washington. Northwest Dairy Association, or NDA, is a
17 cooperative, representing approximately 800 dairy farmers
18 pooled in the Pacific Northwest and Western Federal Milk
19 Marketing Orders.

20 From May of 1979 until a year ago, May of 1999, I
21 was also an officer of the operating company, which has had
22 various names over the years, now known as West Farm Foods,
23 and in that capacity I also was a participant then in the
24 management group of the company for the last 21 years.

25 West Farm Foods is a subsidiary of NDA and our

1 marketing agent. West Farm Foods operates plants at
2 Caldwell, Idaho, Sunnyside, Washington, both of which make
3 cheese and have dryers which dry whey and which dry dried
4 milk powders as well. West Farm Foods also operates drying
5 plants at Chehalis, Washington and Lynden, Washington, and a
6 butter plant at Issiquh, Washington. West Farm Foods also
7 operates bottling plants which make Class I and II products.

8 Our cooperative is vitally interested in the
9 outcome of this hearing process on pricing of Class III and
10 IV milk under federal orders.

11 Because we are located near California, we have
12 for years sought to better align the Federal Order System
13 with California. That continues to be our major concern.

14 The purpose of my testimony today originally was
15 intended just to ensure that the hearing record contains the
16 following information: A comparison of new versus old
17 federal order pricing in our region; price comparisons of
18 California and federal orders; historical California data on
19 make allowance and manufacturing costs; the Cornell study on
20 manufacturing milk price surface; Till McQuay study; and
21 West Farm Foods manufactured products marketing costs.

22 I will offer exhibits with respect to each of
23 these points, copies of which are attached to this
24 testimony. Those have been offered, marked as Exhibit 54.
25 My first exhibit --

1 JUDGE HUNT: Excuse me for just interrupting, Mr.
2 Marshall.

3 You say you had made this testimony available?

4 THE WITNESS: Yes, I had.

5 JUDGE HUNT: Then if you like, and you're subject
6 to cross-examination, you want to offer read as if
7 testified, it could be offered as part of Exhibit 54.

8 THE WITNESS: Thank you. I prefer not to because
9 I will be interjecting, interposing comments.

10 JUDGE HUNT: Okay. All right.

11 THE WITNESS: Thank you.

12 My first exhibit contains a table of price
13 comparisons prepared in my office under my direction. This
14 is the latest version of a report we have prepared for our
15 management and board of directors to compare the impact of
16 the new Federal Order System adopted effective January 1,
17 2000.

18 Note that the comparisons for Class III and IV
19 reflect historical Class III-A prices that were announced in
20 the West. These were different than in orders east of the
21 Rocky Mountains, which are based on a different price
22 survey. These comparisons use available NASS data to
23 compete with the new formulas would have generated had the
24 new orders been in effect prior to January 1st.

25 These model prices are then compared against the

1 actual prices as announced under our federal orders.
2 Federal order data for 1999 were based on announced prices.
3 Note that because the older orders priced all cream,
4 including buttermilk powder and Class III, not III-A, it is
5 difficult, perhaps impossible, to compare hundredweight
6 prices.

7 The data presented for the year 2000 correspond to
8 the federal order practice of showing skim milk pricing
9 based on 3.1 percent butterfat -- that should be corrected
10 to 3.1 percent protein, true protein, and 5.9 percent other
11 solids for a hundredweight of skim, and then assuming 96.5
12 percent of a hundredweight of skim -- a hundredweight of 3.5
13 percent Class IV milk.

14 The result approximates solids nonfat content of
15 8.7 percent, so the California federal order numbers are
16 comparable.

17 The first exhibit shows that the 1999 prices for
18 milk used to produce cheese would have been virtually
19 identical under the old and new systems. Class III would
20 have been about two cents per hundredweight higher under the
21 new system whereas Class IV would have been about six cents
22 lower per hundredweight in our area. Thus the new system
23 seems to have been virtually status quo under 1999
24 conditions.

25 My second exhibit contains two tables of price

1 comparisons prepared in my office under my exhibit. They
2 are marked 2-A and 2-B, now 54-2A and 54-2B. They compare
3 pricing under our Pacific Northwest order with prices for
4 the California State order.

5 Table 2-A is the latest version of a report that
6 we regularly prepare for our management and board to show
7 how raw milk prices compare with those of our California
8 competitors. It shows actual historical data. Table 2-B is
9 similar except that it substitutes for the 1999 federal
10 order data, our model of what the new federal order pricing
11 would have been using the Class III and IV formulas that
12 became effective January 1, 2000 and applying the actual
13 price survey numbers announced by NASS during that 1999
14 period.

15 In viewing these comparisons, it's important to
16 note that California does not have protein pricing, just
17 solids nonfat. In the table of data, all California prices
18 are as announced at 3.5percent butterfat and 8.7 percent
19 solids nonfat. Although it's important to note again that
20 they use component pricing their announcements and the 3.5 -
21 8.7 numbers are merely for comparison purposes.

22 We, of course, have had protein pricing in our
23 federal order pricing for some time. The federal order data
24 for 1999 - 2000 are described in connection with my first
25 exhibit.

1 Another point to keep in mind in viewing these
2 exhibits is that under both the federal order and California
3 systems the same butterfat values are used for the cheese
4 classification as are used for butter powder.

5 This Exhibit 54-2 shows how the new federal order
6 pricing system has increased the butterfat price relative to
7 California's. This is a competitive problem for all of us
8 who make butter under the federal order pricing.

9 The exhibit shows prices of milk used to produce
10 cheese would have been similar for the 1999 average, but
11 this is potentially misleading because of the different ways
12 in which the cheese market crash at the beginning of 1999
13 was reflected in the two systems. Note the disparity in
14 January '99 prices in the comparison with the old system.
15 Because the old federal order system used the BFP, it lagged
16 the cheese market. We feel this impact of the '99 averages
17 in ways that masked the differences between the two new
18 systems shown on Exhibit 54-2B.

19 Note that since the new federal order formulas
20 were implemented January 1, California cheesemakers have
21 enjoyed a 27-cent competitive advantage relative to --
22 equivalent to 2.7 cents per pound of cheese. That was
23 comparing the California price against the federal order
24 Class IV price. This is a competitive problem for those of
25 us who make cheese under federal order pricing.

1 I now depart from the handed out statement. In
2 the testimony of the Western States Dairy Producers Trade
3 Association, we saw a comparison of the implicit make
4 margins that were revealed in a comparison of historical
5 Class III BFP prices relative to the old National Cheese
6 Exchange and the Chicago Mercantile Exchange prices. In
7 effect, that was the comparison that the validity of the
8 told -- that the old BFP should be compared against the NCE.

9 A big part of what I am doing is suggesting that
10 instead the proper measure for is fair should not be that,
11 but should be a California comparison.

12 However, with respect to that table, it should
13 also be noted -- the table that was introduced by Mr.
14 Vandenhovel, and then corrected and handed out here at this
15 hearing, that table which sought to measure an implicit make
16 margin based on the BFP and the CME and NCE prices show the
17 implicit value only on the cheese side of the Class III
18 equation.

19 As Mr. Cropp testified earlier with respect to his
20 exhibit, there were values of whey that could be captured in
21 the early nineties, and I would suggest in the middle
22 nineties, that were not present in 1999. And so when one
23 looks at the variation in cheese market implicit margins one
24 must also look at the variation in whey market implicit
25 margins in order to get a sent of the implicit margin that

1 was available during the period for makers of cheese and
2 whey products.

3 I make that point, in part, as argument, but to
4 alert the folks that I will be arguing that the conclusion
5 drawn by Mr. Vandenhovel is incorrect that the 1999
6 relationship between the BFP and the Class III price was
7 indicative of a different net margin than had been the case
8 earlier in the decade.

9 In fact, when both cheese and whey are considered,
10 I believe this will show -- a comparison will show that the
11 two margins together are more equal throughout that period,
12 and that is something that can be argued on brief based on
13 data which official notice has been taken.

14 Now, as I said a moment ago, our comparison of a
15 valid price is not from what the federal order generated
16 relative to CME, but that the federal order generated
17 relative to California, which is our major competitive
18 challenge whether we are talking about cheese or butter or
19 whey or powder.

20 In all cases our markets are primarily -- in all
21 cases except whey our markets are primarily east of the
22 Rocky Mountains where the people are, and as is commonly
23 said in our business, the price across the country tends to
24 be California plus freight for those kinds of commodities,
25 cheese, bulk cheese, bulk butter, and bulk powder.

1 With respect to whey, of course, a big part of our
2 market is actually the other direction, overseas.

3 Our view as to the proposal, with respect to
4 adjusting butter pricing, is that the rationale for making
5 an adjustment is primarily because the six-cent increase
6 that has been discussed earlier in this hearing that
7 accompanied the introduction of the new federal order
8 January 1st is a competitive problem relative to California.

9 We have heard lots of testimony about the fact
10 that a lot of butter is made from cream. There are extra
11 costs. I do not dispute that. I do not dispute that
12 rationale. It is simply not our rationale. Our rationale,
13 in fact, would not include that because we ourselves do not
14 churn butter -- do not churn a very large proportion of our
15 butter from cream separated at fluid milk plants, unlike the
16 other parties who have been testifying at this hearing.

17 For us, the issue is simply that our butter prices
18 now are misaligned relative to California, and that is shown
19 on Exhibit 54.

20 My third exhibit also pertains to California. It
21 contains two items obtained from the states departments of
22 food and agriculture in connection with their hearing
23 processes under their state order.

24 The first item is Exhibit 54-3A, and it shows the
25 historical weighted average manufacturing costs. I believe

1 that earlier official notice was taken of that. The second
2 item is marked 3B. It shows the history of actual
3 manufacturing allowances established under their state order
4 and I do not believe that has been received in evidence nor
5 officially noticed earlier, perhaps it has.

6 Together, the two Exhibits 54-3A and 3B
7 demonstrate that the State of California has found over the
8 years that they should not and do not automatically adjust
9 their manufacturing allowances to the weighted average price
10 of the California cost of production surveys.

11 For example, in July of 1989, the allowance for
12 powder was set at 16.0 cents even though the cost survey in
13 May of '89 had showed the weighed average cost was 13.7. At
14 the same time the butter allowance was set at 9.7 for bulk
15 butter even though the may survey had showed a weighted
16 average cost of only 8.8 cents.

17 On the other hand, the cheddar cheese make
18 allowance was lower than the cost, but as Mr. Vandenhovel
19 confirmed their formula, and Mr. Schiek, I believe also,
20 their formula in California actually would increase the
21 effective make allowance, the implicit make allowance, as
22 cheese prices increased.

23 California's longstanding practice has been to
24 consider factors other than just the average cost of
25 manufacturing from their survey, and Mr. Schiek so testified

1 earlier this week.

2 In our written comments, I will argue from all of
3 this that it would be unwise for USDA to simply adopt
4 manufacturing allowances by plugging in averages of
5 available survey day because doing so would reflect merely
6 the average and thus jeopardize the survival of half the
7 plants if a simple average were used, or half of the plant
8 capacity if weighted average were used, and that would be
9 unwise.

10 My fourth exhibit is an excerpt from the Cornell
11 model used by USDA to evaluate Class I pricing under the new
12 federal orders. I have attached to this testimony copies of
13 two parts of the key Cornell document; one is now Exhibit
14 54-4A. It was Table 2 from the original Cornell report that
15 I am about to identify, pages 39 through 43, showing
16 manufacturing cost differences on a per hundredweight basis.

17 The other is marked now 54-4B. It is page 21 from
18 the Cornell report which contains maps depicting the same
19 information.

20 Your Honor, at this point I would like to have
21 official notice taken of the entire Cornell report which was
22 formerly identified as follows: Normative Estimates of
23 Class I Prices Across U.S. Milk Markets by James E. Pratt,
24 Phillip Ambishop, Eric Emerba, Henry M. Navivick, M. Mark
25 Stephenson, a publication of the Cornell Program on Dairy

1 Markets and Policy. Their series designation being RB98-05,
2 published in July of 1998. I do have six copies of that if
3 that would be helpful to anyone in the audience.

4 In asking for official notice, I note that earlier
5 this week that a similar study from the Cornell program in
6 the same series was also noted officially.

7 JUDGE HUNT: Is there any objections to taking
8 official notice of that Cornell report?

9 (No response.)

10 JUDGE HUNT: No objections. Then official notice
11 is taken.

12 THE WITNESS: Let me also apologize to everyone in
13 noting that the pages that were intended to be attached to
14 the portion of Exhibit 54-A showing Cornell report pages 39
15 through 43 was inadvertently photocopied on one side only.
16 I do not affects the usefulness of the exhibit, with the one
17 exception I'll refer to in a minute.

18 The primary focus of this Cornell model was on
19 the cost of transporting milk in its various processed forms
20 from production areas to the population that consumes dairy
21 products. As noted by USDA developing the current federal
22 orders, the Cornell study is a model of the most efficient
23 way for orders to operate, and I wish to expand on that
24 point by saying that it is a model of transportation
25 efficiency in measuring relative location value, and does so

1 by beginning with a geographic location factor for where
2 milk is produced, geographic factor location factors for
3 where -- for plants where milk is processed, and geographic
4 location factors for where the population is.

5 And then it seeks to use a least cost model to
6 develop a transportation efficient solution to bringing the
7 milk from where it's produced to the plants that process it
8 to the people that consume it.

9 The Cornell study demonstrates that there is a
10 market oriented reason why milk used to produce manufactured
11 products is work less in the West than it is in the East.
12 That is essentially because of our nation's population is in
13 the East and it costs to move western manufactured products
14 eastern markets. There is a location value that reflects
15 the cost of transporting processed milk to market.

16 Let me interject a comment -- I'm departing from
17 my prepared testimony, and noting that that is precisely
18 what Mr. Jeff Williams was testifying to, and again, as I
19 testified to earlier, where we are in the Pacific Northwest,
20 in the mountain states. There are very few people. The
21 markets for our bulk cheddar cheese, our nonfat dry milk
22 powder and our butter, bulk butter, are primarily east of
23 the Rocky Mountains. In fact, primarily east of the
24 Mississippi River. So there is a transportation cost
25 associated with this location value and that's a big part of

1 what effects both our marketing situation in our region and
2 the costs of operation.

3 I also note that Don Nicholson of the Market
4 Administrator's Office in Tulsa has done extensive work
5 matching milk production areas with population location and
6 he notes in the slides that approximately half the nation's
7 people are in the Eastern Time Zone. I find that a useful
8 point to keep in mind. Forty-nine - 50 percent of the
9 nation's mouths, nation's consumers are in the Eastern Time
10 Zone, and I am in the West.

11 He also, Mr. Nicholson also tracks the difference
12 between per capita production and consumption of dairy
13 products state by state, and his data suggests that more and
14 more manufactured products will be produced in the western
15 states and in the tier states from the Dakotas eastward to
16 Pennsylvania, into New York and Vermont, and products will
17 move increasingly from those states to the other markets of
18 the eastern seaboard and the south.

19 As we look at the attachment to my testimony you
20 see map. And while it's a little bit hard to read because
21 of the size, it shows a price surface. The highest point on
22 that price surface for manufactured product values in both
23 cases is Florida, where there are a lot of people and not as
24 much dairy production, and it just moves steadily lower, the
25 price surface moves lower and our milk has less location

1 value as you move further from Florida and approach the
2 State of Washington where our company is headquartered.

3 We urge USDA to recognize the transportation costs
4 implicit in these economic studies, and we will make this
5 point in some more detail in our post hearing comments.

6 Let me just add as an illustration that in one of
7 the pages from the exhibit that was inadvertently omitted
8 when every other page was omitted was the cost of --
9 correction -- the value -- the relative value at Sunnyside,
10 Washington, and as you can see in that table, which is 54-
11 4B, there is a cheese value with simulated differential
12 values identified for months of May and October.

13 Those numbers for Sunnyside, Washington are
14 missing, but they happen to be 43 cents in May and 24 in
15 Sunnyside, an average of 34 cents. In comparison, Madison,
16 Wisconsin, which is shown, you can see different numbers of
17 80 and 64 cents, which average 72 cents. That shows a 38-
18 cent difference in the location value of milk to produce
19 cheese relative to those two cities, Sunnyside, Washington,
20 where our big cheese plant is, and Madison, Wisconsin, where
21 much of the nation's -- would be processing for much of the
22 nation's cheese production and within the zone of zero base
23 applied by the NCE in making its transportation adjustments
24 as we have seen in an earlier exhibit. I believe that was
25 Exhibit 28.

1 That 38-cent difference would translate to
2 about -- 38 cents per hundredweight difference, would
3 translate to about four cents per pound of cheese in fact.
4 That is consistent with what it costs us to move a pound of
5 cheese to a market in Wisconsin.

6 There has been some discussion about the CME as a
7 substitute for the NASS in the price formulas that are at
8 issue in this hearing. We would oppose such a change
9 because the CME, and especially when you consider the
10 transportation factors that are shown in Exhibit 28, the CME
11 simply is not a national price. It is the value of the
12 commodities sold over the CME at those basing points that
13 are shown in Exhibit 28, which is to say it's the value of
14 those products at Chicago, not the value in Seattle or
15 Sunnyside, Washington. In fact, in Sunnyside, Washington it
16 would be about four cents less according the CME.

17 Therefore, while we oppose moving to the CME, if
18 the Department were to decide to use the CME because it may
19 have some other advantages, there should at least be a
20 transportation credit to be consistent, at least in the
21 West, to reduce the value of the CME price to reflect the
22 value that the CME is discovering for any product sold out
23 of a plant in our region.

24 Again, I'm not sure that's a politically viable
25 approach. It would make economic sense. We have not

1 advocated such a change because we feel that the most
2 politically acceptable thing for the secretary would be to
3 continue the status quo of NASS pricing. Some day it may
4 become possible politically to use the CME rather than the
5 NASS survey and there would be some advantages to that, as
6 Mr. Vandenhovel testified.

7 My final exhibit, that would be 54-5 is a summary
8 of a study prepared from data prepared for Telemuc County
9 Creamery Association in conjunction with a possible new whey
10 processing plant at the site of their new Telemuc County
11 Creamery Association cheese plant now beginning construction
12 at Boardman, Oregon.

13 As noted therein, the study is now part of an
14 evaluation with my company, West Farm Foods, my operating
15 subsidiary, as our two companies may develop a joint whey
16 processing facility. In the course of those discussions we
17 have shared that data from the engineering company, and all
18 of that is described in the attachment, Exhibit 54-5.

19 You will note that the attachment, which I will
20 not read because it's an exhibit, shows a whey processing
21 cost anticipated through the methodology described therein
22 as varying from 17 cents per pound of whey solids -- per
23 pound of whey powder to 20 cents per pound of whey powder as
24 the expected costs for that type of facility. That type of
25 facility would be producing product that would be included

1 the NASS survey.

2 In fact, our analysis is suggesting that we should
3 perhaps make a different kind of whey product as the Agri-
4 Mark analysis that was testified to earlier for the simply
5 reason that at 17 to 20 cents per hundredweight and current
6 whey prices it's not going to break even, suggesting that
7 the make allowance would not cover the product value.

8 Telemuc County Creamery Association joins
9 Northwest Dairy Association and West Farm Foods in urging
10 USDA to place heavier focus on new and modern plants in
11 evaluating the cost of manufacturing operations when
12 establishing the new Class III and IV formulas.

13 Any study which is biased towards older plants and
14 which uses depreciation based on costs in 1980s or '90s, in
15 other words, 1980s or '90s dollars, simply ignore current
16 reality. It's important that the manufacturing margins
17 allowed under the Federal Order System be adequate to
18 justify modern and efficient plants or they will not be
19 built, and our industry eventually would suffer from that.

20 I would also like to address manufactured products
21 marketing costs. One of the factors in the formulas is a
22 marketing cost. The current figure of \$1.0015 per pound,
23 fifteen hundredths of a cent, was developed without a lot of
24 data and unfortunately, the study done by USDA's Rural
25 Business and Cooperative Service was not expanded to survey

1 this key part of what I call the conversion cost, the
2 process of converting raw milk into processed product and
3 then into money with which to pay producers.

4 I'm pleased to join the Western States Dairy
5 Producers Association in the definition of conversion cost
6 that they have suggested in their testimony, Mr.
7 Vandenhovel's testimony.

8 Many in the industry have focused entirely on the
9 cost of converting raw milk into finished product. In fact,
10 those costs would simply get the product into the warehouse.
11 It does not include the following types of costs: warehouse
12 costs for aging cheese or inventorying product during times
13 of soft markets; warehouse workers' costs to load the
14 product onto the outbound vehicles; marketing and sales
15 costs to find a buyer; the cost of transporting to market;
16 invoicing the sale; collection costs; liability insurance;
17 and don't forget taxes.

18 I note that there is some question whether aging
19 cheese as a cost should be included as long as it's excluded
20 from the NASS survey. I concur also with the concept
21 proposed by Dr. Barbano that we harmonize -- he likes to use
22 harmonize -- the system from beginning to end and as long as
23 the price surveys are excluding aged cheese, then the cost
24 of aging cheese should not be included in the make
25 allowance. To do otherwise would not be in harmony.

1 I have received from the West Farm Foods'
2 accounting department certain information with respect to
3 our manufactured products sales costs. I have taken the
4 general ledgers reports and compiled the following:

5 Our manufactured products division sells only the
6 bulk commodities of the kind that would be measured in the
7 NASS surveys.

8 That is to say, it's distinct from our consumer
9 products division which sells products in consumer size
10 packaging. That division's P&L reported \$1,113,848 in
11 selling costs -- that's our categorization name, selling,
12 not marketing -- and that included things like salaries,
13 travel, brokerage costs, et cetera.

14 In addition, some \$57,462 in administrative
15 expenses was recorded for that manufactured products
16 division. The primary items being state wholesaling taxes
17 and insurance. I do not think either of those would have
18 been included in Dr. Ling's "RBCS survey categories that he
19 asks for.

20 The credit department cost allocated to the
21 manufacturing products division was \$262,393. These numbers
22 alone total \$1,433,703, and note the totals were higher for
23 the prior fiscal year. This was not an odd year. Missing
24 from this total is the interest cost of inventory and
25 product, and any cost of using the corporate staff such as

1 legal department or the accounting and information systems
2 costs which we do not desegregate in our accounting, and I'm
3 not able to estimate those additional costs.

4 For the fiscal year ended 3-31-2000, the same
5 fiscal year for the numbers I have just described, our
6 manufactured products division marketed a total of
7 561,582,000 pounds of butter, powder, cheese and whey. For
8 these purposes I think it is impractical to break down our
9 costs by product, so I will not -- so I will compute only an
10 undifferentiated per pound cost.

11 I should add that except for limited exceptions
12 all of these products are sold in bulk and truckload
13 quantities and are the type measured in the NASS surveys.

14 Dividing the above subtotal of 1,433,703 over the
15 561,882,000 pounds sold, the average marketing cost
16 associated with those expenses alone -- those expenses
17 only -- computes to \$.0026, one-quarter of a cent per pound
18 of product sold.

19 I would like to add that a point was made in
20 earlier testimony by Ken Olson of the American Farm Bureau
21 suggesting that the National Dairy Promotion Board marketing
22 assessment somehow covered the producer's obligation of
23 marketing products.

24 I might add that none of the above costs that are
25 identified are covered by the National Dairy Promotion Board

1 nor for that matter the milk program. Without those two
2 programs, milk PAP, and National Dairy Promotion Board
3 activity, the above marketing costs may have been even
4 greater, but I suggest on the record here there may be some
5 confusion about marketing and what that means versus sales
6 cost, which is necessary to actually move product physically
7 to a customer. And I would suggest that in the future the
8 cost allocation for that be described in the federal orders
9 as a marketing and sales expense to help Mr. Olson and his
10 people he represents better understand what this is about.

11 As a member of the National Milk Producers
12 Federation, we generally support the National Milk Producers
13 Federation position except for a few differences that are
14 emphasized in the above testimony.

15 I note that the NMPF position is relatively open
16 on the question of what the proper whey manufacturing cost
17 allowance should be and suggested that additional data would
18 be coming from members. In fact, I have submitted such
19 data.

20 It was also somewhat open on the question of
21 marketing and I have again submitted some data on that.

22 Having said that, let me comment that while I
23 agree generally with the price levels that would be
24 established in the NMPF members and therefore support the
25 National Milk Producers Federation position in general, I

1 disagree about the methodology with which those numbers were
2 developed, and most specifically is my concern, as indicated
3 earlier, about using a weighted average price as though that
4 rigidly would give quote "the right number".

5 Again, I think it's critically important that USDA
6 establish a manufacturing price based on those surveys to
7 give a range of reasonable numbers, but instead to use
8 judgment and consider other factors such as price alignment
9 with California in making those decisions about what the
10 appropriate make allowance would be.

11 I also have some concerns, while I'm on that
12 subject, about the Rural Business Cooperative Service
13 study's methodology. It misses many costs as been discussed
14 earlier in this hearing. And again, as my friends -- Mr.
15 Vandenhovel testified, must cover all costs from the raw
16 product form up to and including the collection. Those
17 would be the financial shrink issues, collection costs, et
18 cetera, it would be financial shrink issues that Mr. Chris
19 was describing.

20 And I might also note that there is the question
21 of shrinkage that's not included in that in-plant study, and
22 I would also add that one of the costs that needs to be
23 considered that I don't think has come up earlier except in
24 my own cross-examination of Mr. Reinke was that after the
25 product leaves the plant there can be additional shrinkage

1 as well because the rejection in product -- in our case we
2 tend to insure some of the cost of that. That's a cost that
3 should be considered, but we also go bare on some of that
4 cost -- some of the cost of product that might be rejected.

5 So in concept, I'm simply asking the Department be
6 open to considering all those costs associated with
7 marketing the product because, of course, the make allowance
8 if it's structured around an average selling price and an
9 average cost of manufacturing is a very tight limit on what
10 all of our costs can be covered from.

11 I would also like to note as a methodological
12 point of dispute with the RBCS study that it does not
13 anticipate the kind of efficient butter and processing
14 operation that we have. We have a very efficient butter
15 operation, at least we have always thought so in terms of
16 past studies by RBCS. Currently our costs are probably not
17 much below the average.

18 One of the ways it gets there is because we
19 centralize the churning of all of the cream from our various
20 operations, and none of our butter powder -- excuse me --
21 none of our powder plants are at the same location as our
22 churn. In each case there is a transportation cost from the
23 powder plants to the churn.

24 The methodology of the RBCS study would not
25 include those transportation costs that allow us to achieve

1 the lower processing cost. So on the one hand the
2 efficiency is included but the transportation cost that
3 yields the efficiency is not included. That is not in
4 harmony and that is a methodological flaw of the RBCS
5 methodology which, I must say in their defense, was not
6 intended to cover the cost of manufacturing but merely to
7 help plant managers look at their controllable cost within
8 their plant.

9 So when we apply it to the problem of developing
10 the proper make allowance one must consider all those kinds
11 of costs.

12 Similarly, as I have suggested, depreciation and
13 capital costs are a problem in the RBCS study. I want to
14 compare that to California which uses depreciation, which is
15 one form of capital cost, and then -- expenses capital
16 investment over time, the undepreciated net book value in
17 the California system is then valued as a capital cost, and
18 this is something the RBCS study does not do.

19 And finally, of course, as I've noted, any system,
20 both California's and RBCS, which relies on historical
21 depreciation or book depreciation, will not keep plants
22 modern because they will reflect the value of the average
23 age of plants rather than the cost of a new plant.

24 And I might also note -- I should also note that
25 if we were to have a period of heavy inflation, we would

1 considerable difficulty in applying depreciation costs on a
2 historical basis.

3 I might also add that the depreciation as a
4 concept is an art. It's not a science. And if, for
5 example, under either the California or the RBCS
6 methodology, a plant that say 10 years old had -- let's take
7 a number -- a million dollars in undepreciated net book
8 value and somebody were to come along and buy that plant, as
9 part of the transaction, they would probably pay a current
10 market value of that plant and that would involve a process
11 known as stepping up the basis for depreciation, an
12 accounting concept that would mean then that there would be
13 more capital value to depreciate. Thus from year to year
14 the same plant would have a higher depreciation number even
15 though it's exactly the same plant.

16 Why the difference? Only because the methodology
17 of relying on depreciation does not consider the difference
18 between historical costs and current costs.

19 Finally, I just want to note that in both the RBCS
20 model study and the California study there is a tremendous
21 range of costs, and that is one reason why it is so
22 difficult to come up with a right number without looking at
23 policy considerations for a make allowance.

24 I might add that in my marketing costs that I have
25 outlined in the last few minutes there is no factor for the

1 transportation costs that we are concerned about yet. As
2 I've pointed out, we do have a greater transportation cost
3 to market than similar manufacturers in other parts of the
4 country that are closer to the Eastern Time Zone.

5 I might add that the NASS price does give us an
6 average transportation cost, yet the variation there is
7 quite a bit as can be seen from the Cornell model. So as a
8 result we have a much greater transportation hurdle to
9 overcome than do plants elsewhere because the NASS survey is
10 based on an average price FOB the plant, and ours is
11 typically quite a bit lower than average because of where we
12 are and because of the problem that our value, our location
13 value is so much lower than in the middle and central parts
14 of the country.

15 I would like to make four final points that are
16 not in my prepared testimony.

17 One is that my friend, Francis Pacheco, entered
18 into his exhibit a study, California Department of Food and
19 Agriculture study June of '98 on butter and powder yields,
20 and he relies on that. I have looked at it closely and I
21 want to point out some potential problems in that study.

22 As has been testified earlier, a powder plant
23 would typically look at see yields in the range of 102
24 percent to 103, maybe 103 and a half percent with respect to
25 the moisture that is left in the powder during the process

1 of drying the milk. But for powder sales to the government
2 and in fact the standard in the industry a moisture content
3 in excess of 104 percent -- correction -- a moisture content
4 in excess of four percent would not be proper. And so the
5 plants tend to shoot for a moisture content close to four
6 percent but less than four percent.

7 And by the way, I am told by the people in our
8 company that the quality of the technology permits you to
9 get closer to that with some confidence that you won't
10 exceed the four percent maximum. Some of the older
11 equipment, though, one does not have that confidence and so
12 you are likely to see a moisture content that on average is
13 only two percent because of the fact that the variation from
14 bag to bag or from lot to lot is so great that they have to
15 shoot for 102 rather than 103 and a half. They shoot for
16 102 because they know that every so often there will be bags
17 or lots that exceed 104, and they cannot do that.

18 The CDFA study that I referred to shows actual
19 powder yields. This, by the way, is Exhibit 31, very end of
20 it. And it shows that in the California survey there were
21 yields in excess of 104 percent, suggesting to me a very
22 high moisture content from at least one of the contributing
23 plants. And I make that point because in my written
24 comments post-hearing I will argue that the numbers in --
25 the yield numbers in that study should be adjusted downward

1 to account for that. Their sales of nonfat loss is shown
2 as 2.13 percent. That's reasonable.

3 And what I will also do is address the yield
4 formula in the current order and its appropriateness. I
5 believe that it is reasonable. The current yield formula
6 for Class IV solids, which is essentially a 102 factor,
7 reflecting a 98 percent yield, and what I will show is that
8 the effective powder yield after shrinkage is about 101
9 percent.

10 In other words, as others have testified, Mr.
11 Wellington among them, the moisture content in an average
12 bag would be higher, that would suggest a higher yield than
13 101 percent. But you also have shrinkage taking it back
14 down to 101 percent, in fact maybe down even lower, and from
15 that then we have, based on the California study that I am
16 referring to, the 101 percent would reflect 93 percent
17 nonfat dry milk powder -- correction -- roughly 96 percent
18 nonfat dry milk powder and roughly five percent buttermilk
19 powder.

20 And I think it's possible to derive from those
21 factors an economic model that shows that the current yield
22 formula if 98 percent is valid as a -- the 98 percent being
23 representative of 96 percent nonfat and five percent
24 buttermilk powder.

25 And the methodology for getting me there requires

1 me to put one more point into evidence, and that is that in
2 making that assumption you can use the value of buttermilk
3 powder and nonfat as entered into an earlier exhibit, but
4 one must apply a conversion cost to develop buttermilk
5 powder. The current order formula does not assign a
6 manufacturing allowance for the buttermilk powder.

7 If we take the testimony of Mr. Wellington that
8 buttermilk powder is more expensive to dry, and I agree with
9 that, Mr. Vankat, I think, would have suggested that as well
10 based on his allusion to stickier products being more
11 difficult to dry, we find that it would be reasonable to
12 associate say a 20-cent per pound cost of buttermilk powder
13 which, in conjunction with the lower value of buttermilk
14 powder in the marketplace relative to nonfat dry milk, puts,
15 in my judgement, the net value of the buttermilk solids at
16 about half the value of nonfat dry milk powder, and thus
17 half of the five pounds of buttermilk powder in the yield
18 would approximate 2.5 percent; thus the difference between
19 the 96 percent nonfat dry milk yields shown in the
20 California study, as I would modify it, versus the
21 secretary's 98 percent yield is a reasonable approximation
22 of the net yield for both nonfat dry milk and buttermilk
23 powder solids.

24 The second point I'd like to make is that the --
25 as we look at the make allowance and yield factors in the

1 current orders it's not clear that the include plant
2 shrinkage and seem not to include farm-to-plant shrinkage,
3 which has been testified as variously a quarter of a cent to
4 half a percent.

5 The Van Slyke Formula does seem to have some
6 assumptions in the yield. The 82 percent butter number may
7 have a shrinkage factor in there . But if so, it seems a
8 bit too low to cover two percent shrink as would be
9 indicated.

10 So I would urge that 82 percent factor in the
11 butter formula to be reconsidered.

12 In earlier testimony today, Mr. Elvin Hollon, in
13 cross-examination from me, we discussed his belief that
14 there is a 30-cent premium in the Idaho market above Class
15 III. I can -- as one whose cooperative markets milk for
16 producers in that area, I can tell you that the 1999 period
17 that he used, that 30 cents was not related to the make
18 allowance issue, but rather reflected a combination of pool
19 draw and depooling.

20 When the Class III value was higher than the blend
21 price, cheese plants would depool and take that value out
22 and use that for a statistical overpayment of the Class III
23 price. At other times when the pool price -- blend price
24 was above Class III, they would have pool draw and they were
25 relying on Class I pool draw to fund that 30-cent premium.

1 In the year 2000, the situation has been quite
2 different under the new federal order. There has been no
3 depooling, and what we do see is pool draws allowing various
4 cheese plants and others in Idaho to pay 30 cents over Class
5 III. In fact, the pool price for all classes as a blend
6 exceeded -- had been in the range of 75 cents to over a
7 dollar this year because of high Class IV values and high
8 Class I utilization under the new order. As a result,
9 nobody is paying in the southern Idaho region anywhere near
10 pool price. The blend price is not seen by producers.

11 Finally, a quick comment on Dr. Barbano's
12 testimony. He offered a way to price producer protein
13 differently, with then some discussion following about
14 changing butterfat price to producers; that is to say on the
15 producer side of the formula to reflect perhaps a blend of
16 different butterfat class values.

17 At this time I would oppose such a change in the
18 butterfat pricing. I think there is considerable value. I
19 agree with Elvin Hollon's testimony that it's very helpful
20 to line up the Class III price to plants with the component
21 value calculation for producers, especially in looking at
22 forward pricing. We are comfortable with that and with the
23 status quo on butterfat.

24 At this point I have no opinion on the rest of Dr.
25 Barbano's suggestions, which I don't understand. But if I

1 get educated by the time I send in my comments, I may
2 comment on that as well.

3 Thank you very much, Your Honor. I'd be most
4 happy to answer any questions.

5 JUDGE HUNT: Let's take a break first and then
6 we'll come back to the questions.

7 (Whereupon, a recess was taken.)

8 JUDGE HUNT: Back on the record.

9 Mr. Beshore.

10 MR. BESHORE: Yes, thank you. Just a couple of
11 quick questions, I think.

12 CROSS-EXAMINATION

13 BY MR. BESHORE:

14 Q Does -- I want to say Dairy Gold, right --
15 Northwest Dairymen, your organization, participate, or the
16 manufacturing arm participate in the NASS survey?

17 A As far as I know, yes, it has, but I'm not
18 directly involved in that part, but I believe it does.

19 Q For all products, as far as you know?

20 A I do not know that to be true.

21 Q Did you participate or that division participate
22 in the NCI or the RBCS cost surveys?

23 A In neither of the surveys that have been entered
24 in -- we did not participate in the NCI survey and we did
25 not participate in this recent version of the RBCS survey,

1 which was discussed by Dr. Ling earlier in the week.

2 Q In terms of market conditions in Idaho, you
3 probably know more about it than anybody who has testified
4 here and you've made some comments about the -- gave some
5 testimony about the current competitive conditions there
6 which are presently resulting in payments to farmers at or
7 under the federal order blend price as I understood your
8 testimony; is that correct?

9 A Yes.

10 Q Okay. The buyers of milk in that Idaho market are
11 primarily cheese companies; is that --

12 A By volume, that would be true.

13 Q Okay. And a number of them are large, modern,
14 newly constructed, relatively newly constructed cheese
15 factories, are they not?

16 A Those terms would describe most of the proprietary
17 plants, but not all.

18 Q Okay. Are the proprietary plants there the
19 majority of the -- do they purchase the majority of the milk
20 volume for cheese?

21 A Certainly true in the Magic Valley.

22 Oh, I'm sorry. Finish your question.

23 Q For cheese, cheese.

24 A For cheese and whey in all cases as far as I know.

25 MR. BESHORE: Thank you. That's all.

1 JUDGE HUNT: Yes, Mr. Yale.

2 BY MR. YALE:

3 Q I guess we will sum this up real quickly.

4 Mr. Marshall, is it your -- the totality of your
5 testimony with the increased make allowances, reduction in
6 the yields and all those, isn't it your real desire to bring
7 the price -- the federal order price in your order down to
8 the level of California's?

9 A I would like to align it with California. I would
10 note that in not all cases would that be down.

11 Q In what case would it be up?

12 A Well, I will refer you to Exhibit 54 and the table
13 showing the comparison of California and federal order
14 prices in our region.

15 Q You mentioned --

16 A I might also add that I have joined in efforts, as
17 you have yourself, to urge California to raise their prices.
18 Those have been unsuccessful.

19 Q So if the Department does not take an issue of --
20 I think the policy right now is have a single price
21 nationwide for manufacturing products, right?

22 And on that basis is it your position then that
23 that price needs to be one at your level that would make it
24 alignment for Oregon-Washington with California?

25 A Essentially the answer is yes.

1 And may I take a moment here, Ben, to add that I
2 don't see any justification for reducing any of the
3 component prices below California levels.

4 Q Now, I want to take one other area. You had said
5 something about the addition of whey changes, the comparison
6 between a BFP and the National Cheese Exchange.

7 How does that have anything to do with that?

8 A As I understood, the purpose for which Mr.
9 Vandenhovel introduced the exhibit that was in his testimony
10 that did make such a comparison it was to argue about the
11 implicit make margins available to a cheese manufacturer and
12 to argue that early in the nineties the relatively smaller
13 numbers that were shown indicate -- were an approximation of
14 what was right or a good number, and the 1999 was at
15 variance -- for 1998 and 1999 were at variance from that,
16 and therefore wrong, and making the additional suggestion,
17 which I agree with, that the BFP was broke and needed
18 fixing, and that indicated that -- in part that was
19 indicated there because it showed that the BFP was not
20 generating as much money that might have been available
21 given a reference to the cheese price.

22 My point was, though, if you look at manufacturing
23 margins for Class III and determining what is fair, one must
24 consider both the whey revenue stream and the protein or
25 cheese revenue stream, and that exhibit did not do so. And

1 I think if you were to have included the whey costs and the
2 whey revenues you would have seen more profitability in the
3 early years and less profitability in '98 - '99, as a result
4 of which there would have been less disparity than was shown
5 in your exhibit.

6 MR. YALE: All right. I have no other questions.

7 JUDGE HUNT: Anyone else?

8 (No response.)

9 THE WITNESS: There is one other thing, Your
10 Honor, that I need to testify to because I testified to it
11 by question of Mr. Vandenhovel, who had a table showing
12 historical data on -- that related to powder production. I
13 had asked him a question for some reason about whether
14 California and Washington - Oregon, the western states
15 produced about 60 percent of the nation's powder. He did
16 not know that. I know that. I can now testify to it from
17 this microphone.

18 In the early nineties that was about the right
19 number. In the late nineties, however, and into the period
20 now in which there is official notice available of actual
21 statistics that can speak for themselves, I believe that
22 number is now higher, especially if you include Idaho. In
23 the last couple of years we have been making powder in Idaho
24 prior to which nobody was.

25 JUDGE HUNT: You want to offer your Exhibit 54

1 into evidence?

2 THE WITNESS: I already did.

3 JUDGE HUNT: All right, we will rule on that then.

4 Any objections to 54 being part of the record in this
5 proceeding?

6 (No response.)

7 JUDGE HUNT: Hearing no objections, Exhibit 54
8 will be received in evidence.

9 (The document referred to,
10 previously identified as
11 Exhibit No 54, was received in
12 evidence.)

13 JUDGE HUNT: And Ms. Brenner?

14 BY MS. BRENNER:

15 Q I just have one question to clarify some of your
16 testimony that related to page 3, the last paragraph before
17 third exhibit, and it was some of your extemporaneous
18 testimony.

19 You referred to the California IV-A price in
20 connection with the federal order cheese price, and I was
21 wondering if you meant the California IV-B price?

22 A I would have, yes. Let me clarify that the
23 California IV-A price is the correspondence to federal order
24 Class IV price for -- at least in this year 2000 it's
25 comparable price of milk used to produce butter and powder.

1 Class IV-B is the price of milk used to produce cheese.

2 Q Thank you.

3 A It corresponds to the federal order Class III.

4 Thank you.

5 JUDGE HUNT: Mr. Cooper, do you have a question?

6 MR. COOPER: No. No.

7 JUDGE HUNT: All right, thank you very much, Mr.

8 Marshall.

9 THE WITNESS: Thank you, Your Honor.

10 (Witness excused.)

11 JUDGE HUNT: Okay, now I have Mr. Grandage.

12 Whereupon,

13 LEVERN GRANDAGE

14 having been duly sworn, was called as a witness

15 and was examined and testified as follows:

16 JUDGE HUNT: State and spell your name, sir?

17 THE WITNESS: Levern Grandage. I am the director

18 of operations at Grassland Dairy in Greenwood, Wisconsin.

19 Grassland Dairy is a privately held butter

20 manufacturing business. We are currently the largest

21 private held butter manufacturing plant in the U.S. We have

22 the capacity to produce about 400 million pounds of butter

23 and anhydrous milk fat on an annual basis, about 20 percent

24 of that in anhydrous.

25 We market approximately 12 percent of the butter

1 in the U.S. We, in terms of milk, process the fat from 8.2
2 million pounds of milk a day.

3 We support Proposal 1 in terms of its use of the
4 CME price for the butterfat calculation, and the reason that
5 we feel that that more accurately holds true for Class IV
6 but not necessarily the other classes of milk is because in
7 Class IV, talking about butter product only , which that
8 price reflects, the price for the input cost is also the
9 price that the product is sold on. And using a NASS survey
10 number any attempt to recoup any costs other than milk input
11 costs in the selling price becomes part of the input cost of
12 the milk price components in the formula. That's not true
13 in the cases of butterfat use in other classifications or
14 other products.

15 We also support Proposal No. 8, the six-cent
16 reduction for the Class IV butterfat price only. I'd like
17 to provide some additional testimony on this issue. There h
18 as been enough, I'm sure this week, and preface my testimony
19 I'm referring to the product of butter, not of the butterfat
20 in terms of other uses and so forth and how it's utilized.

21 In the Federal Order System in which the raw input
22 cost is based on the same level as its sold for butter the
23 opposition to the proposal to use the butterfat reduction of
24 six cents in any other class other than Class IV revolves
25 around these points.

1 Again, number one, the butter cost for the input
2 butterfat is tied directly to the butterfat prices and the
3 sale of butter is also tied directly to those same prices.
4 It's not true for finished products and other butterfat
5 utilization classes. For this reason, butter is not able to
6 pass through any additional cost, whether it would be
7 procurement related to milk or any other cost increase that
8 would occur that would need to be passed through, whether it
9 would be for additional services for a customer, that would
10 end up being reflected in that cost for butter alone.

11 Because those finished product prices are the same
12 as the input prices, the ability to pass through, to change
13 the pricing in relation to the input cost is not there for
14 butter. In other classifications the competitive balance is
15 maintained within those classes because those same input
16 costs are equally charged.

17 In the case of recent years, point number two,
18 today butter or the product of last resort, as it's been
19 referred to in other testimony here, from a competitive
20 nature based on the maximum price that it can pay per pound
21 of butterfat and effectively is set based on the yield
22 factor of a pound of fat to a pound of butter. Those same
23 yield factors are involved in the calculations in the
24 setting of that butterfat price, and those same yield
25 factors are not involved in other classifications.

1 However, this in no way sets the maximum butterfat
2 price which other classifications can use and will have and
3 are currently paying, this issue is indisputable and
4 manifests itself in the current industry data regarding the
5 production numbers and prices and market levels butter
6 production is currently lower. Milk production is higher.
7 All other markets are at support prices and butter prices
8 are moving higher.

9 Currently, other than class uses for butterfat in
10 a competitive markets are paying per pound of butterfat even
11 at current times, if converted at the prices they are paying
12 to butter, would manifest itself in an equivalent butter
13 price on today's market of \$1.19 and a half, \$1.26 and a
14 half equivalent butter price, whereas the maximum that could
15 be paid for that same pound of fat converted to butter and
16 effectively sold at minimal or no margin would be equated to
17 \$1.20974 butter.

18 That currently gives a .067996 cents converted to
19 butter over the butter market price that's being paid for
20 cream going into other uses versus a .04147 for butter.
21 That difference represents \$.0535.

22 So I submit that the six-cent differential is
23 already being manifested itself mostly in the marketplace.

24 These real differences that are currently and
25 throughout recent history are already, as I mentioned, being

1 paid for the butterfat to move to these other class uses
2 from butter. That represents about a 130 multiplier whereas
3 butter, the yield of a pound of fat to a pound of butter
4 equates to about a 123 and a half.

5 During certain high demand Class II or III
6 butterfat usage period highs for these multipliers have hit
7 1.6 or 160 numbers. During those same periods the ability
8 the multiplier that butter can pay does not change. It
9 remains the same. When that happens there becomes a break
10 even point -- let me rephrase that. There becomes a lesser
11 of the loss point to go to the alternative, which is already
12 manufactured frozen storage butter.

13 Those 160 multipliers on the high side are granted
14 rather extreme and not very generally in the industry.
15 However, averages in the 140s are prevalent and the year
16 round averages are in the mid 130s.

17 When multiples are higher than what the conversion
18 for butter will allow margins are eroded on butter to the
19 point where the loss -- the less loss is to switch to frozen
20 or fresh butter manufactured and shipped from other regions
21 if its available. When it's not available the only recourse
22 the butter supplying marketing industry has is to bid the
23 CME cash spot market, and in any attempt to do that to
24 procure a volume of product is only going to increase that
25 fat price, the butter price.

1 If 20 loads of butter needed to be traded, there
2 is no telling how high the price would end up before 20
3 loads were traded.

4 My third point, when price is raised to levels
5 which allow substitution, which was referred to in earlier
6 testimony, of imported anhydrous milk fat or butter or
7 frozen cream all classes which use butterfat except for
8 Class IV have readily -- are readily available to utilize
9 those imported substitutions except for Class IV products.

10 And the reason that is is about 90 percent of the
11 retail butter is a USDA graded product. About 50 percent of
12 the food service butter is USDA graded product. And about
13 50 percent of the industrial use of butter specifies USDA
14 plant approval as a condition of supply.

15 What that means is that the butter industry is
16 unable to utilize the substitutes which are available to all
17 other class uses of milk fat. And I submit, in 1998, when
18 butter prices hit \$2.81 the imported fat was available in
19 the \$1.60 to \$1.90 range, yet was unavailable to be used by
20 the butter industry to supply customers who had a demand for
21 butter.

22 Butter, must like ice cream, cream cheese, cottage
23 cheese, cheese, is a large and ever growing market. The
24 competitive forces that are at work are swaying too far away
25 from the manufacture of butter. It's evident in the

1 historical butter production numbers which have been
2 steadily decreasing the past few years, with the exception
3 of last year and possibly this year.

4 The butter industry's only resort is to squash
5 demand for butter and in effect it also squashes demand for
6 milk fat in all the other classifications and causes extreme
7 upsets in the marketing of milk and milk products.

8 These assertions that I have made here today I
9 feel are very undisputable because the actual market
10 conditions have shown that that has been the case.

11 I thank you. Are there any questions?

12 JUDGE HUNT: Yes, Mr. English.

13 MR. ENGLISH: Charles English.

14 CROSS-EXAMINATION

15 BY MR. ENGLISH:

16 Q Your plant is where?

17 A Greenwood, Wisconsin.

18 Q Is that a regulated facility?

19 A Hasn't been; has been.

20 Q Is it regulated presently?

21 A No.

22 Q What decisionmaking goes through your -- in your
23 process for deciding when to be regulated, when not?

24 A Well, we don't buy any milk or we haven't bought
25 any milk until March. We again started purchasing milk.

1 Q But do you choose the times to take pool milk as
2 opposed to nonpool milk?

3 A No.

4 Q Do you take nonpool milk most of the time?

5 A We take milk at a price.

6 Q And is that price regulated or is it a free market
7 price?

8 A It's a free market price.

9 Q All right. Can you forward contract for your
10 cream needs?

11 A No.

12 Q Are you aware that other players in the industry
13 are forward contracting for their cream needs?

14 A Yes, we are.

15 Q Have you considered having long-term contracts for
16 your cream needs?

17 A Let me reask a question.

18 When you say am I aware of other people in the
19 industry forward contracting for their cream needs, define
20 other people in the industry.

21 Q Other buttermakers.

22 A Yes.

23 Q Without naming names but types what kind of
24 players are your competitors in terms of receipt of raw
25 cream?

1 A Our largest competitors would be in ice cream,
2 cream cheese and cheese. That's where the uses of milk fat
3 have been expanding at rapid rates in addition to butter
4 demand itself.

5 Q And who are your largest competitors in terms of
6 the sale of your finished products?

7 A Without naming names?

8 Q Yes, without naming names. What kinds of entities
9 are they?

10 A Well, obviously since we are the largest privately
11 held butter manufacturing marketing firm in the U.S., that
12 means that we would have to be competing with cooperatives
13 mostly.

14 Q And what kind of products do you produce? Are
15 there any value added products?

16 A Yes, there are possibly value added products,
17 although the butter category is considered by every buyer in
18 the country as a commodity product and therefore its price
19 is scrutinized against the CME butter price.

20 Q Do you attempt to do any butter cost forecasting,
21 cream cost forecasting?

22 A Yes, we do.

23 Q As a result of that forecasting, do you attempt at
24 times to make butter when the multiple is lower and store it
25 for times when the multiple will be higher?

1 A Well, I think, to rephrase that, I think that is
2 the only way to supply the demand of butter in this country.
3 If you go back to, and I don't remember the exact date, but
4 the figure sticks in my mind of 530 million pounds of butter
5 in storage. And when butter prices came down, on a one-year
6 period, in addition to the production at the time, which was
7 much higher than today's production level, an additional 230
8 million pounds of that butter was used out of storage during
9 a one-year period when the price of milk fat was reduced.

10 Q And indeed it is true, is it not, that that
11 storability is one of the reasons why butter is classified
12 as Class IV, correct?

13 A That's correct.

14 Q Would it be fair to say --

15 A Fresh butter has 120 days shelf life. Most retail
16 butter purchasers dictate fresh butter. They want fresh
17 butter in the store for their consumers.

18 Q But you can and do make frozen butter?

19 A When we have to, yes. There are additional costs
20 associated with using frozen butter.

21 Q Would it be fair to say that you are here today
22 because you believe you are having some difficulty competing
23 for your cream, your raw cream supply against those major
24 competitors, ice cream, cream cheese?

25 A Not at all. I don't have a problem competing

1 anywhere. What I'm --

2 Q You're having difficulty procuring a supply in
3 competition with them because, as you say, they can get more
4 money for their product?

5 A That is part of it. The pricing formulas don't
6 allow for let's say ingenuitive marketing on butter when
7 your price is tied to the -- your finished price that you
8 work so hard to market and gain a better margin on is cycled
9 right back into the formula and put on your input cost.

10 Q Do you get a higher margin on those value added
11 products that you sell?

12 A Some.

13 Q Would it be fair to say that you're supporting --
14 I know you haven't been here for the whole hearing, but
15 you've been here today -- that you support Proposal No. 8,
16 which would --

17 A Yes, yes. And the reason being is not because I'm
18 looking to have some type of an advantage in fat pricing,
19 but it has to do more with the overall orderly marketing of
20 milk and its components in the U.S.

21 The butter industry as a manufacturer and marketer
22 of butter, our intent is not to have such fluctuations in
23 the commodity price of butter which drives our customers to
24 undue problems, chasing them away from the butter category,
25 putting them into margarine usages because of the

1 fluctuation in the cost of the butterfat. They need to in
2 certain industries preprice their products as far as 18
3 months in advance. And if you were trying to pick a
4 butterfat market or a price that was going to get you within
5 that range, that's pretty hard to be competitive and price
6 that out 18 months.

7 And what it ends up in the end is if these
8 proposals that I am supporting are adopted the actual result
9 will be lower butter prices and a better response to demand
10 in the marketplace not only for butter but for every other
11 use of milk fat and will allow the base commodity markets to
12 affect the milk pricing to adjust on a supply/demand basis,
13 which is obviously not currently happening.

14 Q But the reason why that would come down, is it not
15 the case, is because you would now have a competitive
16 advantage over those cream makers in receiving your cream
17 supply, correct?

18 A And it's okay for them to have a competitive
19 advantage over me.

20 Q But their competitive advantage comes from the
21 marketplace, correct?

22 A And ours does as well --

23 Q But what you want --

24 A -- because our price is being reported based on
25 what I'm selling it at. My competitive advantage in the

1 marketplace is neutralized because my input costs then takes
2 that higher return I get and adds it back in on my input
3 cost. So eventually, if I raise my price by a penny, the
4 next month my input cost is up by a penny. If I raise it by
5 five cents, the next month my input cost is raised by five
6 cents.

7 Q But as opposed to the market you want the
8 regulated costs now to be different for you as opposed to
9 the cream maker, correct?

10 A Would you rephrase that?

11 JUDGE HUNT: This is being argumentative, Mr.
12 English.

13 BY MR. ENGLISH:

14 Q Do you understand Class IV to be residual use for
15 milk?

16 A I understand Class IV is residual use, but I also
17 understand that butter has a demand market there. People
18 want to buy butter. It's obvious. The retail price is
19 \$3.50 a pound, and it moves, and it's growing. Sales are
20 increasing 10 - 15 percent the last two years, and that's
21 been the highest milk fat price for many, many years, and
22 the sales of butter are increasing. There is a demand
23 there.

24 The marketing system, the Federal Order System
25 should be set up that the product can be moved to the demand

1 area, whether it's butter or ice cream. Let the market
2 decide. The prices and the multiples will adjust
3 accordingly.

4 Q So you don't really consider yourself to be a
5 residual user of cream, do you?

6 A No.

7 MR. ENGLISH: Thank you.

8 JUDGE HUNT: Any other questions of Mr. Grandage?
9 Mr. Beshore.

10 BY MR. BESHORE:

11 Q Mr. Grandage, I think I heard you testify that to
12 be economical you've got to pay a multiple of about 123.5
13 because of the fact that your finished product is priced off
14 the same price as your input; is that right?

15 A That's correct. You can't --

16 Q Go ahead.

17 A Identity standards for butter, there is only so
18 much you can make from that unit. And if it's priced, the
19 input and the output, at the same level.

20 Q What multiples are generally paid by Class II uses
21 such as ice cream?

22 A Bob would probably have that information or
23 members of his staff or association. I can just relay the
24 competitive nature of what we see in the marketplace.

25 Q That's what I'm looking for. You're out there

1 buying cream in competition with the in cream guys every
2 day, right?

3 A If we look at a margin of less than one percent,
4 okay, running butter from cream, you're looking at multiples
5 in the 127 - 126 and a half range as that level.

6 If you compare that cost versus the cost of
7 reprocessing frozen butter or already manufactured butter in
8 another region, then the increase in that cost to do that
9 equates to a break even loss, if you will, to a cream price
10 of about 132, but it's still a loss because the increase in
11 the cost of doing that are not able to be gained through the
12 marketplace because of the pricing mechanism.

13 Q Okay. What multiple is typically paid by ice
14 cream makers for cream in their peak production season?

15 A Well, I can tell you only from the standpoint that
16 when I have discussions, and I probably did not necessarily
17 answer all these questions correctly because I maybe did not
18 understand fully, but Mr. England asked me if we forward
19 price or price -- do contract cream, and the answer is yes,
20 we do when the contract can be negotiated at a level that we
21 can at least cover our costs and break even on that
22 contract.

23 Having said that, most plants on a long-term
24 contract are looking at multiples in the 135 or higher
25 range. Now, in the recent, since these new orders have just

1 taken place since January, prior to January negotiating a
2 contract for 2000 was very difficult because people didn't
3 really know where they really stood. And so in all fairness
4 that current number, if we were to go back and try and
5 negotiate that today, may be different.

6 Q Okay.

7 A But at that time they were in the 135 range.

8 Q Just one other question. You said you purchase
9 the milk -- if I understood your right -- fat daily at your
10 plant in Greenwood, Wisconsin equivalent to about 8.2
11 million pounds of milk?

12 A Equivalent to the skimming of 8.2 million pounds
13 of milk a day.

14 Q Okay. From what geographic area does that cream
15 come?

16 A We purchase cream from 48 states, wherever it
17 available at the price that we can afford to bring it in to
18 Greenwood. We procure butter in the same manner, and our
19 distribution is also through 48 states.

20 Q When you buy cream, do you buy it delivered to your
21 plant or?

22 A We buy it however it works. If they want an FOB
23 price, we need to factor the freight out. If we can get it
24 in a delivered price, you respond to whatever the market
25 conditions require.

1 MR. BESHORE: Thank you.

2 JUDGE HUNT: Any other question for Mr. Grandage?

3 Yes, Ms. Brenner.

4 BY MS. BRENNER:

5 Q Mr. Grandage, what grade of butter do you make?

6 A Approximately 95 percent of the butter we
7 manufacture is Grade AA.

8 Q And the rest is A or?

9 A The rest would be some A and B. However, as has
10 been testified earlier in these hearings, the amount of A
11 and B butter that's actually produced in this country is
12 being reduced in the last few years.

13 What it amounts to is changes in the handling of
14 the milk and the cream. Grade A and B butter simply means
15 that it has defects. Now, the defects can be because of
16 poor manufacturing, poor handling of the cream, or it can be
17 because of the use of whey cream. But as has been testified
18 here, whey cream has been -- being reduced greatly as far as
19 its role in butter manufacturer because of its use back into
20 the cheese.

21 Q I believe a previous witness testified that both A
22 and B butter are made from whey cream. Is that --

23 A If you have whey cream, those are the grades of
24 butter that you produce.

25 Q Okay. Now, you said you make anhydrous milk fat?

1 A Yes.

2 Q Is that something you make regularly or?

3 A Yes, we have weekly contract volumes that we do.

4 Q Is that one of your value added products or is
5 that?

6 A No, the pricing on the anhydrous is less than what
7 the pricing to procure the cream to produce it is per pound
8 of fat. So any margin, any margin you obtain, any costs you
9 incur are offset only by the return you get on the
10 buttermilk solids portions.

11 Q Okay. Is the cost of making it greater than the
12 cost of making butter?

13 A No.

14 Q And who is your major competitor for that? Is it
15 imports or?

16 A Well, in 1998, basically the imported AMF took 90
17 percent of the domestic AMF market away. As a manufacturer
18 of that product and the reality of the situation was it
19 didn't matter, we did not have the fat to supply it, and we
20 allowed our customers out of their contractual agreements
21 with us simply because we could not get the fat to provide,
22 to fulfill our end of the contract, regardless it would have
23 been a good price for us, we couldn't get it, and they
24 didn't want to pay the price, and so we allowed them out of
25 the contracts which allowed them to substitute with the

1 cheaper imported fat.

2 Q And you made butter instead of AMF?

3 A And we tried to supply our domestic customers that
4 required butter the amount of butter they needed.

5 Q You made some reference to somebody squashing
6 demand for butter, and I was wondering --

7 A That was us, the butter industry.

8 Q Squashed demand?

9 A Yes.

10 Q By?

11 A There is certain -- certain butter demand has to
12 be filled from cream. Certain butter demand can be filled
13 from frozen butter. But in the event during 1998, with the
14 pre-pricing of butter fat in other classes as the butter
15 price increased Class II user, for example, whose price was
16 already said could say, "Oh-oh, next month my price is
17 really going up. I'd better try and do as much extra this
18 month as I can," and actually has a negative supply response
19 to an increase in the butter price.

20 And so that increase just continues to carry
21 itself through the marketplace. There is no stop once it
22 starts and it goes for a certain period. It's self-
23 fulfilling until the end, which was at 2.81 where it held
24 for four weeks, approximately.

25 Q And the end comes then when there is more cream

1 available than it takes to support that price level?

2 A Right. And what happened at that point was the
3 amount of butter that was stored for the largest -- the
4 largest -- 60 percent of the sales of butter in the last
5 quarter of the year. And so when the stocks are at 150
6 million pounds at the end of July, that doesn't necessarily
7 mean there is enough butter to supply the demand for the
8 selling season.

9 And so in that case in 1998, I believe stocks were
10 extremely depressed, and prices were high, and they did not
11 stimulate any more production in butter, and therefore when
12 it became apparent that we could not supply our customers'
13 needs the butter industry basically increased the price to
14 the point where the demand was relinquished.

15 MS. BRENNER: Okay, thank you very much.

16 JUDGE HUNT: Anyone else? Mr. Beshore.

17 MR. BESHORE: Just one other question.

18 BY MR. BESHORE:

19 Q We've heard a lot of testimony about how it cost
20 millions and millions of dollars of investments to take
21 water out of milk solids, but you can get your anhydrous
22 milk fat 99.9 percent of the water out of that for the same
23 cost that you can get 18 -- yeah, get it to 82 percent
24 butter.

25 A I did not --

1 Q Can you tell us --

2 A I did not include the investment cost on the
3 equipment to do that; just the operating.

4 Q Just the marginal cost, the operating cost. Is
5 there a higher investment for the equipment to make that
6 anhydrous milk fat?

7 A I didn't think of it in that perspective. I could
8 get my calculator and work on it.

9 Q Well, doesn't it cost you some to take the
10 additional 18 percent of the water out of the milk fat to
11 make anhydrous versus butter?

12 A Yes. It's a completely different process to make
13 anhydrous.

14 MR. BESHORE: Okay. Thank you.

15 JUDGE HUNT: Anyone else?

16 (No response.)

17 JUDGE HUNT: All right, thank you very much, Mr.
18 Grandage.

19 THE WITNESS: Thank you very much.

20 (Witness excused.)

21 JUDGE HUNT: Anybody else want to testify?

22 MR. YALE: I have no testimony. There is just one
23 other official thing --

24 JUDGE HUNT: All right.

25 MR. YALE: -- the National Small Farm Commission

1 report of the USDA, we would like to have official notice of
2 that.

3 JUDGE HUNT: Any object to --

4 MR. YALE: As reported earlier this year or last
5 year's National Commission on Small Farms, and it's a
6 publication of the USDA.

7 JUDGE HUNT: Any objection to taking official
8 notice of the small farm report?

9 (No response.)

10 JUDGE HUNT: All right, official notice is taken
11 of it.

12 MR. COOPER: One other matter, Your Honor?

13 JUDGE HUNT: Pardon?

14 MR. COOPER: One other matter.

15 JUDGE HUNT: Oh, I'm sorry, that's right. Your
16 Proposal 32.

17 MR. COOPER: We have Department Proposal No. 32,
18 which is to make any necessary conforming changes and other
19 provisions to the orders as a result of the amendments may
20 take place as a result of this hearing, and it's a rather
21 technical proposal and no testimony is necessary on it.

22 JUDGE HUNT: All right. Anything else before we
23 set briefing dates.

24 All right, I guess we have be guided by the date
25 that the transcript is ready. You all know, of course, that

1 if you want to get your own copies of the transcript that
2 it's a private reporter, and make arrangements with the
3 reporter to obtain your own transcript.

4 And I understand earlier that the transcript is
5 also going to be available on the internet. I don't have
6 any more details on that.

7 Do you have any at this time?

8 MS. BRENNER: Not at this point. I assume it will
9 be on our web site.

10 JUDGE HUNT: On your web site, the USDA web site.

11 MR. COOPER: But we don't know when.

12 MS. BRENNER: I don't believe that we are
13 expecting to get it for -- I think we ordered five day
14 record, which might make it available as early as a week
15 from Monday.

16 JUDGE HUNT: All right, that would be the 19th it
17 might be available. Today is the 12th?

18 MS. BRENNER: Yes, but a week from Monday would
19 be --

20 JUDGE HUNT: Oh, I'm sorry. A week from Monday,
21 you're right.

22 MS. BRENNER: The 22nd, I think.

23 JUDGE HUNT: I'm getting mushy too more so than
24 usual. All right, that would be the 22nd, right. That
25 would be the 22nd, five days. So some time after that. I

1 guess, could they check with you to see when it might be
2 available?

3 MS. BRENNER: Sure, they can check on the web site
4 and see if it's there.

5 JUDGE HUNT: All right. What about a briefing
6 date? Do you have any suggestions on that? I know the AMS
7 would like to have it as quickly as possible because they
8 are under a real time --

9 MS. BRENNER: Well, a really short, little hearing
10 like this --

11 (Laughter.)

12 MR. ROSENBAUM: Your Honor.

13 JUDGE HUNT: Yes, sir.

14 MR. ROSENBAUM: We have a suggestion.

15 JUDGE HUNT: All right.

16 MR. ROSENBAUM: Which is June 19 for the briefs to
17 be due. That's four weeks after -- four weeks to the day
18 after we expect the transcript to be publicly available on
19 the net. We think that four weeks is sufficient. We
20 recommend a decision which wouldn't put USDA under a lot of
21 time pressure. We understand. And certainly getting the
22 briefing in would expedite that potential.

23 JUDGE HUNT: All right. Mr. Yale?

24 MR. YALE: We recognize the time constraints of
25 the department, we want to cooperate, but we would prefer 60

1 days but we would like to have at least until the end of
2 June.

3 JUDGE HUNT: End of June?

4 MR. YALE: Yes, and I'll tell you why. I mean,
5 part of this is that besides doing the briefing there is
6 going to be a concerted effort on a number of groups' part
7 to try to come up with consolidated positions, and that's
8 going to take time as well.

9 JUDGE HUNT: All right, Mr. Vetne.

10 MR. VETNE: Yes, I have a concern about the time.
11 I suggest, and I would prefer a briefing date about five
12 weeks from today, which is pretty close to what Mr.
13 Rosenbaum suggested. Give five days and a couple of days
14 leeway for the transcript and then four weeks to write.

15 But I also am a bit concerned for those that are
16 absent. You know, this afternoon and today the number of
17 people observing, other than government people, has dwindled
18 down to about 12, representing, as I count it, six parties,
19 six interested companies are here now and were here this
20 afternoon, whereas earlier there must have been somewhere
21 close to 60 or 70 people, representing dozens and dozens of
22 companies. They don't know.

23 JUDGE HUNT: Have you got their proxy to speak for
24 them?

25 MR. VETNE: Well, we're doing their work and you

1 know, it shouldn't be so awkward for those that are not
2 here, and I think five weeks is reasonable. They can call
3 and find out.

4 JUDGE HUNT: That would make it June the 23rd?

5 Mr. Beshore, do you want to speak on it?

6 MR. BESHORE: Yes. I mean, I think we ought to --
7 the quality of the post-hearing submissions is at least as
8 important as the timing when we're talking about a couple of
9 days here, and I think the end of June is -- you know, we
10 need that amount of time to work with, you know, the number
11 of issues and the complexity, and come up with a product
12 that's going to be helpful.

13 JUDGE HUNT: All right, we will make it June 30th
14 then that the briefs are due, and corrections for the
15 transcript due at the same time? Ms. Brenner, do you want
16 the corrections due on the 30th too or do you want it
17 earlier than that?

18 MS. BRENNER: Probably earlier to get them, that
19 might help.

20 JUDGE HUNT: All right. We will have the
21 corrections to the transcripts are due the 19th, June 19th.
22 Proposed corrections to the transcripts June 19th, briefs
23 due June 30th.

24 Any other matters?

25 MR. ROSENBAUM: Yes, Your Honor. I would like to

1 thank you for having presided in such an even-handed and
2 helpful manner. It's very appreciated.

3 JUDGE HUNT: The expert representatives here as
4 well as the testimony made it very easy.

5 So anything else?

6 (No response.)

7 JUDGE HUNT: All right, then that concludes the
8 hearing. Thank you very much.

9 (Whereupon, at 7:30 p.m., the hearing in the
10 above-entitled matter was concluded.)

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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 12, 2000

9 Date of Hearing

10 We, the undersigned, do hereby certify that the
11 foregoing pages, numbers 1418 through 1849 , inclusive,
12 constitute the true, accurate and complete transcript
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14 Sharon Bellamy , who was in attendance at
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17 verified the accuracy of the transcript (1) by preparing the
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