VOLUME I

BEFORE THE SECRETARY OF

THE UNITED STATES DEPARTMENT OF AGRICULTURE

AGRICULTURAL MARKETING SERVICES

In the Matter of Proposed	)	Docket Numbers
Amendments to Tentative	)	AO-14-A77, et al ,
Marketing Agreements	)	DA-07-02
and Orders	)	

National Public Hearing

Monday, February 26, 2007

9 16 o'clock a m

Holiday Inn Select

15471 Royalton Road

Strongsville, Ohio 44136

BEFORE

JUDGE VICTOR W PALMER

US ADMINISTRATIVE LAW JUDGE

UNITED STATES DEPARTMENT OF AGRICULTURE

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I N D E X

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EXHIBITS

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JUDGE PALMER: My name is Victor Palmer. I am an Administrative Law Judge. I am assigned to this rule-making hearing, which has a number of proposals. There are 20 proposals, and I am not going to try to summarize them at all. There are too many and they are too complex.

They basically concern, some of them concern, at least, changing the Class III and Class IV product pricing formulas and so forth and that is complex. It is going to be a hearing involving some complex economic data.

We had a short off-the-record discussion before I started talking right now about what our procedure will be in terms of time and who is going to start testifying and so forth.

Because there are so many proposals. everyone agrees that we are not going to finish this week, even though it was just scheduled for this week. So we are going to have to schedule another session. It will probably be in April. We will all have to look at your calendars. We will set that later in the week.

This week, because of the kind of

proposals they are, we are going to try to limit ourselves to 9 to 5 sessions, rather than these evening sessions that we sometimes do, and to assure everybody being able to get out with planes and so forth, we are here at a place where we have to get to the airport. it takes a little while to get there, we are going to close the hearing at noontime on Friday, this part of it, and reopen it sometime in April. for the next set of witnesses

Some people were stranded Because of the snowfall that hit Washington. Dulles Airport was closed down last night I actually caught a plane, but the only reason I caught it -- I don't know if you are interested, but I will tell you anyway The only reason I caught it is the chap that drives me down to the airport from time to time, he is a worrier, so he picked me up early and I got down there and started to check my bag He said, "The plane you are on has been cancelled and the next one has been cancelled, but we have one going right now " So, I said, "Yeah " I caught an earlier plane and that was the last one out from Reagan for Cleveland

So we are going to be waiting a bit for the Government witnesses. They will be here after 12 noon, maybe a little later. Probably we will close at about 12, recess at 12 and come back at 1 and hopefully they will all be here and they can take the stand.

Meanwhile, Mr. Wellington is going to testify and Mr. Dennis Schad is going to testify this morning.

I think they need a little more time to get ready.

MR. WELLINGTON: I am ready.

JUDGE PALMER: You are ready to go now? Mr. Vetne?

MR. VETNE: John Vetne.

JUDGE PALMER: We are going to have to take appearances too. I haven't done that.

MR. VETNE: That is what I was going to suggest, take appearances and do first --

JUDGE PALMER: And then take a little recess.

MR. VETNE: Do the exhibits and I have a request, a motion to make before.

JUDGE PALMER: Let's do that then. Let's see. You are all -- the folks around here are all attorneys and economists that have been involved in these programs for years, so you know how they work.

But just so the record is clear, this will be a transcribed hearing, we have a court reporter here, and I am asking everybody to give her a copy of written statements. Written statements will be marked as exhibits. I think the rule is that what is in the written statement will prevail. So if there is a variance between the testimony and the written statement, the written statement will prevail, unless the witness says, "I want to change what I said in the written statement, this is not a mistake, which is really what I want to say."

So that will clarify that. And there is cross-examination, and we have a set of rules of evidence that apply.

Enough of that. Now, let's go on and take appearance of counsel. We don't have the Government folks yet. We will hold off on theirs. Let's start with Mr. Beshore. Spell your name. You are going to give your card to

the reporter, too.

MR. BESHORE: Marvin Beshore, B-e-s-h-o-r-e, Harrisburg, Pennsylvania. Attorney representing Dairy Farmers of America and Dairylea Cooperative.

JUDGE PALMER: Next?

MR. HARNER: Tim Harner, H-a-r-n-e-r, General Counsel of Upstate Niagara Cooperative, Inc., representing Upstate and O-AT-KA Milk Products Cooperative.

JUDGE PALMER: Spell that last one.

MR. HARNER: Capital O hyphen. capital A-T, hyphen Capital K-A Milk Products Cooperative.

JUDGE PALMER: Anyone else at that table? We are going to do it around the room. Mr. Vetne?

MR. VETNE: Hi, John Vetne. V-e-t-n-e, 11 Red Sox Lane, Raymond. New Hampshire. I am counsel for basically the same group at the last session, Agri-Mark. Land O'Lakes, Associated Milk Producers, Northwest Dairy Association and Michigan Milk Producers

JUDGE PALMER: Anyone else with

you?

MR. VETNE: Yes, Mr. Wellington and Mr. Schad are here with me.

JUDGE PALMER: Anybody else over there enter their appearance? Let's go up the middle here then.

MR. YALE: Benjamin F. Yale, Yale Office, I am here with Ryan Miltner and Kristine Reed and we are here on behalf of Dairy Producers of New Mexico, Select Milk Producers, Inc., Continental Dairy Products, Inc.. and Lone Star Milk. Inc.

JUDGE PALMER: Yes, sir?

MR. SMITH: Daniel Smith from Montpelier. Vermont. I am here on behalf of the Maine Dairy Industry Association.

JUDGE PALMER: Yes, anyone else in this section? Let's go over to the right. We are going to pass Government counsel. We will take everybody from Government later after lunch. Yes, sir?

MR. ROSENBAUM: Steven Rosenbaum. representing the International Dairy Foods Association.

JUDGE PALMER: Anyone else? All

right. Let's see, do we have the Government. the exhibits, the traditional exhibits that were put in, the notice of the hearing and all that sort of stuff, or will Garrett have that with him?

MR. CARMAN: Yes, we do. Your Honor.

JUDGE PALMER: Can we put those in and mark those?

MR. CARMAN: Yes.

JUDGE PALMER: What we will do with the exhibits is just mark them in series. 1, 2, 3, 4, 5, nobody's name on them, just give them those numbers. So the very first one should be the notice of the hearing. Oh, you put them up on my --

MR. CARMAN: Yes, sir, I gave you a copy.

JUDGE PALMER: That's a good way to get at this. Thank you.

MR. CARMAN: Yes, sir. Number 1, as you mark Number 1, is a copy of the Federal Register, publication on February 9th. 2007, at page 6179, announcing the convening of this hearing, including 19 proposals in that --

JUDGE PALMER: I think we are going to have to get your appearance, so the reporter knows who is speaking. Give your name and identification.

MR. CARMAN: My name is Clifford M. Carman, C-a-r-m-a-n, Assistant to the Deputy Administrator, Dairy Programs, Agriculture and Marketing Services, U.S. Department of Agriculture, Washington, D.C.

JUDGE PALMER: Do I have four copies in front of me or just one?

MR. CARMAN: You have one.

JUDGE PALMER: And the others are with the court reporter?

MR. CARMAN: Yes.

JUDGE PALMER: The first one will be the Federal Register, is marked and received as Exhibit 1.

(Thereupon, Exhibit 1 was marked for purposes of identification and received into evidence.)

MR. CARMAN: Exhibit 2 would be the supplemental notice of the hearing, which includes an additional proposal.

JUDGE PALMER: All right. That

will be marked as 2, and that is received.

(Thereupon, Exhibit 2 was marked for purposes of identification and received into evidence.)

MR. CARMAN: Number 3 should be two pages paper clipped in your set of material. which is the press release as issued by the Agriculture Marketing Service, USDA.

JUDGE PALMER: All right. That is identified as received as Exhibit 3.

(Thereupon, Exhibit 3 was marked for purposes of identification and received into evidence.)

MR. CARMAN: The next package, all clipped together, Number 4, is the Certification of the Notice of the Governors and the Certification of the Marketing Administrators of the Notice to Interested Parties of the Hearing Notice and the Supplemental Hearing Notice.

JUDGE PALMER: All right. Fine. That is also identified and received.

(Thereupon, Exhibit 4 was marked for purposes of identification and received into evidence.)

JUDGE PALMER: And basically then, we can take the testimony of Mr. Wellington. Now, would it make sense to take a short break? Let's take a short break for ten minutes.

(Thereupon, a recess was taken.)

(Thereupon, Exhibit 5 was marked for purposes of identification.)

ROBERT D. WELLINGTON

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

JUDGE PALMER: All right. Let's go on the record. I just swore Mr. Wellington in. I was handed a copy of his statement, and I have marked it as Exhibit 5. So it has been identified as Exhibit 5, and, Mr. Vetne, if you would proceed.

MR. VETNE: Okay. Your Honor, before Mr. Wellington reads his prepared statement, I have a motion to make.

During the course of previous years, in January and September of 1996, we had hearing sessions on a part of the formula for Class III and IV prices, emergency part. This hearing addresses that emergency part, as well as other parts of the Class III and IV pricing formula.

But addressing the emergency part, it continues to address those issues concerning making allowances and surveys, as well as other components.

My motion is to incorporate the transcript and exhibits and interim decision from that proceeding as part of the record of this proceeding, so that we don't need to take additional time to re-create the foundation upon which this hearing will be built.

JUDGE PALMER: Does anybody have an objection to that? Do we need to reserve time for Mr. Stevens to think about that when he comes here? Offhand, I would think that would sound like a reasonable proposal.

MR. CARMAN: If we could.

JUDGE PALMER: You'd like to reserve on that?

MR. YALE: And I would like a chance -- that is something I need to talk to my clients about.

JUDGE PALMER: We have heard what the motion is going to be, or has been presented. We are going to reserve ruling on it and we will discuss it again after the luncheon

recess. You better remember to bring it up again, because I'll forget.

MR. VETNE: Okay. Mr. Wellington, you have been sworn in.

MR. YALE: Your Honor, before he begins, we have some opening things as well.

JUDGE PALMER: Yes, Mr. Yale.

MR. YALE: First off, we want to make a note of an objection to -- although it was legally permissible in five business days, that is extremely too short notice for a hearing such as this. We have three witnesses that would have been available, that are totally unavailable because of the short notice. And it has put us at an extreme disadvantage. That is number one.

Number two is we would like to incorporate the proposals that are dealing with the I and II pricing into this particular proceeding. It is very confusing right now, we have an extraordinary situation, where part of these formulas are part of a tentative final decision that could become a final decision even before this hearing process is over with.

We also are in the midst of waiting

for a tentative final decision on Class I and 2, which may or may not have an impact on this. If the department chooses not to make a decision -- decides not to adopt the proposal at all, then all of the discussions we have here on III and IV apply in total to I and II.

What we don't know is if the department, based upon the hearing record on the I and II would then in turn modify that formula to correspond to whatever formula it decides to do here, which means that what we do here does have an impact on I and II, or decides to ignore what we do here, which means we don't have an impact. That accounts for about 50 percent of the value that is in these formulas. So our request is that that hearing be incorporated into this one as well.

JUDGE PALMER: Again. I am going to reserve until Government counsel gets here. We have had the unfortunate situation where they have been caught in a snowstorm and isn't here. and I would like his input. Again. I will ask you to remember too, when he arrives. to bring those two up. Do you have one too, Mr. Beshore?

MR. BESHORE: No, I don't. I want

to note on that motion that Dr. Cryan, of National Milk, which is the primary proponent in the hearing that Mr. Yale was discussing, has also traveled long and isn't going to be here until this afternoon. So they are not represented yet with respect to that, you know. that issue.

JUDGE PALMER: We want to make sure everybody is here.

MR. YALE: I just wanted to note it before we begin.

JUDGE PALMER: Yes. It is on the record and something we are going to have to contend with. But I haven't ruled on it. I will reserve the ruling until I hear from other people later.

And we are here, so we will get going. All right, Mr. Vetne. If you would be so kind with Mr. Wellington, who has been sworn.

MR. VETNE: Mr. Wellington has been sworn. Mr. Wellington summarizes his experience in his statement, and counsel and parties represented here are familiar with Mr. Wellington. We offer Mr. Wellington's testimony as an expert witness.

JUDGE PALMER: All right. Does anybody object to that? I think everybody knows Mr. Wellington, and he is an expert witness. I presume there is no objection. He will be received as such. We will treat you as an expert. That means you have to really give good testimony.

MR. VETNE: You may proceed.

STATEMENT FOR THE RECORD OF ROBERT D. WELLINGTON

MR. WELLINGTON: Thank you. My name is Robert D. Wellington. I serve as Senior Vice-President of Economics, Communications and Legislative Affairs for Agri-Mark Dairy Cooperative. I have served in that capacity, along with being their economist, since 1989. Prior to that, I worked 11 years as an economist and the Chief of Research and Market Information with the former New York-New Jersey Milk Market Administrator's Office. I have a Bachelor's and a Master's degree in agricultural economics from Rutgers University, where I also taught.

Agri-Mark is a Capper-Volstead Cooperative with approximately 1400 member-owners whose farms produce milk throughout the six New England States and New

York State. Agri-Mark owns and operates a cheese plant in Middlebury, Vermont, another in Chateaugay, New York, a cheese and other dairy products plant in Cabot, Vermont and a butter-powder plant in West Springfield, Massachusetts.

Proposal Number 1. The intent of proposal number 1 is to provide an update to make allowances determined in the hearing held in January and September of 2006. Agri-Mark and other proponents have already submitted comments relative to the interim final decision, and we ask that the hearing record and all comments relative to that hearing become part of this record.

I will not reiterate my testimony and comments submitted at that hearing, but any updating of make allowances proposed under this proposal number 1 are intended to update whatever make allowances are finally determined as a result of that hearing.

USDA Agricultural Marketing Service's. AMS, preliminary economic analysis of Class III and Class IV prices conducted by its Office of the Chief Economist, did a very good job relative to the initial intent of Proposal

Number 1 and we appreciate their efforts.

While we would like also to include updated data from the Cornell study, the limited time and schedule of Professor Mark Stephenson does not allow us to have that additional information for this hearing. I did consider the option of providing individual plant information from Agri-Mark and others, but we believe that USDA has made it clear that it will only consider cost information from surveys such as Cornell and CDFA, which is the California Department of Food and Agriculture.

New data is available from CDFA and Proposal 1, as correctly interpreted in USDA economic analysis, is to amend make allowances to reflect that new manufacturing cost information. This new data is for calendar year 2005.

Scenario A in the USDA analysis shows that such a CDFA update would increase butter, NFDM, which is nonfat dry milk, and cheese make allowances by $.0014, $.0092 and .0029, that should be dollars, per pound respectively. This analysis uses volume weights updated to 2006 data also. The impact of this initial change on

producer prices under Proposal 1 is extremely small.

As stated by USDA in its economic analysis report: "Incorporation of the most recent CDFA cost data and 2006 weighting results in small variations from baseline forecasts. Slight decreases in protein and nonfat solids prices lower the skim price across all classes. This results in an average $.01 per hundredweight decrease in the Federal order blend price. Dairy product prices increase slightly. There is no change in the average all-milk price over the nine-year period." End of quote. That is page 7.

The dry whey make allowance method used in the interim final decision did not use CDFA data. Agri-Mark and others disagree with that part of the decision. If USDA decides to include the CDFA dry whey costs in the final-final decision as we believe they should do, we propose that the 2005 CDFA skim whey powder manufacturing costs at $0.2851 should be included in that calculation.

Table 4 of USDA's economic analysis, on page 8, shows the methodology for Scenario A

involving Proposal Number 1. This table clearly shows the dramatically lower Cornell make allowance costs compared to CDFA costs. Keep in mind that the CDFA study uses audited information as well as more current information. We also have concerns about applying the Cornell survey costs across the entire national volume of dairy products manufactured. Professor Stephenson clearly showed that the cheese costs selected by USDA to be used in the interim final decision are not the average costs incurred by the population; the costs chosen by USDA were heavily and disproportionately weighted in favor of large and low cost cheese plants.

Agri-Mark continues to support the changes proposed in our comments to the interim final decision. However, if those changes are not enacted, then the following procedure should be used to amend the interim decision: Use the product volumes in the individual surveys, not the national product volumes, to weight the CDFA and Cornell information. Table 1 contains the results for such a procedure for all four dairy products.

The resulting proposed make

allowances for cheese is b.1765 per pound. for butter it is $.1336 per pound, for NFDM it is $.1636 and for whey powder, it is $.2075.

Proposal 2. This proposal seeks to have USDA use an annual manufacturing cost survey of U.S. cheese, whey powder, butter and nonfat dry milk plants to automatically update the manufacturing allowance for those products used in Class III and IV component prices.

Federal Orders currently use a weekly NASS survey of hundreds of plants to automatically update dairy commodity prices. since these prices change within a very small time frame. However, manufacturing inputs, such as energy, chemicals, labor, also can change within a relatively short time frame, and this needs to be reflected in the orders.

The Cornell plant survey should be used as a basic methodology to update annual manufacturing allowances on a similar basis. This would allow Class III and IV prices to reflect regularly updated plant costs without the need for lengthy, untimely and controversial hearings and decisions.

We propose that Market Administrator

audit personnel oversee the survey and select the sample plants, as well as collect, audit and assemble the cost information A random. stratified sample of plants should be drawn each year and the results applied across the entire population of plants

The same methodology should be used in each survey each year Any change in the methodology would have to be done via the hearing process

We initially propose several criteria to be applied across the survey results to set the applicable make allowance

First, number 1, the plant cost allowance would be set at a level that would allow a minimum of 80 percent of the milk volume used by the plants in the entire Class III and Class IV manufacturing plant population to cover their costs

Second, in addition, the national cost allowance should be set at a level that will allow a minimum of 25 percent of the producer milk volumes used by Class III and Class IV manufacturing plants in any specific Federal Order pooling at least 4 billion pounds

of milk annually to cover their costs. According to 2006 Federal Order data shown in Table 2, this provision would involve plants in the following Federal Orders: Northeast, Mideast. Upper Midwest, Central, Southwest and Pacific Northwest.

The final make allowance should use the higher of either criteria 1 or 2. This will act as a safeguard to assure that no large milk manufacturing region will have all their manufacturing plants unable to cover their costs.

In Professor Stephenson's testimony at the hearing in this location on September 14th. 2006. he calculated a weighted average cheese manufacturing cost estimate for the population of commercial cheddar cheese plants he had information for. That weighted average estimate of the population was $0.2028 per pound. He stated that that value would cover about 82 percent of the volume of cheddar cheese made in the country and the processing costs of about 33 percent of the plants.

Even though a make cost allowance set to cover 80 percent of the milk volume would

cover fewer than 33 percent of the cheese plants. Agri-Mark believes it would be a fair rate to set. We propose that the same 80 percent rate be used for all four dairy products under make allowance consideration.

During Dr. Stephenson's cross-examination, he mentioned that the weighted value of the cheese plant sample. namely. $.1638 per pound. would likely not cover the manufacturing costs for any cheese plant in the Northeast. This was of great concern for producers and handlers in the region, since more than 5 billion pounds of producer milk were used to manufacture cheese in 2006. That milk volume is down substantially from just a few short years ago and further declines would create severe disorderly marketing conditions for the region.

The second criteria involves using a make allowance that assures that at least 25 percent of the manufacturing milk in any Federal Order with more than 4 billion pounds of combined Class III and IV use annually not be used by plants that are in a loss position, struggling with minimum pricing. This provides

for at least a billion pounds of plant capacity in those Orders. If USDA used the weighted average estimate of the plant population instead of the sample as we propose at the 80 percent level. I believe it would be unlikely that the second criteria would set the national make allowance under all Orders on a regional basis.

The Dairy Division-AMS of USDA originally worked with Dr. Stephenson on his plant cost survey prior to any hearing announcement. I believe that they also provided some funding for his efforts. In my conversations with Dr. Stephenson in 2005. both at his office and when he was meeting with Agri-Mark plant staff and cost accountants in preparation for providing our plant information. he mentioned that his intent was to create a working plant cost methodology for likely use by USDA or some regulatory agency. Agri-Mark believes that the basic methodology is now available, and experienced audit staff at the Market Administrator's offices have the expertise to conduct Dr. Stephenson's model on an annual basis.

Thank you for consideration of these

two proposals. Agri-Mark has also submitted three additional proposals, numbered 10, 11 and 14 in the hearing notice. In the interest of keeping this hearing record as organized as possible, we will testify on those proposals as they are reached in sequence.

DIRECT EXAMINATION

BY MR. VETNE:

Q. Mr. Wellington, on page 2 of your testimony you refer in the third and fifth paragraph to USDA's economic analysis report.

A. Yes.

Q. Are you there referring to the economic preliminary analysis that accompanied the notice of hearing in this proceeding?

A. Yes, I am.

Q. And which is reproduced on the Internet site for this hearing?

A. Yes.

Q. On the last page, third paragraph, in the last line, you refer to second criteria setting the national make allowance under all Orders. Your typewritten statement says "regular basis." but you read "regional basis." Which word do you prefer to accompany the record?

A. Actually, "regular basis."
Q. In your estimation and opinion, if USDA adopts a process whereby 80 percent of the milk volume, rather than percentage of plants, 80 percent of the milk volume is covered in the make allowance, with respect not only to cheese. but with respect to the other products as well, less than half of the plants would cover their costs?
A. I don't know that for a fact. But I believe it to be likely, given the type of plants we have and the volume of some very large plants that hold these different commodities.
Q. We have direct testimony concerning that from Dr. Stephenson on cheese plants.
A. Correct.
Q. And testimony that concerns the plant size to cost relationship. Is it your observation that a similar relationship exists for the other products, the larger the plant, the lower the cost per unit to produce?
A. It is true, particularly for those plants that operate on a year-round basis, such as nonfat dry milk and butter that operate on a seasonal basis.

Q. And, finally, proposal number 2 proposes to establish a method whereby USDA would announce make allowances annually, without requiring hearings, correct?

A. Correct.

Q. And although a make allowance would change or could change year to year, the process would be the same for year to year and it is only a change in the process which would require a new hearing; is that correct?

A. That is what I am proposing, yes.

JUDGE PALMER: All right. It occurs to me, I hadn't thought of this, but Government counsel is not here to cross-examine Mr. Wellington, nor are some of the other people from the Dairy Division. I am wondering. Carman, you may have some questions, and certainly you can put them to the witness. But I am thinking that we will have to do witnesses that testified this morning, kind of save it when these other folks get here this afternoon. You will still be here?

MR. WELLINGTON: I will still be here.

JUDGE PALMER: And, if necessary.

we can put him back on the stand for their cross-examination. We can do that based upon the written statement, although they won't have the benefit of examination by the other counsel. But. Mr. Carman. I would ask you to take good notes and explain it to them. All right. I think that will work.

MR. YALE: Are we saying we are going to go into cross now?

JUDGE PALMER: Yes.

MR. YALE: Here is the problem.

JUDGE PALMER: Okay.

MR. YALE: We had a rush up hearing, and we had a conference, it was informal, it is not official, it is not binding. But we had a discussion with Government counsel and attorneys, and the understanding was that Mr. Wellington would be on the stand tomorrow.

JUDGE PALMER: Oh.

MR. YALE: And part of the reason that we wanted to have the scheduling was so that we could schedule and finalize preparation for witnesses. It was our understanding that Mr. McDowell was going to be

here today, and our primary focus was preparation for him.

Now, I can handle a cross of Mr. Wellington, but the complete preparation was going to follow when we were done with Mr. McDowell.

JUDGE PALMER: All right.

MR. YALE: So my request, and this whole hearing, between the storms and everything else, is turning out to be a little unusual in scheduling. So if we get off the norm. we are already there.

Maybe the thing to do is to allow some other direct testimony. I understand Mr. Schad was ready to present his. And then we can do that. And I am not trying to put Mr. Wellington on the spot. In terms of allowing us more time to prepare -- he is prepared anyhow, but it does put us at a disadvantage.

JUDGE PALMER: I appreciate that. I think we will do that. We won't have you cross now. We will have cross for you later. That way, we know that everybody can participate. I hadn't heard about -- or I

wasn't aware of the fact that there was anticipation that you weren't going to testify until tomorrow. So you are going to be here the rest of the day and tomorrow?

MR. WELLINGTON: Yes, I will.

JUDGE PALMER: Well, let's take Mr. Schad's direct testimony. Maybe even this is a little odd. But at least we will get it on the record and get the exhibit out of the way and everybody can look at it.

(Thereupon, Exhibit 6 was marked for purposes of identification.)

DENNIS J. SCHAD

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

JUDGE PALMER: This will be marked as Exhibit 6. Mr. Schad is sworn and the exhibit -- the statement is marked as Exhibit 6. And, incidentally, we have varied the rules that are stated, I think, in the notice. We are just taking one copy for me, so I can follow along and actually, just one copy for the reporter.

The rest are being distributed, even though the rules say you are supposed to furnish. I don't know how many, a gazillion

copies. That will be the rule. As long as you have an original and one, you are okay, up here. and then have copies for the folks in attendance. All right. The witness is sworn.

MR. VETNE: Okay.

JUDGE PALMER: I would receive Mr. Wellington's statement, even though he hasn't been crossed at this point in time. So we will receive Mr. Wellington's statement. which is Exhibit 5.

(Thereupon, Exhibit 5 was received into evidence.)

JUDGE PALMER: All right, sir.

MR. VETNE: Mr. Schad has been sworn and his testimony concerning proposals 1, 2 and 3, Mr. Schad. like Mr. Wellington. is a veteran of Federal Milk Order proceedings, and has testified before as an expert, and we offer him today as an expert.

JUDGE PALMER: As an expert witness? I gather nobody wishes to voir dire on his expertise? All right. Fine. We will so treat him. Go ahead, sir.

MR. VETNE: Mr. Schad, you have a prepared statement?

MR. SCHAD: I do.

MR. VETNE: Okay.

STATEMENT FOR THE RECORD OF DENNIS J. SCHAD

MR. SCHAD: My name is Dennis Schad, and I am here to testify on behalf of Land O'Lakes, Incorporated. My business address is 405 Park Drive, Carlisle, Pennsylvania. I hold a Bachelor's degree in history from the College of William and Mary in Virginia, and a Master's of Business Administration from Virginia Tech. I have worked for Land O'Lakes and its predecessor cooperatives for 25 years. My current title is Director of Regulatory Affairs. Prior to this assignment, I have held positions in the cooperatives' milk procurement. marketing and transportation departments. I have testified at numerous Federal and state milk marketing order hearings and before the agriculture committees of several state legislatures.

Land O'Lakes, LOL, is a dairy cooperative with over 3,000 dairy farmer member-owners. The cooperative has a national membership base, whose members are pooled on six different Federal Orders. Land O'Lakes owns

three cheese manufacturing plants and a butter/powder plant that receive federally regulated milk.

Land O'Lakes supports Proposals 1, 2, 12. 14 and 17. while opposing Proposals 3, 4, 5, 6, 7, 8, 11, 13, 15, 16, 18 and 20. At this hearing Land O'Lakes has no position on Proposals 9 and 10. I will provide evidence for several of the listed proposals and will provide argument through a written brief on others.

Background of Determining Class Prices. Through the informal rule-making process of Federal Order Reform, the Final Decision of 2000 -- of the 2000 Class III and IV hearing and the most recent temporary final decision, the TFD, USDA has developed a process to determine class prices. This process that sets Class III and IV prices replaced the M-W and Basic Formula Price Series. Theoretically. the Class III and IV prices are now the residual of the market price of a commodity, butter. nonfat dry milk, cheese or whey, less the cost of converting that milk to that commodity.

Determining the class prices starts with the NASS price series, which describes

commodity-specific products, cheddar cheese in 40-pound blocks and 500-pound barrels, butter in 25-kilogram and 68-pound boxes and NFDM and whey in, quote, "bag, tote or tanker sales," end quote NASS reports the total price received at these plants for the commodities The manufacturing allowance is fixed, any increases to the selling price to capture increased costs are reported to NASS, and all dairy farmers. regardless of whether their marketing organization incurred the costs, benefit from the higher class prices

The second step of the process is to determine the cost of converting milk to the commodity, whose price is quoted on the NASS survey The department is scrupulous in making sure that the commodity manufacturing cost is tied to the product described by the NASS survey Additionally, the department considers the factors that determine the volume of the commodity product that is processed out of a hundred pounds of milk

The residual of this calculation represents an approximation of the value of milk used in Class III or Class IV products and is

used to set the Class III or IV price. The price is designed to be a minimum regulated class price for the commodity. Additionally. USDA has defined the Class IV price to be the market clearing price and has sometimes explicitly added a component for balancing costs in the make allowance calculation.

Land O'Lakes supports Proposals 1 and 2. In the temporary final decision, in the Federal Register, number 71, page 67467, the Secretary published product price formulas for Class III and IV milk, based on a weighted average of the Cornell Price Series and the price survey published by the California Department of Food and Agriculture. The spirit of Proposal 1 is to require AMS to update the product price formulas when an input-survey to the weighted average calculation is updated or changed.

On November 29th, 2006, CDFA released its Summary of Weighted Average Manufacturing Costs. I hope it will be an exhibit at some point. These costs update the CDFA manufacturing cost data to 2005 averages. USDA used the updated numbers to calculate the

weighted averages contained in Table 4 of the Preliminary Economic Analysis, Class III and IV prices

Among the recommendations filed in Land O'Lakes' Exceptions and Comments to the temporary final decision are two that are especially relevant to Proposal 1 First, Land O'Lakes recommends that the CDFA cost of manufacturing whey powder be incorporated into the USDA weighted average calculation that determines the Federal Order Class III prices The TFD set the CDFA survey as the, quote. "gold standard" of manufacturing cost surveys The department chose to abandon the Rural Business Cooperative Service cost survey because the Cornell survey more closely approximated the procedures of the CDFA survey The CDFA whey powder cost survey includes three plants that aggregately manufacture 98 million pounds of whey That volume represents 82 percent of the skim whey powder processed in California The CDFA whey survey is a valid, audited and representative manufacturing cost survey that should be included in the Class III price formula calculation

The second recommendation was to continue the practice of weighting the CDFA and Cornell survey data by sample volume. The TFD weighted the commodity cost by the entire volume of the commodity produced in California or outside of California. For example, the result in the TFD was that the average manufacturing costs for four sampled butter plants in the Cornell survey were weighted by the volume of all the NASS butter produced by all butter plants located outside of California, rather than the actual volume produced by the four plants. While these four sampled butter plants produce 125.6 million pounds of butter, the impact in the make allowance calculation of the costs of those four plants were weighted as if they had manufactured 995 million pounds. The weighting procedure in the TDF -- I am sorry. TFD, was neither statistically valid, nor reasonable.

The following chart summarizes the butter, nonfat dry milk, cheese and whey make allowances had USDA used the sample-weighting procedure used by the 2003 final decision. Note that the CDFA changed its input in the 2005

nonfat dry milk survey and utilized costs from nine. instead of ten plants The impact of the CDFA procedure is most striking in the medium cost group For that reason, the following chart used the CDFA nonfat dry milk population cost and weight

The following is the chart which uses the costs of the Cornell and the CDFA, the updated CDFA, weighted by the sample volumes of the cost groupings that USDA chose to use with the exception of nonfat dry milk, which instead of using the medium cost grouping. I chose to use the grouping for the entire California group

At the bottom, there is a summary of changes, and the first column represents the temporary final decision, and the second is the Preliminary Economic Cost Analysis and the third is the results of the Land O'Lakes methodology

While Land O'Lakes agrees with much of the spirit of Proposal 2, we offer specific changes to the language of the proposal We would like to replace the language that grants the Market Administrator the authority to survey plants to an authority granted to the Director

of AMS. It is important that the plant survey be national in scope. The sampled plants should be determined by a draw from the national population of plants located outside of California. Additionally, Land O'Lakes believes that the results of the national survey should be combined with the CDFA plant survey.

Land O'Lakes also disagrees with section 2 of Proposal 2. We don't believe that the commodity make allowances should be snubbed at the cost of the highest cost region. As class prices are determined from commodity price sales from a national market, it is consistent that make allowances be determined by the weighted average of the manufacturing cost of plants across the country. NASS breaks out the sales of cheese between the Upper Midwest region and the remainder of the nation. Snubbing the cheese make allowance at a level that covers the cost of cheese manufactured in that region opens the door to considering the regional price of cheese in determining the region's Class III price. Land O'Lakes believes the benefits of the national class price far outweigh consideration of regional manufacturing prices

in the make allowance calculation.

Land O'Lakes believes that the Secretary should conduct a manufacturing cost survey each year, based on an adequate number of plants, so that a representative sample of plants is drawn. If the number of plants and volume produced in those plants is short of the population, then valid statistical extrapolation techniques should be utilized to estimate the population averages. The Secretary should combine the survey of the Federal Order manufacturing plants with the relevant CDFA survey.

Finally, the Secretary, like the CDFA survey, should clearly --

JUDGE PALMER: Why don't you restate that. There is an error in what you just said, I think. State it again.

MR. SCHAD: Strike that. Reading the paragraph again. Finally, the Secretary, I am referring to the USDA Secretary. like the CDFA Secretary, should clearly identify a target percentage of volume of product covered by and a target percentage of plants covered by each of the proposed make allowances. For

example, the CDFA has stated, "As a general rule, the acceptable level of coverage" parenthetically, "(by the manufacturing cost make allowances)," end of parentheses, "ranges from 50 to 80 percent of the product produced." I am sorry, "product processed," end of quote That is from CDFA Panel Report, February 20th. '05, page 12 By explicitly considering the volume covered by proposed make allowances, the Secretary will make a more informed decision and offer the industry a clearer sense of the impact of the proposed changes

Land O'Lakes opposes Proposal 3

Proponents of Proposal 3 request that USDA revise the temporary final decision from the January 20th, 2006 hearing from a weighted average of Cornell and CDFA manufacturing costs to one that includes only Cornell weighted averages Since 2000 Federal Order Reform, the department has, as a matter of policy, combined relevant manufacturing cost from California and plants outside of California In the final decision from the 2000 hearing, the Secretary wrote

"The use of manufacturing plant data

from California that does not procure any of the milk that would be priced using these costs should not cause concern. The costs of manufacturing dairy products may vary slightly by region, but adoption of representative make allowances in product price formulas should not fail to use a well documented survey that includes a large number of audited data, such as the CDFA survey." It is Federal Register 67. pages 67915 and 6.

As long as the department determines product prices from a national NASS survey that includes California commodity prices, it is appropriate for AMS to include California manufacturing costs in the make allowance determination.

MR. VETNE: Your Honor, Mr. Schad, a couple of places, mentioned publications of or decisions of the California Department of Food and Agriculture. We will identify the Web site on which those may be found and request judicial notice.

JUDGE PALMER: All right. That will be done.

MR. YALE: Wait, we are going

to take judicial notice of CDFA's --

JUDGE PALMER: If it is a publication of a Government organization. I guess we take judicial notice of it.

MR. YALE: We are not going to be able to examine them on their methodology?

JUDGE PALMER: No, it would be there.

MR. YALE: We would object to that, strenuously, Your Honor.

JUDGE PALMER: All right.

MR. VETNE: What I said was not the California exhibits, but the California decision, the determination of the Government of California and what they do, as well as the publication of the most recent survey, and I will identify the cite and readdress this.

JUDGE PALMER: Let's readdress it later then. and I will listen again.

MR. YALE: All right.

JUDGE PALMER: I will listen again. I didn't hear that quite — I didn't realize there was more than just a publication of numbers. We will listen to that again. All right. sir.

MR. VETNE: Mr. Schad, do you have anything you want to add before you --

MR. SCHAD: Not at this point. sir.

MR. VETNE: Okay. This witness is finished with this point.

JUDGE PALMER: We will reserve cross-examination. I have a couple of questions. I may as well get mine out.

First of all, we are going to receive his statement and reserve the cross-examination.

(Thereupon, Exhibit 6 was received into evidence.)

JUDGE PALMER: Go back to page 6 where you start talking about snub. I know everybody here knows what it means. It is not the clearest of terms to some judge reviewing this record later on.

What do you mean by "make allowances should be snubbed at the cost of the highest cost region"?

MR. SCHAD: My testimony was that I did not -- Land O'Lakes does not believe that make allowances should be snubbed. And if I describe that, as we understand, section 2 of

Proposal 2, it would have national make allowances set on the weighted -- either the weighted average of the Cornell or California surveys, or at a level that addressed the make allowances -- I am sorry, the cost of production -- manufacturing cost for a commodity in a specific Federal Order.

JUDGE PALMER: What does "snubbed" mean, as you used it? Does it mean that --

MR. SCHAD: "Snub" means in the context that I am using it, if, for example, the cost of manufacturing in the Northeast was at a level above the national average, then you would use the Northeast level, rather than the national average.

JUDGE PALMER: Snubbing means to use the higher number?

MR. SCHAD: In the context of how I am using it, yes.

JUDGE PALMER: And later on in that same paragraph, I think there is a typo. I think you meant to say, "snubbing the cheese make allowance." It says "subbing." So do you want to correct that to say "snubbing"?

MR. SCHAD: Yes, please.

JUDGE PALMER: "Snubbing the cheese." All right. That was all my questions. And you may sit down and we will decide what we should do for a while. I don't think we have any other witnesses, do we, this morning? We can just take direct testimony type thing. except we would do it with farmers, give testimony or take statements here. Carman would take whatever questioning you need there.

We are just worried about the -- I want to make sure all the economists that are going to be involved in the process and the Government attorney has a chance to ask any questions they would have.

So nobody is available at all? Well. it looks like we are going to recess until -- would 12:30 be good, Mr. Carman, or do you think we should wait until one?

MR. CARMAN: I have not had any update on expected arrival.

JUDGE PALMER: Let's make it 1:00. Meanwhile, anybody that said they didn't have enough time to prepare for the hearing, has enough time to prepare now. Thank you, I will see you at 1:00.

(Thereupon, a recess was taken.)

JUDGE PALMER: Let's go on the record. We recessed a few hours ago because of the weather problems we had that kept a number of folks from getting here, most importantly. the Government counsel, and the folks -- a couple of people from the Dairy Division, although the Dairy Division was ably represented here this morning by Mr. Carman.

And just to bring them up to date and make sure we understand everything, I am going to let you officially enter your appearance. even though the reporter does have your card and so forth. I will let you officially enter your appearance for everybody from the Government.

MR. STEVENS: Yes, I am Garrett B. Stevens, Office of General Counsel, Marketing Division. United States Department of Agriculture.

MS. PICHELMAN: I am Heather Pichelman, also with the General Counsel's office. Marketing Division, U.S. Department of Agriculture.

JUDGE PALMER: Do we want to have anybody else have an appearance as such?

Mr. Carman is here, he has entered his appearance. Yes, sir?

MR. SCHAEFER: Henry Schaefer. Department of Agriculture, Dairy Programs.

MR. JABLONSKI: Gary Jablonski with Dairy Programs in the Seattle Market Administrator's office.

JUDGE PALMER: And the other table, with the exception of Mr. Carman, everybody else is an observer?

MR. ROWER: Jack Rower. R-o-w-e-r. AMS Dairy Programs.

JUDGE PALMER: How about the other two people at that table, did you wish to enter your appearances?

MS. TAYLOR: Sure. I am Erin Taylor, Dairy Programs, USDA.

MS. HOOVER: Jill Hoover. Dairy Programs. USDA.

JUDGE PALMER: Thank you all. Let me bring you up to date as to what happened this morning. We took direct testimony from Mr. Wellington and Dennis Schad, and we stopped with the direct. We have their statements, they have been marked as Exhibits 5 and 6 and they

are available. I believe you probably have copies of those on your table.

Now, we also had a couple of motions come up, and I am going to let them be restated. I am trying to decide what is the best way to proceed.

Do we discuss the motions first and then resume cross-examination of Mr. Wellington and then Mr. Schad? If I understand. Mr. McDowell is also here, and I gather Mr. Cessna is here, too, so they are both here. I don't know what would be everybody's preference. I want to leave a little bit of preference.

Would it be a preference to get Wellington and Schad finished? No? The preference would be that we hold off on the cross?

MR. STEVEN: I think the Government would --

JUDGE PALMER: And I think that's your preference, Mr. Yale?

MR. YALE: Yes, that is our preference as well. I think as far as dealing with the motions, in all fairness -- our objection, our motion to bring in I and II was

National Milk's proposal and, in all fairness. Roger Cryan, who represents National Milk, ought to be here and participate in that discussion. As much as I would like to get a default, but, you know. I think we need to go the other way. So until he comes, and it can wait until that time.

JUDGE PALMER: Why don't we just start then like we would have if we had started this morning with Mr. McDowell.

Mr. McDowell, are you ready to come forward and take the stand? Then we will revisit everything tomorrow.

GERALD CESSNA

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

HOWARD McDOWELL

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

JUDGE PALMER: Let's get your names on the record and explain for the record what is happening. We have both Mr. McDowell and Mr. Cessna, who are going to testify in sort of a joint fashion. I presume Mr. McDowell will speak first; is that right, Mr. McDowell?

MR. McDOWELL: That will be fine.

JUDGE PALMER: And then Mr. Cessna, and then they are going to be available for examination.

Mr. McDowell, would you first state and spell your name for the record so the court reporter can get that.

MR. McDOWELL: My name is Howard McDowell. M-c-D-o-w-e-l-l.

JUDGE PALMER: And Mr. Cessna.

MR. CESSNA: My name is Jerry Cessna. C-e-s-s-n-a.

JUDGE PALMER: Do you have copies?

MR. McDOWELL: This copy is not good.

MR. STEVENS: Your Honor, if I may, I think it is about a three- or four-page statement. It is pretty straightforward. We didn't make copies because we have been working on the draft.

JUDGE PALMER: All right.

MR. STEVENS: It is not the final form. If you would indulge us, we would like him to read his statement into the record, and then we will proceed from there.

JUDGE PALMER: So he will just -- first of all. you have given your name, who are you affiliated with, et cetera?

STATEMENT OF HOWARD McDOWELL

MR. McDOWELL: My name is Howard McDowell, I am a Senior Economist on the Economic Analysis Staff and Dairy Programs of the Agricultural Marketing Service of the United States Department of Agriculture.

I have been a Senior Economist since 1999 when I joined Dairy Programs. Since January of 2007 I have been Acting Chief of the marketing -- of the Market Information Branch.

Dairy Programs was asked to compute a price series using both NASS and CME prices as proposed by Mr. Wellington of Agri-Mark. We were unable to obtain a final version of the proposed series, so we did not compute a series.

The preliminary analysis reported in the hearing announcement was done by the Economic Analysis staff under my supervision. My appearance today is not in support -- is not in support of, or in opposition to, any proposal, and the analysis discussed should only be interpreted as what the possible impacts

would be should a proposal be adopted. In no way should this analysis be construed as addressing the merits of any proposal.

The preliminary analysis was posted on the Dairy Programs' Web site on February 12th. 2007. Since then. Appendix A. including more detailed tables, and Appendix B, that includes additional analyses or proposals by Dairy Producers of New Mexico, have been posted on the Web. The analysis was done using Dairy Programs' Baseline Econometric Model, and the model was calibrated to the baseline the USDA published in February of 2006.

A documentation of the model was posted on the Web on the Dairy Programs' Web site along with the analysis. The model documentation has been available on the Dairy Programs' Web site with every economic analysis done for hearings since October 2001.

For 2001 and '2, the documentation is in an appendix of the economic analysis. For the 2006 and 2007 analyses, the documentation is prominently displayed as a separate document.

I am going to briefly highlight the model and its use in preliminary economic

analyses Preliminary analyses are performed with the model with the goal of providing an unbiased and consistent analysis of proposals. using a model that will capture interactions between the proposed changes and market prices and quantities

Sometimes analyses generate unexpected results because a proponent may not have been able to analyze a proposal with a market simulation The key addition the model provides is an estimate of how the proposals interact with the market Static analyses done by AMS staff and others are particularly useful in examining the behavior of proposals under different monthly short-term situations The annual econometric model forecast out through the baseline period ten or so years, and prices are estimated internally, not taken as given

The model is trued up to generate prices and quantities as published in the USDA Agricultural Baseline Projections, assuming current policy Because prices are variable in the model, changes in Federal Order formulas and other policy parameters can be analyzed and the changes in both consumer and producer prices can

be estimated.

The changes presented in analyses are changes from the baseline as a result of changing policy or program parameters. A static analysis does not capture these types of interactions.

The most important results include the identification of which variables change. direction of change and magnitude of change. Of additional value is a consistent model that can be used to generate results to evaluate a range of proposals.

The model includes equations representing the supply of milk, the allocation of milk to separate products and the demand for milk in dairy products. The equations are estimated by Dairy Programs' staff economists using annual data beginning in 1980. We update the estimations as we can and as needed.

The model includes equations necessary to model the Federal Order system of classification and revenue pooling, the Milk Price Support Program and the MILC program. The model provides direct estimates for the major wholesale dairy product prices, fluid milk

prices f.o.b. plants and the United States all-milk price, which is a plant level price. From the dairy product prices, Federal Order prices are calculated and the Federal Order marketings are estimated.

There has been some discussion in the past concerning Dairy Programs' estimated elasticities as compared to others. Dairy Programs uses publicly available data to estimate equations using standard least-squares statistical procedures. The equations are publicly available.

One reason for estimates to differ is that the underlying data is different; either the series are slightly different or the model years are slightly different. We have consulted with economists who have similar models from time to time. Our elasticities have been of similar magnitudes.

However, one thing can be said with regard to elasticities and simulation results. As equations are more price elastic, price effects of policy changes are reduced. As equations are more inelastic, price effects of policy changes are increased.

JUDGE PALMER: Repeat those.

MR. McDOWELL: I will read those two sentences again more slowly. As equations are more price elastic, price effects of policy changes are reduced. As equations are more inelastic, price effects of policy changes are increased.

MR. STEVENS: And he meant to say "policy changes" each time. I think you eliminated the word "changes" when you first read the first sentence. You want that to reflect the "policy changes"?

MR. McDOWELL: "Price effects of policy changes." The critical issue is to evaluate proposals with the consistent model with responses in the right direction and of a reasonable magnitude. Dairy Programs' model fits that description.

My colleague, Jerry Cessna, and I are going to briefly highlight the analysis that we have done.

JUDGE PALMER: May I ask if one of these copies, the one he read from or the one that you have, Mr. Stevens, could be given to the court reporter for her assistance?

MR. STEVENS: Certainly.

JUDGE PALMER: Why don't you do that. That will help.

MR. CESSNA: Jerry, J-e-r-r-y.

JUDGE PALMER: And it's Cessna?

MR. CESSNA: And it's Cessna.

JUDGE PALMER: We want to get your full identification, too, now.

MR. CESSNA: Full name?

JUDGE PALMER: Yes, full name, who you work for, why you are here.

MR. CESSNA: My full name is Joseph Gerald --

JUDGE PALMER: We didn't really mean to do that to you.

MR. CESSNA: Okay. Jerry Cessna. All right.

JUDGE PALMER: And who are you affiliated with?

MR. CESSNA: I have something to read.

JUDGE PALMER: Okay.

STATEMENT OF JERRY CESSNA

MR. CESSNA: I am a Senior Economist with the Economic Analysis Staff and

Dairy Programs of the Agricultural Marketing Service of the U.S. Department of Agriculture. I have been an Economist with Dairy Programs since March of 2001. I have a Bachelor of Business Administration degree from Baylor University, and a Master of Arts in Economics degree from Middle Tennessee State University.

What I would like to do now is just to go through the analysis, flip through the pages and talk about some aspects of the analysis. There are copies of the analysis in the very back.

MR. ROWER: They are on the table in the back.

JUDGE PALMER: I think it might be helpful at this point if we made that into an exhibit. So when anybody is referring to your testimony, they will have an exhibit number and they will be able to look at it. So we will mark it as -- get one for me and one for the reporter again. It would be helpful for her to read your terminology. We will mark it as Exhibit 7 and we will receive it, because it is the Government exhibit.

(Thereupon, a discussion was held off

the record.)

(Thereupon, Exhibits 7, 7-A. 7-B and 8 were marked for purposes of identification.)

JUDGE PALMER: We have just marked for identification, just so we have it on the record, a group of statistical documents. I am going to say it one more time. The very first one is marked as Exhibit 7, the second and third line of which says, "Preliminary Economic Analysis, Class III and Class IV Prices."

Then as Exhibit 7-A is Appendix A to that document, as Exhibit 7-B is Appendix B to that document. Then we have marked as Exhibit 8 a document that says "National Econometric Model Documentation."

All right. Now, gentlemen, if you would be so kind as to tell us about these documents.

MR. CESSNA: I will generally talk about what the documents are.

JUDGE PALMER: Sure.

MR. CESSNA: We have the main document, the Preliminary Economic Analysis. Then Appendix B has detailed tables that go year

by year -- I am sorry, Appendix A has detailed tables that go year by year to show the effects of these proposals or these scenarios.

Then Appendix B concerns certain proposals by Dairy Producers of New Mexico and combining up some of the scenarios and looking at the separate butterfat price scenario.

So, anyway, I would like to start with the main document and then our econometric baseline explains about the model we are using to analyze all these scenarios.

If you go to the main document --

JUDGE PALMER: Which we are calling Exhibit 7.

MR. CESSNA: What you are calling Exhibit 7.

JUDGE PALMER: You might write it down yourself. Otherwise people will get confused if you say "main document."

MR. CESSNA: Okay. Exhibit 7, we will look at the first page and work our way through the document.

First of all, I would like to draw your attention to what is in the USDA baseline or what the baseline assumes.

If you look down at the second paragraph, it assumes that the Milk Price Support Program will continue unchanged. The Dairy Export Incentive Program will be utilized to the maximum extent, beginning in 2006-2007 fiscal year. The Milk Income Loss Contract program will continue unchanged through 2007, September 2007, and that the Federal Order system will remain unchanged.

Now, for most of the time when we do analyses as Dairy Programs, we can use the USDA baseline and run our scenarios off of that. This time, we have made an alteration to what we are calling the baseline in this study.

And that is, we were using the interim final decision make allowances, and we have altered the baseline to incorporate those interim final decision make allowances. That is what we are calling the baseline as we work through these scenarios. Okay.

And if you look in the middle of the page, you can see what the make allowances are related to that interim final decision.

JUDGE PALMER: Those are those subparagraphs for cheese, butter, NFDM and dry

whey?

MR. CESSNA: That's right. If you go to page 2, our analyses all begin with calendar year 2007. We have run them from calendar year 2007 to the end of the baseline that we have here, 2015. I think Howard kind of went over generally that our model documentation covers supply and demand for the milk market. the fluid market and dairy product markets.

Okay. If you go to page 3, this is a brief description of the scenarios that we are analyzing in this proposal, in this analysis. So we have got Scenarios A through J, and these are the scenarios that we analyze with our model.

JUDGE PALMER: When you say it is scenarios, you are saying that there are different proposals before us today and you have analyzed each of those proposals and gave them letters A through J; is that right?

MR. CESSNA: Right. We have analyzed most of the proposals and they have the Scenarios A through J.

JUDGE PALMER: For example, I see Agri-Mark is Scenario A, but they have proposals

1 and 2; is that right?

MR. CESSNA: Correct.

MR. McDOWELL: We were not able to analyze every one of the proposals. So the ones that we have analyzed and have scenarios for, we have labeled them A, B, C, D, et cetera. We will mention the ones we did not analyze as we go through here.

JUDGE PALMER: If I look at something from Agri-Mark, and they have more than one proposal, this would be all their proposals together as Scenario A?

MR. McDOWELL: No, sir. Just as we said, this is the scenario that Agri-Mark proposed dealing with the make allowances.

JUDGE PALMER: Oh, make allowances.

MR. McDOWELL: I think it will become clear as we move through here.

JUDGE PALMER: Good enough.

MR. CESSNA: If you go to the next page. I think it will explain what he is talking about there. You can see, if you look at Scenario A, go down that column and you can see the changes that are made relevant to

Scenario A. And you look at Scenario B, and you can see the changes that are relevant to Scenario B and work your way across.

Scenario H was a little different, it is concerned with a separate butterfat price. And that didn't fit neatly into the table. So the changes there are explained down at the bottom of the table, you will see Scenario H there.

JUDGE PALMER: Did you use any kind of software thing for this? It would be helpful to the parties in trying to analyze it themselves. Or did you have to create your own program to put these together?

MR. CESSNA: These scenarios were analyzed using the SAS, the SAS software.

JUDGE PALMER: What is it called?

MR. CESSNA: SAS, S-A-S. Statistical Analytical System, somebody said. I wasn't sure exactly what it stood for.

JUDGE PALMER: Go ahead, sir. I am sorry.

MR. CESSNA: Okay. Now, if you look at Table 3, what we are looking at are the results for these scenarios, and these are

summarized results. What we have are nine-year averages. So we have the Agri-Mark proposal, we can look down the column and see the changes relevant to the over nine years these scenarios that are modeled.

And you will see that across the page, A through J. There are two pages to that table. pages 5 and 6.

Okay. So I am going to be working through on page 7, and I will talk about the scenario we have at the top of page 7. That is Scenario A. And what we did there is we analyzed the proposal that Agri-Mark has to amend the manufacturing allowances based on record evidence that may include the most current plant cost survey information available.

What we did there is -- since the interim final decision, CDFA has published some more manufacturing information, and we were able to use that and work that into the scenario.

JUDGE PALMER: I tell you. I have gone back to page 5. I am a little confused. I don't know if anybody else is. It says at the top, "Nine-year averages, 2007 through 2015."

I am not quite sure -- for example.

if I look at Agri-Mark, Class I, under the A. Agri-Mark and it says Class I, it says 0.00. There would be no change there, I take it, from the baseline; is that right?

MR. CESSNA: No change for the baseline and that is on average. There could be a change year by year. But if you took a nine-year average of all the changes, it would be zero.

JUDGE PALMER: But the nine-year averages are looking forward?

MR. CESSNA: Are looking forward.

JUDGE PALMER: How would you know the numbers for, let's say, the year 2015?

MR. CESSNA: That is what our model is projecting.

JUDGE PALMER: All right.

MR. CESSNA: Our model is projecting what the number is, change from the baseline.

JUDGE PALMER: These are all forward projections. Averages now are not averages of past years, these are averages of projected years?

MR. CESSNA: Right, averages of projected years. Now, the detail about this is in the table, in Appendix A. If you look year by year, you can see in Appendix A what is going on.

JUDGE PALMER: Okay, sir.

MR. CESSNA: All right. So back to an explanation of Scenario A, we got new information that was from the CDFA. We also got more up-to-date information that NASS has about what cheese production, nonfat dry milk, butter and whey, what those productions are in California and what they are in the U.S.

So we have got new manufacturing allowances that we can use for California, and we also can weight them with new data that is available from NASS. All right.

So what happens when we -- if you go to page 8, you can see the new calculations of the make allowances, if you use that new CDFA information and if you use the new weights. And so we come up with these make allowances for this scenario using that method.

So what happens is we have small variations from the baseline forecast. There is

a slight decrease in the protein and the nonfat solids prices. And there are lower skim prices across all classes. We have a resulting average of .O1 per hundredweight, a penny per hundredweight decrease in the Federal Order blend price. A penny per hundredweight decrease in the Federal Order blend price.

JUDGE PALMER: That is b-l-e-n-d, blend.

MR. CESSNA: And over the nine-year period, there is no change in the all-milk price.

JUDGE PALMER: There is no change in the what price?

MR. CESSNA: In the all-milk price.

JUDGE PALMER: All, a-l-l, milk price, okay.

MR. CESSNA: All-milk price. Down at the bottom of the page, you'll see there was a proposal to amend the Class III and IV product pricing formulas annually based on an annual manufacturing cost survey of dairy product manufacturing plants.

We didn't see a way to analyze this

proposal. It would depend on what the surveys would say into the future. So we didn't do an analysis for that particular proposal.

All right. Now, if you go to page 9, you can see at the top of the page, there was a proposal from Agri-Mark to adjust the protein price to reflect the lower price for whey butter. And in that case, there was no specific adjustment that was requested in that proposal. and we didn't have data to be able to perform an analysis relevant to that proposal. So we didn't do an analysis of that one.

The next one you see is the proposal to lower the adjustment to the barrel price containing the protein price formula from 3 cents to 1.5 cents. Now, International Dairy Foods Association has a similar proposal that would adjust -- that would eliminate the 3 cent adjustment to the barrel price altogether. So we didn't see a need to run scenarios for both. We ran a scenario only for the IDFA proposal.

The next one was a proposal to use a combination of NASS and CME prices to determine the cheese price to be used in a Class III and IV product price formula.

In that case, that proposal was designed to have -- it was intended to align the Federal Order milk prices more closely with the CME prices. It wasn't designed to raise or lower on average what the prices would be, so we didn't see that it was necessary to analyze that proposal with our model.

The next proposal we have is from Dairy Farmers of America. There was a proposal to change the butterfat yield factor to 1.215, and this proposal was very similar to a proposal from Dairy Producers of New Mexico. Dairy Producers of New Mexico is proposing to change the butterfat yield factor to 1.211, very similar proposal. So we only analyzed the one from Dairy Producers of New Mexico.

Down at the bottom of the page, there is a proposal from the Dairy Farmers of America and Northwest Dairy Association. Now, this proposal is to remove the barrel cheese price as a component of the protein price formula.

And what we did first there, we looked at, what has the average of those prices. of those prices have been going from 2000 to 2006? If you eliminated the barrel price, how

much would the difference be on average? We found that the difference is almost a penny. .0087 per pound, $.0087 per pound.

JUDGE PALMER: Help me out also with the math on that. In terms of a penny. what is that, what proportion of a penny is that?

MR. CESSNA: It is about .87, .87, 87 percent of a penny.

JUDGE PALMER: Eighty-seven percent of a penny, okay. Good enough.

MR. CESSNA: So we did a statistical analysis of that difference, the difference on average, if you took the barrel out. And we found that that is a statistically significant difference, if you eliminated the barrel from the cheese price.

Okay. So what we did is we took that difference and we plugged that into our pricing formula to see what would happen in the model. And we found that what happens is you directly affect the protein price. You lower the protein price, and this, in turn, lowers the Class I and Class III prices.

With the lower milk prices, the milk

supply contracts, dairy product prices rise. You end up getting an average decline, this is over the nine-year period, 3 cents per hundredweight in the Federal Order blend price and 2 cents per hundredweight in the all-milk price. And there is a slight decrease in marketings over the projection period.

Okay. Now, I think you wanted to talk briefly about the way we approach the scenarios for Dairy Producers of New Mexico.

MR. McDOWELL: What we did with this set of proposals, it was a long set of proposals, and we tried to address the proposals in such a way that you could see incrementally what some of the changes were.

In particular, there were two sets of yield factors that were proposed. We ran one of those scenarios separately and then combined them up. So we have some combinations there. That is how to sort of proceed with that.

Additionally, we had some questions concerning the results after they were out. And so we decided that we would try to run some additional comparative type runs, and so that is, in essence, what Appendix B is. So we will

get through this set first and then address some of them in Appendix B.

MR. CESSNA: Okay. First of all, if you look down about the middle of page 10, you will see the proposal to amend the protein yield factors. This would increase the protein yield factors in the formulas.

And what happens if you increase those protein yield factors is the Class III and Class I prices go up, and with the increase in milk prices, milk production goes up. And with -- and the increase in milk production, the product prices go down, because you have a -- you don't have as tight a milk supply as you did before.

And so you have got, with the product prices going down, your Class II prices and Class IV prices are going down. So you have some offsetting effects there.

So, let's see, we have got average increase of 7 cents per hundredweight in the Federal Order blend price and 5 cents per hundredweight in the all-milk price. The Federal Order Class I falls by 18 million pounds, marketings increase by 132 million

pounds in the Federal Orders and 191 million pounds in the U.S. on average and that is over the nine-year projection period.

Okay. Now, at the bottom of that page. page 10, there are proposals to change the yield factors for butterfat and nonfat solids. There was a proposal to do that.

Well, what we have done there is we have taken what is in Scenario C and we have added to it the yield factor proposals for the butterfat and the nonfat solids and that is added to it for Proposal D.

And what plays out here is that there is an inverse relationship between protein and butterfat in our Federal Order formula. And that is worked through in this scenario. And what happens is you get an increase in the all-milk price, and it is 3 cents per hundredweight, but it is not as great as the increase in the milk price from Scenario C, which was 5 cents per hundredweight.

So this reflects the larger decline in the butter price in Scenario D, compared to Scenario C. And all total, Federal Order marketings rise, although Class I and II show a

slight decrease over the forecast period.

JUDGE PALMER: Can I get a definition from you of the "all-milk price"? It is a new term for me. I hadn't heard it used before. What do you mean by "all-milk price"?

MR. CESSNA: What we are talking about for the all-milk price is the U.S. average price. It is the price that the plants pay. FOB the plant.

JUDGE PALMER: So that would be blend price plus?

MR. CESSNA: It is blend price -- well, it is not necessarily blend price plus.

JUDGE PALMER: Howard wants to take a shot at it.

MR. McDOWELL: In the Federal Order area, it is the blend price plus over-order payments.

JUDGE PALMER: Okay. Over-order payments.

MR. McDOWELL: In addition to that, it reflects milk that is marketed outside of the Federal Order system. It is a standard price that NASS reports --

JUDGE PALMER: For the whole United States, a single price?

MR. McDOWELL: That's right.

JUDGE PALMER: Everything is included?

MR. McDOWELL: That's right. All grades.

MR. CESSNA: All grades of milk.

MR. McDOWELL: Let me interject one statement here. The reason why it is relevant is that the manufactured dairy product market is national, and the Federal Order system is working off of manufactured dairy product prices. So we need to account for a national market in order to generate these prices, in order to analyze the effects on the Federal Order system.

JUDGE PALMER: I understand. Go ahead. I apologize for interrupting, but I wanted to clarify it in my mind, because I had not heard the term before. Go ahead.

MR. CESSNA: Okay. Dairy Producers of New Mexico has a proposal to change the butterfat yield factor to 1.211. They claim that an error was made in the formula that is

currently used by USDA for the butterfat price. And so we plugged this into the model.

What we have, we have offsetting effects here. The increase in the butterfat yield factor increases the butterfat price, and it lowers the protein price in the Federal Order formula.

While the Class II and the IV prices rise. Class I and III prices fall. So you have got offsetting effects. There is no change in the Federal Order blend price, and we actually have a 1 cent decrease per hundredweight on average over the period in the all-milk price.

All right. The next proposal was the one to use the CME pricing series for cheese. butter and nonfat dry milk.

What we did there is we looked at what have the CME prices been for the years 2000 through 2006. And we got an average of what they have been over that time period. And then we compared the average with the NASS weighted average prices, as we are currently using them in our formulas. You can see down there toward the bottom, for cheese, butter, nonfat dry milk, you can see what the differences are.

And what we did is we did some statistical analysis to find out, are these differences significant And we found that the cheese, the difference in the cheese price, we were not able to determine that there was a significant difference between the CME and the NASS price over that period

Now, for butter, you can see -- well. for cheese, you can see it is about half a cent. you know, and that did not appear significant with our statistical test

For butter, the difference is almost 2 cents And our statistical tests come out that that is a significant difference, and that for nonfat dry milk, it is almost 4 cents, and so that is statistically significant

Okay We plugged these differences into our model, and what we get there is. in the protein price formula, the increase in the butterfat price more than offsets the increase in the cheese price, and that causes the protein price to fall

The Class III and I prices fall, and that offsets the increases in the Class II and IV prices The Federal Order blend price rises

by an average of 3 cents per hundredweight, but the average all-milk price is unchanged over the nine-year period.

One thing that we are not able to determine is what would happen in market behavior if the Federal Order system were to start using the CME prices. It is possible that there could be some more activity on the CME that there would not have been before, and maybe we wouldn't see these differences exactly like we have seen since 2000 through 2006.

Okay. At the bottom of page 12. we start to talk about a proposal to establish a separate --

MR. McDOWELL: Did you get G?

MR. CESSNA: Oh, did I skip one? Okay. Let's talk about Scenario G, in the middle of the page.

This is a proposal to amend the manufacturing allowances to match the average weighted average total costs by the Cornell study.

There, we have got, you can see in the middle of the page what the make allowances would be, if you used just for the Cornell

study. And we have got some declines in what the make allowances would be.

Now, for the nonfat dry milk, what they are proposing that we use is the nonfat dry milk cost. plus $.088 per pound. Okay. That is for whey. Did I say that wrong? That is for whey.

Okay. Now, we plug these make allowances into the model. When we do this, we get lower make allowances, resulting in higher minimum milk prices. And producers respond to the higher prices by increasing marketings an average of 255 million pounds, and this results in lower dairy product prices.

Butter has the largest decrease in price, nearly 4 cents a pound, and Class II and IV prices at tests fall due to their relatively high butterfat contents. The all-milk price on average, it rises by 7 cents per hundredweight over the projection period. That is on average.

Okay. And then Scenario H, we start to talk about that at the bottom of the page. And in that case, what we have done is we have -- this is a proposal to have a separate butterfat price for Class III that differs from

Class IV.

And if you -- I think it would be probably best to go back to -- let's see here. Go back to page 4, Table 2, and what we have done there is we have got the same make allowances and yield factors in this particular scenario, but there is a separate Class III butterfat price that is computed, as you see there at the bottom, and then we have a protein price that is calculated differently than in our current formulas.

One thing that was not clear -- go ahead.

MR. McDOWELL: In essence, what was proposed was to pull apart the protein price formula, take the butterfat adjustment out of it, so you had the protein alone, the butterfat alone, and the factors that were involved in the adjustment dealing with that coefficient 1.17. that all just disappears. So that is, in essence, what is taking place here.

MR. CESSNA: Okay. There was a little bit of ambiguity in this proposal. And it wasn't clear what to do about the advanced pricing. It said use the butterfat price, is

what is in the proposal language. Well. the butterfat price, it could be the Class III butterfat price or the Class IV.

So what we have assumed here is that we have got -- if a Class IV price is higher than the Class III price, we are going to use the higher of, we are going to use the higher of Class III or IV price in determining which butterfat price to use in the advanced pricing.

All right. So let's flip to page 13, and you can see about the middle of the page the proposal has the primary effects of lowering the protein price and raising the butterfat price using Class III pricing. So we have a lower protein price, higher butterfat price for Class III.

Over the nine-year period, the protein price falls by about 53 cents per pound on average. The Class III butterfat rises by an average of about 36 cents per pound on average over that period. The overall effect is a decrease in the protein price that more than offsets an increase in the Class III butterfat price. So you have got lower milk prices, the milk supply decreases and dairy product prices

increase.

We have higher butterfat and nonfat solids prices, this results in the higher Class II and IV prices, the all-milk price falls by an average of 18 percent hundredweight, the producer revenue on the average, this is average per year over that nine-year period, $447 million per year decrease.

Okay. And then Dairy Producers of New Mexico had a proposal to use enhanced NASS surveys. Well, this was a proposal that concerned information gathering and there was no economic analysis that was relevant for this proposal.

All right. On the next page there were proposals by International Dairy Foods Association, IDFA. There was a proposal to adjust the protein price formula to reflect the lower value in reduced volume of butterfat recoverable as whey cream. There was not a specific adjustment that was proposed. There was not data available for us to be able to perform an analysis for that proposal.

The next proposal was a proposal to eliminate a 3 cent barrel price adjustment

containing the protein price formula.

Now, this would lower the average cheese price that is in the protein price formula, and we come up with a difference of -- it is 1.69 cents per pound on average.

So what happens there, if we eliminate that 3 cent adjustment, the Federal Order price falls by 5 cents per hundredweight. the all-milk price falls by 4 cents per hundredweight. Total marketing is declined slightly, and this tightening results in increased dairy product prices over the projection period. The higher dairy product prices result in a small decrease in the demand for manufactured dairy products. And with a decrease in the Class I price, there is a small increase in Class I use.

Now, one thing that is interesting about this is that the 3 cent adjustment, the 3 cent adjustment is about twice the magnitude as if you just took barrels out altogether out of the formula, which was the other scenario. Scenario B. So we have got about twice the magnitude of that Scenario B with this.

And the change in the formula, of the

change that we worked into the formula results in about twice the changes in all the impacts. it is about twice the change in all the impacts.

All right. Down at the bottom of the page, it talks about a proposal by Maine Dairy Industry Association, and this proposal would be an incorporated factor to account for any monthly spread between component price calculation for milk and a competitive pay price for equivalent grade A milk.

And in this case, this would involve a new survey that doesn't exist at this time. and we didn't see a way to analyze this proposal.

All right. If you go to page 15. we discuss the proposal that National All-Jersey has to eliminate the other solids price altogether in the formula and add the equivalent value of dry whey to the protein price formula.

And what you see there in the middle of the page, there is a lot of math there. And what it shows there is that what happens to the Class III skim milk price is that there is no really change in the Class III skim milk price. We have taken the value, some of the value of

other solids, now it is in the value of protein. So for Class III skim price, there is no change. For that reason, our econometric model was not appropriate for this proposal.

So what we have done here is we have done some analysis with some spreadsheets to kind of show what this proposal would do.

Now, what we would expect from this would be some distributional effects. We would have some distributional effects. Where some producers would gain from this proposal, other producers would lose from this proposal.

So if you go to the next page, on table 16 -- Table 5, page 16, and look at the top, there are some product prices there, and then there is what the new product prices would be under the National All-Jersey proposal.

So that gives us something to plug into our spreadsheet for these -- we have got five producers that we have here.

Now, this scenario and our Federal Order formulas assume kind of a standard level of protein and other solids in producer milk. And those standards are 2.99 for protein and 5.69 percent for other solids.

Now, for a producer that has protein and other solids at the standard levels as Producer 1, there is no change in what he -- in the component value, and protein and other solids value that he received.

For Producer 2, Producer 2 has a protein that is above the standard, but has other solids that are at the standard. And in this case, this producer would gain about 4 cents per hundredweight with this spreadsheet that we have worked here.

Producer 3 has protein that is below this standard 2.99, and this producer would lose 4 cents per hundredweight.

If you go to the next page, you see just the opposite kind of effect with the other solids. We have got a Producer 4 has other solids that are above this standard level, and so that producer has a gain, where the Producer 5 has other solids that are below the standard. and that producer actually sees a gain from that. Did I say that right? It is a loss on Producer 4. Producer 4 has a loss, Producer 5 has a gain.

Now, it is going to be rare that a

producer has exactly the standard on either the protein or other solids. And so what plays in here is what the protein value is relative to the other solids, because he is losing that other solids value, but gaining on the protein.

Okay. The next proposal is a proposal by National Milk Producers Federation. And it is a proposal to incorporate a monthly energy cost adjuster in computing the make allowances.

Now, this energy cost adjuster would be based upon Producer Price Indices for electricity and natural gas. And I did some checking into what was available on the U.S. Department of Energy site, and I found some baseline forecasts that the Department of Energy, the Energy Information Administration had for energy pricing.

And what I did is I looked over the historical period, I compared the Producer Price Indices to what these energy prices are that are reported at this site for the Energy Information Administration, and if you look on page 18, you will see some regression results.

As you would expect, these Producer

Price Indices for electricity and natural gas are very highly correlated with these reported natural gas and electricity prices that are reported by the Energy Information Administration, EIA.

So where this will come into play. this allows us to project what these Producer Price Indices would be, based on the baseline that the Department of Energy has.

Okay. Now, if you look there in the middle of the page on page 18, you will see what the make allowance adjustment that is being proposed by National Milk Producers Federation is.

So what you end up having is you would have energy cost adjustments that would reflect the percentage increases in the Producer Price Indices.

Okay. So if you go to Table 8, what I've done there, you can see what the historical values are for the prices, and the historical values for the Producer Price Indices, and you can see what the forecasts are based on these prices by the EIA, and that is using the regression analysis on the previous page.

Okay. And then you can see graphically on page 20 how this turns out.

Okay. Now, if you go to page 21. what I have done here, we have got the CDFA data for 2004 in Table 9. And what we have to do to get a consistent set of data is the Cornell study has data that goes from July 2004 through June 2005. It roughly goes from there. There are some plants that reported areas before that and some after that.

So we have got to get a common base period that is consistent, adjust the CDFA data from this 2004 period to a 2004 to 2005 base period. So that is what is done going from Table 9 to Table 10.

Then if you go to Table 11 on page 22, what we do there is plug in the make allowances that are adjusted for that time period difference for CDFA, plug those in, and come up with effective make allowances for the base period.

So we have got -- so we have make allowances that are a little higher for the base period than what is in the interim final rule.

Okay. Now, if you go to page 23. I

know this kind of gets involved, but I had to go step through step to get to this point If you go to page 23, we didn't have Cornell energy prices available We didn't have an energy price available for electricity and for fuels. so what we did was we assumed that for the U S , it was the same proportion as for California So that is what we have done in Table 12

So that way, we could come up with some base period make allowances that would correspond to July 2004 through June 2005

If you go to page -- if you go to Table 13 on page 24, you will see the base year that has the make allowances, it has the cost per pound for electricity, for fuels and the effective make allowance for those base periods

Then we can use our Producer Price Indices that have been forecast, and we can forecast annually what these costs per pound would be and what the effective make allowances would be under this proposal

Then the next thing that we did, we took all the make allowances that we had -- effective make allowances that we had come up with and plugged them into the model to get some

annual results.

Let's see, if you go back to page 20. you will see down at the bottom of the page, an econometric analysis was performed for this proposal. It is labeled as Scenario J.

What happens is the change in the make allowances are very small on average, there are some changes over time, but they are very small on average. And they round to a tenth of a penny for each product on average. The average changes in the all-milk prices are zero -- actually, on average, there are no changes in any of the milk prices, in any of the Federal Order milk prices and the all-milk price.

Now, if you look in Appendix A, you will see that each year, there are some changes, but they are small and they round out to zero over the nine-year period.

Okay. So those are the analyses in this -- what do we call this?

MR. McDOWELL: Exhibit 7.

MR. CESSNA: This is called Exhibit 7. Exhibit 7. Okay.

MR. McDOWELL: Now we are going to

7-B.

MR. CESSNA: Right. Now we will talk about 7-B. You'll need to get Appendix B to take a look at that.

Okay. For Appendix B, what we have done is we have combined scenarios that are for Dairy Producers of New Mexico. We have got three scenarios, and Scenario K, we have combined all the proposals that are in -- that are covered by the yield factor changes, which is Scenario D, the use of the CME price series. which is Scenario F, and make allowance changes in Scenario G. So we have got a combination of those, and that is what K is.

And L, in Scenario L, what we have done is we have just changed the yield factors. the yield factors that are proposed by Dairy Producers of New Mexico.

MR. McDOWELL: Wait just a second. I want to interject here just a little bit in terms of what we are doing.

With the Class III butterfat price not broken out, which is involved with Scenarios D, F and G, we wanted to do a similar set of runs with the butterfat price broken out

separately. So that way, we have got comparable runs with the two different butterfat situations. So that is what we are comparing here.

And hopefully, it will shed a little more light in terms of how these different proposals interact with each other and in total. So keep in mind Scenario H, because it is comparable to which one?

MR. CESSNA: Scenario H -- well, it is --

MR. McDOWELL: Comparable to L?

MR. CESSNA: Comparable to -- well, Scenario H is comparable to the baseline.

MR. McDOWELL: Yeah, right.

MR. CESSNA: Scenario H is comparable to the baseline. We didn't change any yield factors or anything, so we have got something that is comparable to the baseline.

MR. McDOWELL: Right. Okay.

MR. CESSNA: Okay. Now. Scenario L is comparable to Scenario D, because there we have got yield factor changes, we have got yield factor changes. But in Scenario L, we have got yield factor changes and a separate

Class III butterfat, separate Class III butterfat.

With Scenario M, we have all the changes proposed by Dairy Producers of New Mexico, including the separate Class III butterfat.

So we did two sets of comparisons here. If you look at Table B-2 -- let's see. no. B-3, which is on page B-4, you will see that here we have got comparisons of K, L and M to the baseline.

Then if you go to Table B-4, you have got the baseline -- you have got another -- you have H compared to the baseline and you have got L compared to D and M compared to K. So we have got -- so we have got similar proposals that we are comparing here.

Okay. So what are the changes here? If you look on Table B-2, with Scenario K, what you can do is you can add up all of the changes for Scenario D, F and G, and you get almost the same thing that is in Scenario K. It is almost -- if we hadn't run Scenario K and we had just added up those, the impacts of those scenarios, we get almost the same thing that is

in Scenario K.

So we show that if we adopted all those changes, it is the sum of all those different proposals, we end up getting the same thing, as when you combine them all.

Okay. Now, with Scenario L, let's see, with Scenario L, the average Class I and III prices, this is on page B-1, if you look at page B-1, average Class I and III prices of 3.5 percent butterfat fall by 6 cents per hundredweight, and Class II and IV prices at 3.5 percent butterfat rise 38 cents per hundredweight.

Now, it may appear strange at first glance the Federal Order blend price falls by 20 cents and that is more than any of the class prices. So we have the blend price falling by more than any of what the class prices are falling.

Well, this can be explained by allocation. We have a different allocation. As the Class II and IV prices rise, Class II and IV use falls by 135 million pounds and 198 million pounds respectively.

As the Class I price falls. Class I

use rises by 77 million pounds, and for Class III, the price falls and Class III use also falls by 27 million pounds.

So we have a strange situation where we have got some class prices going up and we have the blend price falling more than any of the class prices.

Okay. Now, with Scenario M, that is throwing everything in that Dairy Producers of New Mexico has proposed, it is really hard to disentangle the effects there, because you have got so many things that are working together.

And there again, we have a strange situation. We have got all the prices going up relative to the baseline, all the class prices going up, but the blend price goes down. And again, what we have is we have some re-allocation, Class I, II, III and IV, that is causing that to happen.

Okay. Now, if you go to Table B-4, you will see the comparisons where we have got Scenario H compared to the baseline. Scenario L compared to D and Scenario M compared to K. In that situation, you can look through there and see that you have similar results in all those

proposals, you know, if you go comparing all of those different scenarios.

All the directions are the same. For example, Class I price goes down, Class II price goes up. Class III down, Class IV up. The blend price goes down. You can go through and the directions are all the same. But you have bigger impacts in that first comparison than you do in those other two comparisons.

So I guess that is about all I have to say about those.

MR. McDOWELL: I think that is it.

MR. CESSNA: Okay. So I guess we are ready for questions and I will defer those to Howard at this point.

DIRECT EXAMINATION (BY MR. STEVENS)

MR. STEVENS: Before you get to that, let me do one thing. Garret Stevens, from the Office of General Counsel.

I just want to reiterate what Howard said, maybe both of you, in his statement. Let me get to it in a minute. Howard testified to this, and, Jerry, you tell me what your position is on this. He testified that his appearance today is not in support or in opposition of any

proposal, and the analysis that he has discussed should only be interpreted as what the possible impacts -- and I want to get it right -- could be, would be? What was your -- do you remember your statement on that?

MR. CESSNA: I don't think we could say "would be."

MR. STEVENS: So might be?

MR. CESSNA: That is what we think are likely results, that they would be in this ballpark.

MR. STEVENS: And that would be the possible impacts, should a proposal, any particular proposal be adopted?

MR. CESSNA: That's correct.

MR. STEVENS: Okay. In no way is this analysis to be construed as addressing the merits of any of the proposals.

In other words, it is a predictive document, a document which seeks to predict the future, as best can be done in what you fed into it.

MR. CESSNA: Right.

MR. STEVENS: But it doesn't address the merits of any of the proposals.

whether they should be adopted or not?

MR. CESSNA: That's correct.

MR. McDOWELL: That's correct. I agree.

MR. STEVENS: That is your testimony, is it not, Dr. McDowell?

MR. McDOWELL: That's correct.

MR. STEVENS: That is all I have. And I guess they are subject to cross-examination at this point, Your Honor. I offer the witness.

JUDGE PALMER: Come up to the microphone.

MR. YALE: Kind of a follow-up of what Mr. Stevens and what the report is, this is on behalf of Dairy Producers of New Mexico and the others are in support. In light of the fact of the fantastic job you guys did, our analysis was suggesting something else. Yours gave us the insight of a major shift in allocation from higher value to lower value products that had a negative impact, not just on producers but the industry, with the separation of the III and IV butterfat.

Because of that analysis that you

have done, and we now have had a chance to review that, we are not going to propose or support the proposal to separate the III and IV because of that work.

And I apologize you did the work. But it was because you did the work that we came to the position that we did; and it is much better to have done that now, before we went through the whole hearing assuming one thing and then have an economic analysis suggested.

JUDGE PALMER: Which proposals?

MR. YALE: Just the one that's on separating III and IV, and that is Proposal 4.

JUDGE PALMER: So you are withdrawing that?

MR. YALE: We are withdrawing Proposal 4 because of the work, the analysis you did. I know you did a tremendous job and we appreciate that. But that's the fruit of it, is it shows something going on that we could not have done with our simple models. We appreciate that dramatically. Thank you.

JUDGE PALMER: Very good. There is a discussion going on off the record for a

second.

MR. YALE: The question is, if we withdrew the separate III and IV, H and then I think it is K through -- or L and M would then be --

MR. CESSNA: H, L and M.

MR. YALE: Of B and A? Of Appendix A and Appendix B.

MR. CESSNA: Well, Scenario H is in Exhibit 7, and in Exhibit 7-B, that is L and M.

MR. YALE: But it is a tremendous service that you have done, we appreciate that very much. So it would be H, L and M.

JUDGE PALMER: Are withdrawn?

MR. YALE: Well, they are not going to be relevant, unless somebody else has something. But they are instructive, because it does tell the industry the impact of having that policy decision of a single class butterfat.

JUDGE PALMER: Questions? Yes. sir?

CROSS-EXAMINATION (BY MR. ROSENBAUM)

MR. ROSENBAUM: Hi, Steve Rosenbaum

from the International Dairy Foods Association. I guess I will just ask a question and y'all can decide who will answer it, although sometimes that ends up being -- no one wants to answer it.

But anyway, I have some questions about the baseline material. So Exhibit 8, if I could ask y'all to pull that out, and page 4 is where I have some initial questions.

JUDGE PALMER: Of which one?

MR. ROSENBAUM: Eight. Now, my understanding is that USDA has an existing baseline projection through 2015, correct?

MR. CESSNA: That's correct.

MR. ROSENBAUM: Except for adjusting that to reflect the newly adopted make allowances, the baseline you are working off of for the analyses that you presented today are the same as the underlying USDA baseline; is that correct?

MR. CESSNA: That's correct.

MR. ROSENBAUM: I take it that baseline is used for purposes other than Federal Order analyses, correct?

MR. CESSNA: That's correct.

MR. ROSENBAUM: On the Table 2,

there are a series of items relating to the milk supply. I want to make sure I understand how these -- how these operate, at least in a general sense. I take it that in your projection, in the underlying baseline projection, you have made certain projections regarding what you believe the all-milk price will be through 2015, correct?

MR. McDOWELL: The process of putting together the baseline is done by a committee. And so the baseline is not a forecast in a strict statistical sense. It is a plausible trajectory of quantity and prices. Okay.

So with regard to how our model works, these are our equations, but we have to true up to what the baseline is. And so, when we do our policy analysis, we are looking at changes off the baseline, and that is what works through these equations.

MR. ROSENBAUM: Okay. All right. But I take it your baseline would, for example have some projection as to all-milk price. correct?

MR. McDOWELL: It does.

MR. ROSENBAUM: And also some projection as to feed value; is that right?

MR. McDOWELL: It does.

MR. ROSENBAUM: What is feed value, for these purposes?

MR. McDOWELL: NASS publishes a milk/feed price ratio. And the commodities used for that feed price, that feeds into that ratio are corn, soybean meal, I think soybean meal and hay.

MR. CESSNA: Alfalfa hay.

MR. McDOWELL: What we do is we pick off from the baseline that deals with those other commodities, those prices, and in the same proportions that NASS uses to create the price and that is what we use.

MR. ROSENBAUM: Okay. And you are, therefore, able to determine what impact a change in the relationship between the all-milk price and the feed value will have on the number of cows, is that what this is showing?

MR. McDOWELL: Yes, yes.

MR. ROSENBAUM: And the price elasticity there of .025, could you just, so I understand it. a .025 -- let me start that

again. A .025 change in what will result in a -- let me put that differently.

A 1 percent change in what will result in a .025 percent change in what? If I stated that correctly.

MR. McDOWELL: A 1 percent change in the milk/feed price ratio will result in a .025 percent change in the number of cows. short-term.

MR. ROSENBAUM: Okay.

JUDGE PALMER: Meaning that the more feed costs, the less cows you are going to have? Is that right, is that a simplification of how it works?

MR. McDOWELL: That works.

MR. ROSENBAUM: Or is it, the higher the feed cost as a percentage of the all-milk price, the fewer cows you will have?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: And you are tracking that in terms of number of cows in the top portion of Table 2, as I understand it, but then you have a separate track for year-over-year change in milk per cow? You have "all-milk price over CPI all." Can you explain

for me what that is capturing.

MR. McDOWELL: In the milk per cow, right?

MR. ROSENBAUM: Yes.

MR. McDOWELL: Notice that the -- is this whole thing lagged or is it just --

JUDGE PALMER: You can leave their conversation off and let them talk.

(Thereupon, a discussion was held off the record.)

JUDGE PALMER: Now Mr. McDowell will answer.

MR. McDOWELL: The lag applies to the all-milk price here on the milk per cow, but it is the current year feed value that is in action there. So we broke that up a little bit and improved the fit.

MR. ROSENBAUM: All right. You have a parameter feed value over CPI all. correct?

MR. McDOWELL: Oh, the CPI is a deflator.

MR. ROSENBAUM: I see.

MR. McDOWELL: It is getting it into constant dollars.

MR. ROSENBAUM: Okay. Well, then tell me what -- you have two price elasticities here, which are the same, except for one is negative and the other isn't. Can you just explain what those two are, what they are capturing?

MR. McDOWELL: The first one says that if an increase of 1 percent in the all-milk price takes place, in the following year, there will be a .036 increase in the milk per cow.

Similarly, with respect to feed value, if a 1 percent increase in feed value takes place, in the current year, there will be a negative .036 percent change in the milk per cow.

MR. ROSENBAUM: So the first of those is capturing what the impact is of milk production per cow as the milk price changes. and the second is capturing what the milk per cow output is as a reflection of changes in the feed value?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: And in both cases. you are eliminating general inflation by dividing it over a CPI all?

MR. McDOWELL: Yes.

MR. ROSENBAUM: If you could turn then to the next page, Table 3, we now have some, among other things, some elasticities for various products, correct?

MR. McDOWELL: That's right.

MR. ROSENBAUM: With respect to U.S. fluid milk, the first entry for which you have a parameter that has a corresponding elasticity is Class I price at fluid test, plus over-order premium, over CPI all, correct?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: Once again, the "over CPI all" is simply a way to eliminate general inflation?

MR. McDOWELL: That's correct.

MR. CESSNA: That's correct.

MR. ROSENBAUM: Now, tell me what you are showing here, a 1 percent increase in the price of what results in a negative .048 of what?

MR. McDOWELL: Well, what we are looking at here is the price of milk as delivered to plants. And so we are estimating that price to be the Class I price, the Federal

Order Class I price at test, plus the over-order premium.

So 1 percent increase in that price will result in a .048 decline -- am I getting this backwards? Increase in price will result in a decline in the quantity demanded of milk.

MR. ROSENBAUM: And the price that you are tracking in that analysis is the price at the plant level, correct?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: But is the assumption that that simply is passed on dollar for dollar at the retail level, with no markup?

MR. McDOWELL: No, we assume that there is a markup; and it has generally been the case that you would construe an elasticity at the plant level to be approximately half of what the elasticity would be at retail.

MR. CESSNA: Can I say something?

MR. McDOWELL: Yes.

MR. CESSNA: Okay. We don't have a retail price in the model. We don't have a retail price in the model. And we used the Class I price at fluid test plus over-order

premium. There is no retail price in the model.

Now, what we -- we show a retail price in our tables, and that is assuming constant margins. But we are not -- it is not affecting the outcome of the model.

MR. McDOWELL: We are focusing on milk markets at the plant. So when we focus, when we focus with this Class I price, this is what is directly related to the value of pooled milk. And so what we do is estimate changes in retail prices, given changes in this FOB plant price.

MR. ROSENBAUM: Do I understand. based upon your previous answer that, in effect, the model assumes that at the retail level a 1 percent increase in the price of fluid milk results in a negative 0.96 percent decrease in fluid milk sales?

MR. McDOWELL: That would be an approximation. That is a rule of thumb that economists have used for a long time, that the plant level elasticities for raw product are on the order of about half of what the retail price elasticity is.

MR. ROSENBAUM: And you had

mentioned that you had consulted with some other economists on questions of elasticity.

Was one of the ones you consulted about the elasticity at the retail level of fluid milk?

MR. McDOWELL: Yes. I generally run between -- ours is on the low side. You see them at .10, you see them at .11, some of them are at .12.

MR. ROSENBAUM: Have you seen some higher than that too?

MR. McDOWELL: I have seen some higher than that, but not with annual data.

MR. ROSENBAUM: And then for butter, tell me what the elasticity -- before I get into butter, still on fluid milk, on per capita disposable income, a 1 percent increase in per capita disposable income results in a .278 percent increase in consumption?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: Just the concept that as people become wealthier, they can buy more fluid milk, is that the idea?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: And for butter --

well, so I don't have to keep asking these questions repeatedly, every time you divide by a CPI of some kind or another, you are simply trying to eliminate the influence of general inflation, correct?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: So I won't go through those time by time. For the butter price, it is a 1 percent increase in the butter price at what level results in a negative .033 percent decline in, I assume that is in butter consumption?

MR. McDOWELL: These are wholesale prices. We are trying to remember that we are trying to estimate NASS prices.

So this would be -- these are wholesale dairy product prices. So the demand would be at the wholesale level.

MR. ROSENBAUM: Okay. And if you could turn to page 6, I know you have a footnote that explains this to a certain extent. But it is a little bit dense, at least for me. I don't mean that negatively for you, but hard for me to follow as a noneconomist.

Something like retail ice cream

price, where you don't have a specific elasticity, could you explain how that is computed or implied, however you want to describe it?

MR. McDOWELL: Yes. Most of the equations that we have estimated are estimated in log-log form. The dependent variable is logged, the independent variable is logged, and in that situation, the coefficient estimate is an estimate of the elasticity.

For the ice cream demand, that is a linear equation, the variables are not logged. So in order to calculate an elasticity, we use the coefficient there --

MR. CESSNA: Could I say something about that? The retail --

MR. McDOWELL: Wait, wait a minute.

MR. CESSNA: All right.

MR. McDOWELL: So the elasticity is calculated using the coefficient, the slope variable and the prices and quantities at the means of our data sample that we are working with.

MR. ROSENBAUM: Do you want to add

something?

MR. McDOWELL: No, no.

MR. CESSNA: Okay.

JUDGE PALMER: He did want to add something.

MR. ROSENBAUM: He did. I know. I wish I could do that with my witnesses, "You don't want to add anything." Not my witnesses here. I mean in general.

(Laughter.)

MR. ROSENBAUM: Okay. Let me switch. if I could. to Exhibit 7.

Do y'all have a copy with you of the actual notice of hearing?

JUDGE PALMER: We can give them one.

MR. ROSENBAUM: If you don't, I can --

JUDGE PALMER: We have one here. This is -- do you want the first one or the supplemental?

MR. ROSENBAUM: I think the first one is fine, I think that is all we need.

JUDGE PALMER: Actually, I think they are both there.

MR. ROSENBAUM: My questions are going to be no surprise. I am trying as best I can to equate your scenarios to specific proposals. In some cases, I was able to do that, and in other cases it was a little less clear to me how they lined up. I wanted to just walk through them, if I could. Whatever is easiest for y'all to look at for your scenarios. we can compare those to what has been marked in Exhibit 1, which is the February 9, 2007 Federal Register notice.

Now, as I understand it, correct me if I am wrong, Scenario A is your analysis of Proposal 1, which is simply to update, as I understand it, would be to update the III and IV make allowances to include the most recent CDFA data; is that fair? That is what you were trying to capture?

MR. McDOWELL: You are looking at the supplemental, so we are looking right here.

MR. CESSNA: Okay.

MR. McDOWELL: And then he is asking if that is the Scenario A for Agri-Mark.

MR. CESSNA: Okay.

MR. ROSENBAUM: Am I correct about

that?

MR. CESSNA: Yes.

MR. ROSENBAUM: And Scenario B, as I understand it, corresponds to Proposal 13, which is the proposal to remove the barrel cheese price. I want to make sure that's correct.

MR. CESSNA: That's correct.

MR. ROSENBAUM: And if I understand your analysis, on page 6, what you are showing is the result of that proposal would actually be to reduce farmer income by $47 million a year.

I am sorry, I am now looking at Exhibit 7, which is your Preliminary Economic Analysis, and I am looking specifically at Table 3 of that, at page 6.

MR. McDOWELL: Okay. Now we are with you. Bear with us just a minute. Okay. Re-ask your question, please.

MR. ROSENBAUM: Yes, I am just seeking confirmation that -- well. I think you have already confirmed that your Scenario B corresponds to Proposal Number 13.

MR. McDOWELL: Okay.

MR. ROSENBAUM: And that the effect

of that proposal is a $47 million decline on average in farmer revenues?

MR. CESSNA: That's correct.

MR. McDOWELL: That's correct.

MR. ROSENBAUM: Okay. Now. Scenario C is the first one where I am not sure that there is a direct corresponding proposal, but it appears to me to perhaps be -- well. I will let you, if you could, help me out, if there is any specific proposal to which Scenario C corresponds or whether that is pieces of -- it is a piece of a proposal or what exactly?

MR. CESSNA: Scenario C?

JUDGE PALMER: That would be Dairy Producers of America?

MR. ROSENBAUM: It is one of their proposals, but they have got quite a few. And I am not sure any exactly --

MR. McDOWELL: I am not sure we are able to do that. When the proposals were sent into Dairy Programs, there was a set of proposals from Dairy Producers of New Mexico that dealt with yield factors, both protein and the other solids, dealt with prices, et cetera, and then there was a set that included all those

things with butterfat prices broken apart.

In order to make sense of all of that in a way that we could work with that would also be illustrative, we had to group them differently than was grouped in the hearing announcement. And I regret the confusion, but we could not run -- we were physically unable to run as many proposals as there are in the announcement, so I apologize.

MR. ROSENBAUM: I am not asking for any apologies. I am just trying to be able to follow.

MR. McDOWELL: That is all we can do.

MR. ROSENBAUM: Maybe there -- I see on Table 2 of Exhibit 7, on page 4 of Exhibit 7 for Scenario C, there is a .022 change in the protein yield factor, a .081 change in the butterfat yield factor and a .04 change in the butterfat recovery factor. Are those the three changes that are captured by Scenario C and no other?

MR. McDOWELL: That's correct. Right, what we show in that table is exactly what it is.

MR. ROSENBAUM: And you would confirm, it doesn't, as far as you can tell looking at the notice, correspond precisely to any specific proposal, but rather to concepts that may be reflected in more than one proposal?

MR. McDOWELL: That's correct. What we did was deal with the protein price formula in one swoop. That is how we were dealing with that.

MR. ROSENBAUM: And are these -- are the three changes in yield factors shown in Scenario C entirely a question of a farm-to-plant shrink, or is there more than that or if you know?

MR. McDOWELL: They are the factor of changes as best as we could read the proposal. In the proposal, there were numbers that were different from what the current language was, and so that is what we used, as best as we could match it up. Those are the changes.

So if you see a change there, for example, on the protein yield factor there is a change of .022, that reflects a figure that was in the proposal that would be 1.383. plus a .022

and that is all that is.

MR. ROSENBAUM: So that is .1382 to 1.405, that is what that change reflects?

MR. McDOWELL: I believe it is probably 1.50 -- 405, that's correct.

MR. ROSENBAUM: The butterfat yield factor is --

MR. McDOWELL: Make that addition there and that is what was proposed.

MR. ROSENBAUM: That's the 0.99 going to 1.02, I would think. Or is that not right?

MR. McDOWELL: Let's get this original proposal out.

MR. ROSENBAUM: I think that is it.

MR. CESSNA: I have got the original proposal here. We are looking at the actual proposal from Dairy Producers of New Mexico.

MR. ROSENBAUM: Okay. And the -- but the .081 is added on to what, based upon your review of the proposal? What is the current factor that you are adding?

MR. McDOWELL: It is added to 1.572.

MR. ROSENBAUM: So that takes it from the 1.572 to the 1.653.

MR. McDOWELL: Right, what is listed in Table 2.

MR. ROSENBAUM: The butterfat recovery factor you have got a change of 0.04. What is that added onto?

MR. McDOWELL: 0.90. it's added to 0.90.

MR. ROSENBAUM: So that is the 90 percent to 94 percent butterfat recovery percent assumption; is that right?

MR. McDOWELL: That's right.

MR. ROSENBAUM: Scenario D then, once again. I don't think that corresponds to any specific number proposal. But as I understand it, that starts with the same three changes to protein yield factor, butterfat yield factor and butterfat recovery factor you already discussed in the protein price and makes certain additional changes to the butterfat price and the nonfat solids price.

MR. McDOWELL: Right.

MR. ROSENBAUM: Just continuing on with the kind of question I had before, the

0.020 in the butterfat yield factor is added to what existing number to come up with what new number in the formula, do you know?

MR. McDOWELL: 1.20.

MR. ROSENBAUM: All right. So it is 1.20 up to 1.22?

MR. McDOWELL: Correct.

MR. ROSENBAUM: Now, okay. Was that revised to instead simply go up to 1.215. is that accounted for separately in your analysis?

MR. McDOWELL: That is the --

MR. CESSNA: There is no producer by Dairy Producers of New Mexico for 1.215. They have got one that is 1.211. and one that includes 1.22.

MR. ROSENBAUM: Okay. So D was, Scenario D is going from 1.2 to 1.22.

MR. BESHORE: We could maybe cut out a lot of dialog about the 1.215. The 1.215 factor which is in Proposal 3, DFA Proposal 3, is withdrawn, okay, and will not be presented. They didn't run it anyway. But we don't need -- I am sorry, Proposal 5. We don't need to be concerned with discussing it one way or the

other.

MR. ROSENBAUM: Okay. Thank you. Marvin.

Then on the nonfat solids price, still in Scenario D, 0.03 is a change in the nonfat solids yield factor from 0.99. the current 0.99 to a new 1.02; is that correct?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: Scenario E only reflects a change in the yield factor for the butterfat price from 1.20 to 1.211, correct?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: And I am not certain there is any -- do you know whether there is actually a specific number proposal that does that and nothing else, in terms of the --

MR. CESSNA: I know in Dairy Producers of New Mexico in their proposal they have that. They have a proposal to change it to 1.211. I don't know if there is one in the hearing notice.

MR. ROSENBAUM: Well, I think Proposal 6 both changes the yield factor from 1.20 to 1.211 and at the same time changes the

butterfat recovery percentage from 90 percent to 94 percent. But your Scenario E only captures the first part of that change; is that correct?

MR. CESSNA: That's correct.

MR. ROSENBAUM: Okay. And then Scenario F, I believe, corresponds to Proposal 15, if you could just confirm that for me, which is the proposal to do various things with the NASS series and the CME series. Maybe you could confirm that for me.

MR. McDOWELL: That is CME and --

MR. CESSNA: I believe that's correct.

MR. ROSENBAUM: I believe it is Proposal 15. I just wanted your confirmation.

MR. McDOWELL: Yes.

MR. ROSENBAUM: Scenario -- I think you mentioned this already, Proposal 15 had -- included the proposal to do some additional survey work, but it doesn't actually feed into the price formulas, and for that reason, that part of Proposal 15 isn't reflected in your analysis, correct?

MR. McDOWELL: Right.

MR. ROSENBAUM: You said that

already. Then Scenario G, I believe it corresponds to Proposal 3, which is the reduction in the make allowances, if you could confirm that for me.

MR. CESSNA: That one matches that one.

MR. McDOWELL: Okay. So it is Proposal 3.

MR. ROSENBAUM: All right Scenario I is Proposal 12, if you could confirm that for me.

MR. McDOWELL: Yes.

MR. ROSENBAUM: Did you get that affirmative answer?

MR. McDOWELL: Yes.

MR. ROSENBAUM: And Scenario J is Proposal 17, if you could confirm that for me.

MR. McDOWELL: Yes.

MR. CESSNA: That's correct.

MR. ROSENBAUM: Now, switching topics, I want you -- I want to understand how your model works in a particular scenario.

Let's assume that the regulated price for --

JUDGE PALMER: I wanted to take a

break at about this time. We have been going for two hours. You are going into a different subject, so let's take a break for ten minutes.

(Thereupon, a recess was taken.)

JUDGE PALMER: All right. Rosenbaum, you were asking questions. Go ahead. sir.

MR. ROSENBAUM: Yes, if y'all could pull out again Exhibit 8, which is the baseline -- well, it is the Model Calibrated to the USDA Agricultural Baseline Projections to 2015.

If you could turn back to page 5 again, which I asked you some questions about already, but I have got another couple of questions. One of the parameters listed, one we already talked about a little bit, is one that depends upon the Class I price at fluid test plus the over-order premium.

JUDGE PALMER: Pardon me, I shouldn't interrupt you, but I lost the one we are looking at. What are we looking at?

MR. ROSENBAUM: This is Exhibit 8.

JUDGE PALMER: Okay. We are all set.

MR. ROSENBAUM: Page 5. Okay. And we are on Table 3, and it is the parameter that reads "Class I price at fluid test plus over-order premium."

Now, correct me if I am wrong, but the USDA Agricultural Baseline Projections to 2015 does not itself have any assumptions as to Class I price or over-order premium; is that correct?

MR. CESSNA: That's correct.

MR. ROSENBAUM: Now, do you, for purposes of performing your modeling, make projections of those two items, the Class I price at fluid test and over-order premiums?

MR. McDOWELL: We have to run our model in such a way that it generates the all-milk price that is in the baseline with the quantity that is in the baseline. And so the rest of this that goes along with the model has to be consistent in order to do that.

Now, we are using the average of the Class I, the Federal Order Class I differential. plus whatever the mover is to get it up to a Federal Order Class I price, and recently we have been using the over-orders, the over-order

premiums that are reported by market information branch. Prior to that, we were using some internal estimates. For years prior to that, it was internal estimates.

MR. ROSENBAUM: Well, when you are looking forward, what over-order premiums are you assuming -- I am not sure I followed that. I am sorry. Could you tell me that again?

MR. McDOWELL: What I just described was the data we used to estimate this equation.

MR. ROSENBAUM: Could you list those data points one more time for me, please?

MR. McDOWELL: Well, it is the Federal Order Class I price, plus the over-order premium estimates, in recent years have been reported in a public document. For some years prior to that, it was an internal estimate.

MR. ROSENBAUM: But for purposes of this analysis, you are using the over-order premium as recently reported and for purposes of the analysis you have done for this hearing?

MR. CESSNA: Historically, we are using some internal estimates. Most recently there is data that is out there that is

available for over-order premiums, and so we have got data, I think, for 2004 and 2005. So for 2004, we would be using that data. But before that, it is internal estimates of over-order premiums.

MR. ROSENBAUM: And in terms of projections going forward, what do you do, in terms of coming up with an over-order premium?

MR. McDOWELL: Here it is right here. The answer to that is in the model documentation, on page 16, at the bottom of page 16 are the -- the second equation from the bottom is where the Class I over-order payments are estimated as a function of the ratio of Class I use to the sum of Class III and Class IV uses, as a function of total cheese production. and then there is a variable there to modify the intercept for years '94 through '96.

So we are estimating over-order payments as a function of a measure of the scarcity of milk, basically.

MR. ROSENBAUM: Okay. So as Class I useasa -- I am sorry. Strike that.

As the ratio of Class I use over Class III and IV use goes up, you are assuming

that, I assume, over-order premiums would rise as a result, is that the idea?

MR. McDOWELL: Um-hum.

MR. ROSENBAUM: Can you say "yes" or "no" for the record?

MR. McDOWELL: Yes, that is the idea. Sorry.

MR. ROSENBAUM: Is there more than just that. Does cheese production --

MR. McDOWELL: Yes, all other things being considered. If cheese production itself is going up, that is drawing milk away from other uses and would cause the premiums to go up.

MR. ROSENBAUM: All right. So either an increase in the ratio of Class I usage to Class III and IV usage or an increase in total cheese production will cause the Class I premiums to go up in your equation?

MR. McDOWELL: That's correct.

MR. ROSENBAUM: Okay. That is all I have. Thank you.

JUDGE PALMER: Any more questions?

(No response.)

JUDGE PALMER: I am sure there has

to be some. We have two people. Mr. Schad?

MR. SCHAD: Good afternoon.

JUDGE PALMER: Again, for the record, Mr. Schad.

CROSS-EXAMINATION (BY MR. SCHAD)

MR. SCHAD: Good afternoon. My name is Dennis Schad, representing Land O'Lakes. Hopefully I have one question for you.

Page 8, I believe it is -- I am sorry, Exhibit 7. Page 8, page 22 and page 1.

JUDGE PALMER: This is Exhibit 8?

MR. SCHAD: No, I am sorry. this is Exhibit 7.

JUDGE PALMER: Exhibit 7?

MR. SCHAD: Yes. All three of those pages, all three of those notations talk about different make allowances. And I understand --

MR. McDOWELL: What were the pages again, please?

MR. SCHAD: Page 1. You listed out the make allowances of the current -- this is on Exhibit 7. You have just listed out from the Temporary Final Decision, then you have page 8, where you have a --

MR. McDOWELL: Okay.

MR. SCHAD: Okay? Then you have on page 22, another one that is similar to page 8, and page 22 is in the section about the energy adjuster.

What I am trying to understand is what other difference can you explain -- we all know what page 2 is, but page 8 and 22.

MR. CESSNA: Okay. Page 1 shows the make allowances from the interim final rule, make allowances that are currently used. Federal rule formulas.

Page 8 is a calculation of make allowances based on the Agri-Mark proposal for using the most recent data.

MR. SCHAD: Okay.

MR. CESSNA: And page 22 is the make allowances are calculated to get a common base period, make allowances for National Milk Producer Federation proposal.

MR. SCHAD: How did you do that for page 22?

MR. CESSNA: Okay. First I got new -- different make allowances -- different manufacturing costs from the CDFA. I updated the

energy cost to reflect the changes in the Producer Price Indices from 2004 to the base period that we have got in here as of July 2004 to June 2005.

So the energy prices are increased. and so using that, we are able to come up with some new manufacturing costs that are adjusted for that time period difference.

MR. SCHAD: So you have adjusted California on page 22 to something, rather than either 2004 or 2005 costs, a hybrid of the two?

MR. CESSNA: It is adjusted to an average of Producer Price Indices from July of 2004 through June 2005, because that time period most closely resembles the data from the Cornell study.

MR. SCHAD: Okay. So when I am looking at page 22, you have taken the two cost surveys and given it a common time, is that what you are saying?

MR. CESSNA: Right, for energy. for energy prices.

MR. SCHAD: All right. Thank you very much.

JUDGE PALMER: Mr. Beshore?

CROSS-EXAMINATION (BY MR. BESHORE)

MR. BESHORE: Marvin Beshore. Good afternoon, Mr. McDowell and Mr. Cessna.

When you were determining how to -- what scenarios you could run and which ones you couldn't, did you call the proponents or have any communication with the proponents to attempt to clarify the proposals, or how did you go about that process?

MR. McDOWELL: We first tried to figure out, well, are there some analyses that we can work with and some that we can't. So there were some that were simply not fleshed out well enough or they required data or surveys or other information, other than what we could possibly get our hands on.

So that was one set of proposals. There were things that we couldn't work on.

And beyond that, it was essentially trying to fashion the proposals in a way that we could work with what we had.

With regard to communication. I can think of one telephone call that was made to try to clarify a proposal, and I can think of

another telephone call that was made to try to clarify the meaning of a number in a proposal.

Other than that, I am not aware of any. Two, right?

MR. CESSNA: That's right. That is all I can recall too.

MR. BESHORE: Did any of the proponents have any -- such as, I will pick one. Yale and company here, did Dairy Producers of New Mexico have any input into how you fashioned their scenarios and combinations of their scenarios and that sort of thing?

MR. McDOWELL: There was one factor.

MR. CESSNA: Well, when we looked at Dairy Producers of New Mexico proposals, in their actual proposals, there was, for their nonfat, increase in nonfat yield, they did not have anything in their -- in their proposals about that. But you go to their proposed language, and it had the increase to 1.02 for nonfat dry milk.

So I made a phone call to them, does that go with a certain proposal? We didn't have really a clear answer about that. We included

it with scenario -- I forget which scenario --

MR. BESHORE: The one that changed all the yield factors, D, E or whatever it was.

MR. CESSNA: Right.

MR. BESHORE: You grouped K, L and M, those different examples, you tried to group in ways that made sense analytically?

MR. McDOWELL: Those scenarios were put together because, as I understand it, Mr. Yale called John Mengel and was questioning the results. They were surprising to him. I am talking about the results for Scenario H.

And so at that point, we decided that we needed to try to do a little bit more to flesh out and illustrate what was going on with those scenarios. And other than that, he had no influence at all. We put that together the way we thought would be best for you people to look at and make sense of.

MR. BESHORE: Right. I think those runs are all helpful. As Mr. Yale indicated, you know, the eyes are on the numbers. I mean, the industry is certainly interested in, you know, in what the results of

the work is.

A question or two with respect to the analysis of the National Milk Producers Federation proposal relating to the energy adjuster. And I hope this is not repetitive of what Dennis Schad was just asking, because I didn't catch all of that.

But can you identify for me, or explain how you determined what quantities of energy were utilized for each pound of product, in order to determine what changes in energy price meant to changes in make allowance?

MR. CESSNA: The changes in the -- the changes in the make allowance is to adjust for that period, difference from 2004 to that 2000 -- you know, when we were adjusting that California amount. Is that what you are asking about?

MR. BESHORE: Actually. I am not.

MR. CESSNA: No?

MR. BESHORE: I am trying to -- and Dennis may not have asked about this at all. I may have gotten completely off subject with that reference.

I am trying to be sure or understand.

to be sure the record is clear on -- in Table 13. I guess it is for one, or in Scenario J, when you did Scenario J, how did you -- how did you apply the projected energy cost that you got from the Energy Information Administration? I guess, how did you apply those, translate that into changes in the make allowance?

MR. CESSNA: Okay. We had -- we calculated these energy costs for the base period, and the percentage increases in the Producer Price Index correspond to the percentage increases from the base period of those energy costs.

MR. BESHORE: Okay. So then maybe I am back in the base period. How did you determine the -- if you did -- the amount of energy that there was in the make allowance for nonfat dry milk, for instance?

MR. CESSNA: Okay. What we are looking at are shares of cost, not amount of quantities.

What we did was we took the share from the CDFA study, the share electricity as a percentage of the total cost and fuel costs as a percentage of total costs from the CDFA study.

and we applied that same percentage as though the whole United States had that same percentage, since we didn't have what the shares were from the Cornell study when we put this together.

MR. BESHORE: That is on Table 12, I guess?

MR. CESSNA: Right, that is Table 12. That is derived in Table 12.

MR. BESHORE: That was your baseline and you used the projected cost that you got from, was it the Energy Information Administration?

MR. CESSNA: That's correct. That is for illustrative purposes. We came up with those shares for illustrative purposes, to show how this would work.

MR. BESHORE: Okay. Was it your judgment in coming up with those shares that that was a, you know, a reasonable way to evaluate what the energy cost was in production of a pound of cheese, butter, nonfat dry milk or whey?

MR. CESSNA: We are not -- we can't say that is the share for the United

States. We are not able to say that is a reasonable estimate that the United States has the same share that California does. We just used the information that was available to us and put that together.

MR. BESHORE: Okay. But that was the information that California had, correct? I mean, that --

MR. CESSNA: Right. That is the information that California had, adjusted for that base period.

MR. BESHORE: Base period change. Okay. Let me -- I have got a couple of questions about baseline, you know, Econometric Model Documentation, Exhibit 8. Undoubtedly. these -- the premise for these questions comes from the fact I am not an economist and have never run an econometric model, and I am not sure I really know how it works.

Can you tell me, how does income -- you know, what are your assumptions for per capita disposable income over the nine-year period in this model, in the baseline?

MR. CESSNA: The assumptions are from the USDA baseline, USDA publishes a

baseline and they have what the personal disposable income projections are.

MR. BESHORE: And do you have any -- can you tell us at all what they are projecting over the next nine years?

MR. CESSNA: I don't know it off the top of my head.

MR. McDOWELL: It is available on the Web.

MR. BESHORE: At what Web site?

MR. McDOWELL: On the USDA Web site.

JUDGE PALMER: They are suggesting you might look at footnote 1, Exhibit 8.

MR. CESSNA: Footnote 1, Exhibit 8.

MR. BESHORE: Okay. That is the publication OCE 2006-1, that is what you are referring to?

MR. CESSNA: Right.

MR. BESHORE: Which I assume is on the Web site somewhere. But the footnote doesn't, I don't think, indicate a Web site. In any event, whatever disposable income assumptions there are, it is in that

documentation?

MR. McDOWELL: Yes.

MR. BESHORE: At a place or two here -- in one of the footnotes, it is indicated or in the substance of the baseline, it is indicated that the -- you use price series for products, and some of them are wholesale and others are retail, if I read, if I noted that correctly. Ice cream, I think, is a retail price index that was used for evaluating demand and some of the others are wholesale prices.

Did I observe that correctly?

MR. CESSNA: I think the retail -- I think ice cream is only retail price. I think the other ones are wholesale prices.

MR. BESHORE: Okay. So what is the fluid milk? That, if I understood, that price was really something not wholesale or retail, it was a plant cost proxy of some sort. if I understand?

MR. McDOWELL: As I indicated earlier, this is intended to estimate the price that processors are paying for milk and fluid use that includes both the minimum Class I price

that the order sets, plus over-order payments.

MR. BESHORE: Okay. But then that cost, the model takes that cost and translates it into a change demand at the retail level?

MR. McDOWELL: Not really. It is translating changes in that price to changes in demand at that level.

MR. BESHORE: At the plant level?

MR. McDOWELL: Yes.

MR. BESHORE: Changes in that price result in changes at the plant level?

MR. McDOWELL: Right.

MR. BESHORE: Somewhere embedded in that is an assumption of what happens to the product that the plant processes, that there is less or more demand at the consumer level.

MR. McDOWELL: It is assumed that the demand for milk at that plant level is derived from demand for fluid milk at the retail level.

MR. BESHORE: And is the relationship between those levels embedded in those elasticity numbers that Mr. Rosenbaum was discussing earlier?

MR. McDOWELL: If one were to estimate a retail elasticity or a retail demand. one would expect it to be similar to this equation, with the exception that the elasticity on price would be approximately double to reflect the fact that in addition to the price for raw milk that processors are paying, the retail price reflects packaging, hauling, et cetera, et cetera, and it would reflect that.

MR. BESHORE: Okay. I will see if I ask this question right. How does the model estimate demand for milk at the plant level, fluid milk, when it doesn't have a retail price at the fluid level?

MR. McDOWELL: There is no problem in doing that. We estimate it with the price that we have there. We are trying to focus on farm level demand for milk. We could have estimated it from the retail side. Instead we estimate a change, I think, in the retail price. given a change in the farm level price.

It is clear that these things are linked. One can approach it from one place or another. I think that is the answer.

MR. BESHORE: Okay. Is there an

assumed static linkage then in the plant price and the retail price in the model?

MR. McDOWELL: Do we have that in here?

MR. CESSNA: No. We have a retail price that is calculated in our table that just assumes constant margins. That could be sort of assumed to be the outside, outside possibility of what the retail price, how much the retail price would change. But we don't have a retail price in the model that we are estimating.

MR. BESHORE: Are the margins assumed to be constant on an absolute dollar basis or on a percentage markup basis?

MR. CESSNA: I don't think we are making an assumption about the markup.

MR. BESHORE: How are they determined then?

MR. CESSNA: I am not sure I understand the question.

MR. McDOWELL: I think what we do is simply convert hundredweights of milk to a gallon. And what we are reporting are the changes in the fluid milk prices measured, where

we are measuring on a hundredweight basis, we convert it to a gallon basis and talk about the change that would be equivalent on the retail side.

MR. BESHORE: Just the per unit cost based on the plant cost?

MR. McDOWELL: Right. So it is only measuring the change at retail of the change in the milk cost alone, that is it. So we are not assuming anything else about the rest of that margin. So, in essence, we are assuming that those margins are held constant.

MR. BESHORE: Okay. In the equation on page 16 of Exhibit 8, the proxy for dairy processor revenue, it -- and just looking at this and reading over it, you have got product prices for -- or product volumes, I guess, sales volumes for everything except Class I, which is -- well, you have fluid used, but you have price. I don't know. You have product prices, but you have got raw milk price in Class I but product prices for everything else. Am I looking at that correctly, process product prices?

MR. CESSNA: We have wholesale

prices for everything except the fluid milk.

MR. McDOWELL: The label on this could be improved. Essentially what this equation is measuring is the total value of milk and dairy products used in the prices that we are at in our model, times the quantities that are appropriate.

So we are simply using the prices that we are estimating. That is what we are doing here.

So an alternative label could be value of milk and dairy products at the prices that are solved for in the model.

MR. BESHORE: Okay. So the model solves for those prices with product prices -- process product prices in all categories except Class I, where it uses the raw milk cost?

MR. McDOWELL: That's correct.

MR. BESHORE: When you -- I think you said you used the phrase "true up," you true up your equations to the baseline at some point.

Can you tell me what that means?

MR. McDOWELL: Yes. The committee that we are a part of is the dairy -- the Interagency Commodity Estimates Committee for

Dairy, and it includes us and it includes people from Farm Services Agency, it includes people from FAS, it includes people from the Economic Research Service and NASS.

And the committee comes up with the estimates for the all-milk price, the quantity of milk produced, and there may be some other variables in the baseline now that I might be missing. But there are certainly not as many variables as we have in our model.

So what we do, we run our model with variables such as income and things like that that come from outside, and then we start seeing, well, it looks like we may be off this way or that way. And the standard practice to deal with truing models up is to use something called add factors that shift the intercepts of these demand and supply functions around to get them in the right spot, such that you can go out with the baseline projection.

MR. BESHORE: Okay. Are the estimates trued up -- are the committee's estimates trued up to the model, or is the model trued up to the committee's estimates?

MR. McDOWELL: The latter, the

model is trued up to the committee's estimates.

MR. BESHORE: So ultimately, the internal factors in the model are a product of the baseline estimates of the committee?

MR. McDOWELL: I don't know if I would say it that way. The people that are involved in putting the model together and doing the statistical work to get parameters in our model are all on our staff. But we true that model up to the projections that the committee puts together from all sources, all the agencies.

MR. BESHORE: And the kinds of things that you have to change to true it up would be things like these elasticity factors?

MR. McDOWELL: More usually, it is something like the intercept. For example, on the number of cows or milk per cow, it may be that for some reason projections are different from what our model is coming up with for a variety of reasons.

MR. CESSNA: It is the intercepts that we are changing, not the slopes or the elasticities. It is the intercepts each year we are changing to get them to match what

the committee has for the baseline.

MR. BESHORE: But to change the intercepts, you have to -- it means that something that went into creating that intercept had to be adjusted; is that fair?

MR. McDOWELL: We add an add factor to it, but we don't re-estimate the equation because of that.

MR. BESHORE: Okay. There is just a plug factor that changes the location of the intercept?

MR. McDOWELL: That's right. And that is standard practice.

MR. BESHORE: Okay. You talked about feed price ratio.

JUDGE PALMER: Let me ask this: Is there a point, though, where the truing up factor that is used is so high or so great in number that you say, "Wait a minute. I am not sure I should stay with this particular statistic"?

MR. CESSNA: Well, we are going to match up to the baseline, you know, that the committee has come up with. And we have a part in what the committee is coming up with.

JUDGE PALMER: But the committee is doing it on the basis of estimates. If the committee has estimated something or another. and your number -- I don't know what the factor would be, but your number is way off. you say to yourselves, "I suppose the econometric study is wrong," or --

MR. McDOWELL: We do update our estimates, and if there is -- there is no question about that. You can go back and look at the documentation and you can see how some of these equations have changed, particularly with our parameter estimates. That is sort of standard practice. Yes, we do modify things.

I can tell you right now, with the ethanol -- excuse me a second.

JUDGE PALMER: I am sorry, go ahead.

MR. McDOWELL: For example, with the ethanol programs that are going on right now, we are looking at feed prices that are basically outside the realm of recent history. So we are going to have to do something to deal with that. We have things like that that come around. Yes. we do re-estimate it.

JUDGE PALMER: I am wondering if there is a numerical factor? If you are 10 percent off, maybe that is all right, but if you are 90 percent variance, does that mean you don't true it up, you redo all your work, or what happens?

MR. McDOWELL: If we are 90 percent in disagreement with our committee, we have another discussion.

(Laughter.)

JUDGE PALMER: Okay. Back to you.

MR. BESHORE: Okay. Feed costs and milk/feed price ratio, on Table 2 of Exhibit 8, Mr. Rosenbaum, I think, was going through some of the information on that table. And as I understood your responses to his questions, that there was an implicit milk/feed price ratio built into the cow number and -- built into this equation, it gives you the number of cows. I guess.

What is the -- is that ratio constant, milk/feed ratio, or what is it?

MR. CESSNA: No, it is in our projections. It is not constant in our projections. Now, the feed value is constant.

MR. BESHORE: The feed value you derive from the --

MR. CESSNA: That comes from the USDA baseline. We have the price of soybeans, corn and alfalfa hay, and we come up with a feed value. And it changes year after year, but it reflects the USDA baseline. And scenarios don't change the feed value, but the milk price changes. So when the all-milk price changes. our milk/feed price ratio will change when we do a scenario run.

MR. BESHORE: Okay. So that ratio was just, when you were testifying to it. that is just a product of the baseline projections of feed prices and the baseline projection of the all-milk price, in that -- you just put them together and calculate the ratio?

MR. CESSNA: Yes, for the baseline and for the scenarios, it is our projected all-milk price divided by the USDA baseline derived feed value.

MR. McDOWELL: When we start off. the all-milk price is also a baseline all-milk price. So we get changes off the baseline.

And as a result of that, there would

be a change in the milk/feed price ratio as well.

MR. BESHORE: Can you tell us what the relationship is between milk/feed price ratio and number of cows? In other words, if milk/feed ratio is under 2 1/2?

MR. McDOWELL: Yes, yes, sir, Mr. Beshore. I answered those questions just a few minutes ago with Mr. Rosenbaum. And I will refer you to page 4.

MR. BESHORE: I have it. Of Exhibit 8?

MR. McDOWELL: Yes. And we have been through this.

MR. BESHORE: I don't mean to be repetitive. But maybe I am dense.

MR. McDOWELL: Well, this equation is estimated in log form on both sides. So the elasticity is the estimate itself. So if there is a 1 percent increase in the all-milk price/feed value relationship there, you get an increase in the number of cows of .025 percent. Okay? A 1 percent increase in that ratio gives you a .025 percent increase in the number of cows in the current year.

MR. BESHORE: Now, when that ratio is typically in USDA publications and industry parlance expressed as 2.5 or 3, are you familiar with those terminologies?

MR. CESSNA: Yes.

MR. BESHORE: So would a 1 percent change be from 2.5 -- 2.51 or --

MR. McDOWELL: Well --

MR. BESHORE: Or can't it be translated in that way?

MR. McDOWELL: You just simply take whatever number it is and you multiply it by 1 percent and that gives you the change in the milk/feed price ratio. That would be a 1 percent change. And it would result in a .025 percent change in the number of cows.

MR. BESHORE: Okay. I think that is all the questions I have right now. Thank you very much.

JUDGE PALMER: Mr. Vetne? Do we need a break again? I am fine. Are you guys okay?

MR. McDOWELL: I am okay.

CROSS-EXAMINATION (BY MR. VETNE)

MR. VETNE: John Vetne.

appearing for Agri-Mark, et al.

Gentlemen, thank you for coming. You have been doing this for six years, and the light is beginning to turn on very dimly. I appreciate your being here.

JUDGE PALMER: What light is turning on?

MR. VETNE: The light in my head, you know, the cartoon where "Why are we doing this and what does it mean?"

JUDGE PALMER: Okay.

(Laughter.)

MR. VETNE: I want to start off with some questions about the baseline. The baseline is a model developed by the Office of the Chief Economist of the Department of Agriculture and an interagency consultation, and the projections are the product of a committee that looks at past observations and tries to translate commercial behavior and price behavior and supply behavior to the future, is that pretty much correct?

MR. McDOWELL: I would word that differently. I would say that the baseline is put together by committees in USDA to come up

with a plausible scenario of prices and quantities, assuming current policy for the purpose of running policy analysis. The committee would not say that the baseline is intended to be a full-blown, statistically valid forecast.

MR. VETNE: I have gone onto the Office of Chief Economist Web site. and on that site they are careful to say. "This is a projection, not a prediction." Would you agree with that?

MR. McDOWELL: I think that is consistent with what I just tried to convey.

MR. VETNE: There is data, however, hard data, built into the model, based on observations, what has happened during a past period, producer response to prices, consumer response to price changes, feed growers' response to price changes, feed growers' response to new technology. All of that is built into the database, correct, observations from the past?

MR. CESSNA: That's correct.

MR. VETNE: And what is that period of past observations that one is looking

at?

MR. CESSNA: Something from 1980 --

MR. McDOWELL: Again, it has been pointed out in documentation and it is 1980.

MR. VETNE: Okay. So the model captures real life data from 1980 to whatever the current year is and then takes observations of behavior and projects that to the future?

MR. McDOWELL: Would you repeat that question?

MR. VETNE: Okay. The model is based on observations of the past, milk producers' response to prices, grain producers' response to prices, supplies, and observes those behaviors and tries to project from those observed behaviors what is going to happen in the future?

MR. McDOWELL: No, sir, that is not what we do.

MR. VETNE: Okay.

MR. McDOWELL: The econometric model is intended to estimate changes from the baseline in the dairy market variables that we are interested in. The model does not project a

forecast, which is what your question implies.

MR. VETNE: Okay.

MR. McDOWELL: We are -- what we are doing is estimating changes from the baseline that are caused by a change in policy or program parameters.

MR. VETNE: Okay. If I used the term "forecast" inadvisedly, I apologize.

The projections, however, whether captured by the Dairy Programs' use of the USDA baseline or USDA's overall use of its baseline. those projections are based on observations of past behavior?

MR. McDOWELL: In a broad sense, that is true.

MR. VETNE: When one comes to. for example, in this case, we use the baseline projections published in 2000 -- February 2006. When those baseline projections were made in the USDA model, it captured what had happened to feed supply and feed prices and milk supply and milk prices during the intervening year, from 2005 to 2006, am I correct about that?

MR. McDOWELL: Can you -- of course, we are using this model, we estimate the

equations based on the data that we have, and we use it against the baseline, and we -- given the baseline and a change in a policy, we estimate changes in the variables that would result from that change in policy.

Now, you asked -- you are continuing to ask me this question in various different ways and I keep coming back to this answer. I am not sure I am following what the difference in the way you are asking me is.

MR. VETNE: Okay. For example. the model used contains some assumptions about elasticity of cow numbers and milk production based on price changes. Are you with me so far; is that correct?

MR. CESSNA: That's correct.

MR. VETNE: Okay. And those numbers, again, tell me if I am correct, those numbers are derived from observations of producer behavior in response to price changes in the past; am I correct?

MR. CESSNA: That's correct.

MR. VETNE: And when one looks. again, in the past to see what number to use, each year you have one more year of data to see

if producer behaviors have changed in response to price; am I correct?

MR. CESSNA: That's correct.

MR. VETNE: Okay. So the baseline starts with where we are at now, it looks to what has happened in the past and. based on observations of the past, makes projections for the future, am I correct there?

MR. McDOWELL: No --

MR. STEVENS: Let me interject here. I am wondering, Your Honor, what this has to do with any of the proposals that are before the hearing today. I mean, we can talk for a long time about the work that these gentlemen have done. But if it is not related to specific proposals, I don't know how it moves the hearing record forward.

So I would ask, Your Honor, that if you could, if you could ask counsel or direct counsel to maybe relate this to one or more proposals to get some idea of where we are going with this, because we could spend a lot of time on this, and it wouldn't be productive in terms of getting a full record for the Secretary to make a decision on the proposals that we are

considering in this hearing.

JUDGE PALMER: Mr. Vetne, do you want to respond? Would you respond?

MR. VETNE: Yes. The Dairy Programs' use of the model, as I understand it. takes a vehicle that is already constructed by the Office of Chief Economist and then makes modifications to that vehicle, focused on milk price changes.

I am trying now to get some information on the foundation, you know, the prefabricated vehicle that comes from the Office of Chief Economist, so we know what underlies the modifications that are done to that model when it comes to --

JUDGE PALMER: All right. I will allow the question.

MR. STEVENS: Let me just add one point.

JUDGE PALMER: Yes.

MR. STEVENS: Again, these gentlemen testified in their direct that these are not offered for or against any proposal. that they are not really here talking about the merits of any of the proposals. We are talking

about an econometric study that they do.

I understand the points -- I believe I understand the points that Mr. Vetne is making, but again, I don't see how this is moving us forward in terms of getting to the proposals that we are noticed here to take a record on, to assist the Secretary in coming to some decision on what the industry wants to do with respect to these proposals.

JUDGE PALMER: Well, I take it that the point of that is that the econometric study is being offered to help us analyze the proposals, and Mr. Vetne wants to know if there are flaws or problems with the validity of the construction of the economic study and, if so. how he might address them. I presume that is what you are doing?

MR. VETNE: Well, actually. I am trying to understand it.

JUDGE PALMER: Okay.

MR. VETNE: So far. I haven't -- if I have suggested that I have addressed the merits of a proposal by these questions, I haven't. If I have suggested that I have addressed any of the proposals on the

merits, I haven't. I am trying to understand how Dairy Programs --

JUDGE PALMER: I am going to let you do a bit more, provided the witnesses are comfortable with it.

MR. VETNE: If the reporter could kindly go back to the question I asked just prior to Mr. Stevens.

(Thereupon, the Reporter read the record as requested.)

JUDGE PALMER: Are you ready? Would you address that one, sir?

MR. McDOWELL: I will address it. There is confusion, I might preamble my answer.

JUDGE PALMER: Sure.

MR. McDOWELL: The way you are asking the questions, it seems to me there is confusion between what we are referring to as the baseline, that is put together by the department, with several agencies involved, and our use of the model to work against that baseline to do policy analysis.

Now, you asked with regard to past. and whether past observations are used to come up with the baseline.

It is the case that past observations are a huge portion of what is involved in developing a baseline, because whenever you are talking about a plausible path into the future, it has to begin from now and it had to have come from sometime in the past.

MR. VETNE: Exactly.

MR. McDOWELL: So it is clear that the underlying data has to include the past and present data.

In addition to that, it includes a variety of expert opinions that are developed from models that look at various kinds of impacts, other kinds of information that may be qualitative in form and not quantitative.

There is an enormous amount of information, such as drought, weather, all those kinds of things that deal with going into the baseline.

You get out into the future, you can't assume that there is going to be droughts. But if there is a drought this year, it clearly affects what we assume for next year. That is the baseline.

Now, whether it is Dairy Programs.

Jerry and I and our staff, working with a statistical model or whether it is anybody else working with a statistical model, the very nature of statistics is that you have to use existing data to estimate something.

So anyone who is estimating relationships statistically is having to use previously generated data. I will stop now. Are we making progress?

MR. VETNE: Yes, we are.

(Laughter.)

MR. VETNE: Yes, we are. I think that is a "yes" answer to my question. I was talking about the USDA model or USDA baseline. Is it also true that the USDA baseline shows a dynamic interaction between various sectors of agriculture? For example, if something happened to dramatically increase pork demand, pork producers would need a lot more feed, which would raise prices and thereby impact prices for dairy farmers. Do those things interact in the USDA baseline?

MR. McDOWELL: That's correct.

MR. VETNE: You mentioned, I think, ethanol. The increasing demand for corn

to produce ethanol has raised feed prices for the corn component. It has increased and is projected to increase acreage to be planted in corn in response to that price.

And you are nodding your head "yes" so far; is that correct?

MR. McDOWELL: You have been making statements. I don't believe you have been asking me if that was the case or not. I am nodding my head in agreement with your statements.

MR. VETNE: Did you agree with those statements? That is my perception of what is in the USDA baseline.

MR. McDOWELL: I agree with those statements.

MR. VETNE: And the baseline also includes, as of now, an increase in availability of distiller's grain, which is a byproduct of ethanol production, right?

MR. McDOWELL: I don't know if it is in the baseline, per se. I don't know the answer to that question.

MR. VETNE: Okay. There is a new baseline release as of February 14 of 2007.

Do you know how that baseline differs from the February 2006 release that you employed in your model?

MR. McDOWELL: I don't have that available right now.

MR. VETNE: Okay.

MR. McDOWELL: One could look at those numbers and one could compare them. We don't have that available here right now.

MR. VETNE: You are measuring changes from specific price inputs. Do you know of anything that has happened between February 2006 and February 2007 that would result in different projections of changes?

MR. McDOWELL: I can't comment on that right now. The baseline that we were obligated to work on, work with, was the one that we had. And the analysis was released before the release of the new baseline.

MR. VETNE: Okay. And the USDA baseline are projections that assume continuation of current policy -- I think you answered that -- which would then capture current Federal Order pricing policy, including Class I prices. Class II prices and so forth.

MR. McDOWELL: I think that is an accurate statement. Implicitly it does.

MR. VETNE: In looking at Exhibit 8, which is the National Econometric Model Documentation, and from pages 4 through -- pages 4 and 5, at least, there are some price elasticities included. I think in response to one question you referred -- you used the term "short-term elasticity."

Are all of these under the column "Price and Income Elasticities" short-term or are some longer term?

MR. McDOWELL: The ones that are there are short-term, one year.

MR. VETNE: One year. Okay. Is there a rule of thumb for a difference between short-term and long-term elasticities?

MR. McDOWELL: You often see five-year elasticities being referred to as an intermediate term. Longer term would be longer than that. But five years is a rule of thumb that people are looking at, in which time a lot of the shorter term response is played out.

MR. VETNE: By "shorter term response played out," what do you mean?

MR. McDOWELL: Well, when you shock the system in one year, there is some response, and then there is some response in the next year and in the next year.

If you will notice in the equation -- right here -- in the equation for milk supplied. the number of cows --

MR. VETNE: What page are you looking at, sir?

MR. McDOWELL: Page 4.

MR. VETNE: Okay.

MR. McDOWELL: The fourth term down there is the lag in the number of cows.

MR. VETNE: Um-hum. And "lag" means what?

MR. McDOWELL: Well, it means that, among other things, if all other things are held constant, that the number of cows in year N is 94.5 percent of the number of cows in the year N minus one, the previous year.

So you can look at the previous year and multiply it by 94.5 percent, and that would be one of the factors that would give you an estimate for cows the following year.

MR. VETNE: Okay. As I recall.

you prepared an economic analysis of the make allowance decision that was published in 2002. and that economic analysis included discussion of different regional responses. I think there were 14 regions, milk producing regions, and in some regions, there was a greater response to changes in price feed ratio and in other regions, there was a smaller response.

Are you aware of any observations between your release of that analysis in 2002 and today, that would indicate that the regional differences are, in fact, different today than they were back then?

MR. McDOWELL: Well, we have spent some time trying to get that work updated, and it is in the process right now of being updated.

MR. VETNE: Are you aware of any significant changes in the differences between regions, as far as their response to price?

MR. McDOWELL: I am not prepared to talk about that today.

MR. VETNE: In response to an earlier question, you indicated that retail price elasticity is about double that of

wholesale milk price elasticity.

What happens to the extra milk that the wholesalers buy, if they respond half as quickly as consumers? How does that balance out? That is my question.

MR. McDOWELL: The easy way to look at that -- may I rephrase the question?

MR. VETNE: Sure, rephrase it so you can answer it.

MR. McDOWELL: Why is the elasticity at retail approximately double the elasticity at wholesale level? And the reason why is, is that an elasticity is defined as the percentage change in quantity, given a percentage change in price. Okay.

Now, one obvious example or an obvious way to look at this, is if you consider the slope to be the same, that is, the change to be the same with respect to a change in price. everything in that calculation is the same with the exception that the retail price is about double the wholesale price.

MR. VETNE: Got it.

MR. McDOWELL: Okay. So that is the difference in the calculation.

MR. VETNE: So a change of 10 cents at the wholesale price might translate to 5 cents at the retail level?

MR. McDOWELL: Probably the other way around. You are starting from a different level, is the point that I was trying to make.

MR. VETNE: If a price is -- I am sorry.

(Pause.)

MR. McDOWELL; I think I have said what I want to say there.

MR. VETNE: So if an increase in the Class I price produces an increase in the wholesale price that is identical, it will be a greater percentage of that wholesale price than it is a percentage of the retail price?

MR. McDOWELL: I don't know about that. I am having a hard time following you.

JUDGE PALMER: I do too. I think he was trying to say that the prices for retail go up more than the price for wholesale, given a given event. Is that right, or am I wrong?

MR. McDOWELL: The line of questioning had to do -- to begin with, the line of questioning had to do with what is the

difference between the elasticities. And the difference between the elasticities is explained by the fact that prices at retail on a constant unit are about double those at farm level.

JUDGE PALMER: It is not an event thing, it is just a reflection of how you are trying to plug these things in?

MR. McDOWELL: That's correct. that's correct, level of price for a similar quantity.

MR. VETNE: That is all I have. Thank you very much.

JUDGE PALMER: Any other questions? Yes, yes, sir.

CROSS-EXAMINATION (BY MR. MILTNER)

MR. MILTNER: My name is Ryan Miltner with Yale Law Office. Good afternoon, Dr. McDowell.

MR. McDOWELL: Good afternoon.

MR. MILTNER: Like Mr. Beshore, I am not an economist, so my first questions have to do with helping me understand some of the terms in the exhibits that we have marked.

And my questions have to do with the documentation in Exhibit 8. And I am looking at

page 4.

At the top of the Table 2, there is a t-Value, the Pr greater than absolute value of t. Am I reading that correctly?

MR. McDOWELL: (Witness nodding head up and down.)

MR. MILTNER: Then an R-Square. I'd just ask if you can explain for me what each of those represent. What is the t-Value and what does that show us in this table and the other tables in the documentation?

JUDGE PALMER: This is going to be hard, isn't it? This is basic statistics.

MR. McDOWELL: T statistic is a measure of, in lay terms, statistical significance of a number from zero in the context here.

And what one would try to hope for is to be able to reject statistics or reject hypothesis that some parameter is equal to zero. with some confidence.

Now, having said that, I will try to relate that to the terms here. And I am going to pick some examples. If you look at the fourth term down, the lag on the log of the

number of cows, the parameter estimate on that is about .945 with a very large t-Value approaching 10.

The probability that we could be wrong and that this parameter estimate of .945 is really zero is out there in the fourth decimal point to the right, what is that, one-one thousandth of a percent? So it is highly likely, it is highly likely that this parameter is not equal to zero. Okay?

MR. MILTNER: Okay.

MR. McDOWELL: Now, if you go to the one immediately above that, just looking at trend there, your estimate of the coefficient on it is .012. The t-Value is only 1.4. So there is some chance, about 17 percent, that it may not really be that -- it may not be .012, it might be zero. That is a way you can interpret this.

MR. MILTNER: Okay.

MR. McDOWELL: What you really like is t's of 2 or greater, and sometimes you can't get that. So you do the best you can. given the data that you have, and the problem that you have at hand.

MR. MILTNER: If I recall from my statistics, which was limited, but a t of 2 would give you a probability of about 5 percent?

MR. McDOWELL: Maybe even less than that.

MR. MILTNER: And a 3 would give you about 99.7 percent?

MR. McDOWELL: Ballpark figures.

MR. MILTNER: Then can you explain for us what the R-Square represents then?

MR. McDOWELL: R-Square is a measure of fit, overall fit in terms of explaining the variation. In this case, it is the dependent variable, which is the number of cows. The R-Square of .975 says that 97.5 percent of the variation through the sample period can be explained by this equation.

MR. MILTNER: So the higher the R-Square, generally the better your equation is?

MR. McDOWELL: The better the fit.

MR. MILTNER: Okay. I am going to totally change gears on us here. And I want to look at Exhibit 7, page 5. I think it is page 5 I want to look at. No, I am sorry. it is

page 6.

And I recall from your testimony last year, and I think again today, that the model operates on an annual basis, correct, it does not, cannot give us information on a month-by-month basis?

MR. McDOWELL: That's correct.

MR. MILTNER: But, of course. Federal Order prices are set on a monthly basis. And each month, based on the level of Class III and Class IV prices, we set a Class I mover. correct?

MR. McDOWELL: That's correct.

MR. MILTNER: Okay. And the Class I mover is the higher of our Class III and Class IV prices. And that, whether Class III or Class IV is the mover, can vary month to month, so whereas, the inference is the Class II price is always Class IV plus a set differential.

So I was looking at this Table 3, and because the relationship between Class II and Class IV is fixed, you would see what you would expect, that the changes from the baseline for any of the proposals is the impact on Class II and Class IV skim prices are identical. But

also, the difference between Class I and Class III skim prices are identical.

And that would only -- I believe that would only be the case if for the entire period of the forecast that Class III was the mover; is that correct?

JUDGE PALMER: I will give you a lot of room in answering that, if you have problems or qualifications with it.

MR. McDOWELL: That's correct.

MR. MILTNER: So could it be -- this is entirely hypothetical, and maybe we don't know the answer.

Could it be that Class IV would be the mover for certain months throughout the forecast period, but because Class III was predominantly the mover, that is what the model shows?

MR. McDOWELL: Just a second.

MR. MILTNER: Okay.

(Pause.)

MR. McDOWELL: It is possible for the Class IV to be the mover in a particular month. I can't tell you exactly how many months out of the last several years the Class III has

been the mover. But it has been most of them. I do know that.

This is an annual model; there is no way that we can capture all the variability that takes place across the months of a year. I want to come back to the notion that the purpose of this analysis is to project the changes in the milk prices and quantities from the baseline with respect to changes in policy variables. To the extent that we are missing one or two months in which the Class IV was a mover and not III, we missed that.

MR. MILTNER: I want to get into another area the model may not capture, if I might.

Because each Federal Order has different utilizations of milk among the four classes, obviously Florida is a higher Class I market than the Upper Midwest, and even in the manufacturing classes, some orders are predominantly Class III and others are predominantly Class IV or have higher proportions of Class IV.

Would you expect that for any of the changes or many of the proposed changes.

especially those that deal with protein prices. that the impact on any given marketing area would be different region to region?

MR. McDOWELL: A few minutes ago we discussed the fact that we had published in 2002. I believe, some original estimates of supply, so we understand and recognize -- we also mentioned that we were updating that study. So we understand and recognize that supply responses are different in different regions of the country.

Now, with regard to the utilizations in the different orders and how it plays out in this particular model, in many of the analyses in recent years we have been dealing with make allowances having to do with manufactured dairy product prices, and the manufactured dairy product markets are national in scope.

So we believe that we are capturing very much the marketplace for those products.

In terms of the Class I differential that is in this model, it is an average, and of course, the classes are the Federal Order as a whole and national as a whole.

Now, if one wanted to, one could take

the changes in the component prices and go even a little bit further, get the changes in the skim milk prices and the change in butterfat prices and use the differentials that are in the different orders, or even at a specific location, and calculate a Class I price and could very easily extrapolate these results to a regional level, in terms of the way these changes would play out, given different classification uses.

MR. MILTNER: So is my presumption correct that even though the all-milk price, for instance, under Scenario B, for instance, it says that the all-milk price declines 2 cents over the projected period, the Florida order may have an all-milk price, or not all-milk price, but it would be a mailbox price that may go up a penny, while another order would be down 4 cents. And I am not fixing numbers. I am just saying that there could be a disparate regional impact based on the utilizations.

MR. McDOWELL: That's correct. I essentially agreed with that and stated that.

MR. MILTNER: Do you know when

your analysis of regional supply responses and the like would be completed?

MR. McDOWELL: I sense there is interest in that.

(Laughter.)

MR. MILTNER: There is some interest in that.

MR. McDOWELL: We will move on it. I won't give you a date.

MR. MILTNER: Thank you. Does the model, either the baseline or the model itself with its various responding factors take into account the energy costs and the fuel costs that are incurred by dairy farmers?

MR. McDOWELL: To the extent the fuel costs are built into feed prices, the answer is, "yes."

To the extent that -- otherwise. I would say no, other than trend. Over time, with the exception of some blips, energy prices have gone down. We are in a different environment now, and we will have to re-evaluate that situation. There is no explicit accounting for energy prices in our supply response.

MR. MILTNER: Can you help me

understand what trend encompasses? I have heard the term a few times.

MR. McDOWELL: Well, if you look at milk production, that is a pretty good variable that we have some interest in here. You will see that it has been trending up along a line.

And so sometimes a trend can be linear, as in straight line, sometimes it is curvilinear or some other kind of function. But that would be the simplistic way of just looking at this movement of this variable, without any other explanatory variable.

Well, then, around that trend, we say, as an economist, what are these other factors here that are involved here. The trend. for example, with milk production has things like genetics involved, all these things. We don't have a genetic model here showing that milk production, where cows get bigger in that kind of way.

JUDGE PALMER: By genetics, you mean the genetic improvement of the cows themselves?

MR. McDOWELL: Right. Clearly

that is embodied by the fact the number of cows is declining over time. Milk production is going up; the cows are going down.

So then around that, we will try to develop some explanatory variables that are economically significant variables to help define and deal with market behavior.

MR. MILTNER: And to tie back into the question I had about fuel costs and energy costs, you mentioned that they were probably incorporated in the feed factors in the model, and I know that those questions have been asked.

But other than the feed price ratio and the production per cow, is there any other factor in the model that directly considers the price of feeds or the available supplies of feeds?

MR. McDOWELL: Oh, yes. The availability of feeds is clearly reflected in the feed value, which is based on -- that is feed prices. Okay? So feed prices, feed value are clearly explicitly in the model.

MR. CESSNA: Number of cows and milk per cow.

MR. McDOWELL: We just had some confusion with baseline again. The baseline clearly considers energy prices, the baseline. Again, our model is projecting changes off the baseline, with respect to policy changes dealing with dairy.

And so we don't have a -- we don't have a fuel price or energy price explicitly dealing with milk production.

MR. MILTNER: I do want to ask about the baseline then. This baseline used for this preliminary model, this preliminary analysis, was a February 2006 baseline; is that correct?

MR. McDOWELL: That's correct.

MR. MILTNER: Okay. And there was a statement made, and I don't know which of you said it, but it was that with the ethanol programs, feed prices are outside the realm of recent history, so we are going to have to do something about that in the baseline.

So does the February 2006 baseline incorporate the runup in feed prices?

MR. McDOWELL: I mentioned a while ago I couldn't compare the two baselines. I

don't have those numbers in my head. I would venture to say that if you would compare the baseline that was just released, the 2007 baseline, against the one from a year ago, that you will see some changes that reflect the development of ethanol and the recent runup in feed prices that we all know about.

Again, I want to come back to what this model is doing, and it is used to project changes from the baseline. And the energy is not a policy variable that we are concerned with with regard to changes in the Federal Order program.

MR. MILTNER: But if feed prices have run up, and I think everyone agrees they have run up, and those prices are not in the February 2006 baseline, would that affect, for instance, the feed price ratio that is in here -- and that could have a dramatic impact on things like milk production and milk production per cow and number of cows going forward, that wouldn't necessarily be reflected in here?

MR. McDOWELL: Again, I think that would be reflected in a new baseline.

We are examining changes from the

baseline with regard to changes in milk marketing parameters.

MR. STEVENS: Your Honor, might I suggest at this time, I believe the witnesses need a break. I don't know of the hour and I don't know how many more questions --

JUDGE PALMER: The hour is five of five. I was hoping to conclude with him tonight.

MR. STEVENS: That is fine. But I don't know, you can ask them if they need a little break. But I think they are a little tired up there, and I think the record suffers if they are not --

JUDGE PALMER: All right.

MR. MILTNER: I would agree and have no problem. I have one question to ask and I don't even need an answer right now.

JUDGE PALMER: Okay, fine.

MR. MILTNER: Since we have the new baseline documentation and since this hearing is going to likely reconvene in a month or two, is it possible to have the analysis done with the new baseline provided for everybody? I don't know if you want to talk with other folks

at the department before we get a "yes" or "no" on that. That is something that I would like to at least request. And I don't have anything else at this time.

JUDGE PALMER: I am not going to ask them to give an answer to that. I don't think that they can.

Are there any more questions for these witnesses? I would like to excuse them.

MR. SMITH: Very briefly, Your Honor.

JUDGE PALMER: Okay.

MR. STEVENS: Are you all right?

MR. McDOWELL: We can go a little longer.

JUDGE PALMER: I would just like to get you off. And give your full name, sir.

CROSS-EXAMINATION (BY MR. SMITH)

MR. SMITH: My name is Daniel Smith, I represent the Maine Dairy Industry Association.

Point of clarification about the existence of a document. So hopefully this will be relatively straightforward.

On page 14 of Exhibit 7, you refer to

the proposal by the Maine Dairy Industry Association, and indicate that implementation of the proposal would require use of a plant survey that does not exist at this time.

In the proposed -- in the notice of the rule, on page 6184, which is also the reference to the proposal by the Maine Dairy Industry Association, the notice says. "The proposal seeks to derive a factor by using an updated version of the department's 1994 to 1996 simulated analysis of the competitive pay price for grade A milk."

I just want to clarify, there is repeated reference in the '96 reform rule-making process to the department's so-called 1994 to '96 simulated analysis of the competitive pay price for grade A milk.

I would just like to confirm that that study was done and the analytical model. does it still exist in the department's database? Regardless of the proposal, and what is referred to to incorporate a factor into that study, just does that --

JUDGE PALMER: Stop there. I don't know if I understand the question. I will

see if they do. Do you understand the question?

MR. CESSNA: Does it mean, can we find that survey back from 1996?

MR. SMITH: First question is, does the survey from 1996 --

MR. McDOWELL: The document exists. That is different from the survey.

This is a series of prices that was used in the past.

MR. SMITH: I am referring to the simulated analysis, not a survey, the simulated analysis.

MR. McDOWELL: Now you are talking about the document of the study?

MR. SMITH: Correct. That is what I am looking for.

MR. McDOWELL: Okay. A copy could be found.

MR. SMITH: A copy can be found. I would like to ask that the court take notice of the existence of that study and ask if we could have that entered as an exhibit to the record to clarify between the two, that that analysis exists.

JUDGE PALMER: All right. Is

there any problem with that?

MR. ROSENBAUM: I am a little uncertain what it is that we are taking notice of.

JUDGE PALMER: I am uncertain too.

MR. SMITH: I know it is three minutes of five.

JUDGE PALMER: There is apparently some document that I guess had something to do with establishing the baseline in the past, is that what it is?

MR. SMITH: No. It is just as part of the rule-making in the Federal Reform Act rule-making, as stated in the proposed rule, there is a simulated analysis of a competitive pay price for grade A milk, it was a study done as part of the rule-making. It is just a straight study.

JUDGE PALMER: I am not going to ask him to bring it forward. They are giving you their econometric study today, and though that may have something to do with something. I don't think it has anything to do with their testimony.

So you have found out that it exists.

and if you want to try to get a copy of it, that is fine. Can you tell him how he would obtain a copy of that, where that would be? Is that possible?

MR. McDOWELL: I really think this is probably a better question for somebody else. to be honest. You are talking -- we do economic analysis and I think a copy can be found.

JUDGE PALMER: But this hasn't got anything to do with the study you did?

MR. McDOWELL: Yeah.

MR. SMITH: Just to clarify, we tried the other route before I came here to put this on the record. What I am just trying to do is get it documented that an analysis exists. If we could go to the next step and just have the department make that part of the record, because it is part of the proposal, that would be helpful.

JUDGE PALMER: I am going to refer that over to Mr. Stevens and --

MR. STEVENS: We will look into it.

JUDGE PALMER: They will look into it and report back before this is over. As far

as these gentlemen, I don't want to put the burden on them.

MR. STEVENS: Your Honor, we have a procedural matter, we need to go off the record for a minute. Mr. Huber has gotten a request we need to discuss today, just for a few minutes.

JUDGE PALMER: Let me ask you this -- we will go off the record. Let me ask you this: Should we now receive Exhibits 7, 7-A, 7-B and 8?

MR. STEVENS: I would ask they be received.

JUDGE PALMER: And they are received.

(Thereupon, Exhibits 7, 7-A. 7-B and 8 were received into evidence.)

JUDGE PALMER: Have we concluded all examination of these two witnesses?

(No response.)

JUDGE PALMER: We apparently have. so I am going to ask that they be excused and thank you very much.

Now we will go off the record for a moment and find out what other problems we might

have.

(Thereupon, a recess was taken.)

MR. VETNE: John Vetne representing Agri-Mark, et al., one of my clients is Foremost Farms, USA. They could not have a representative at this hearing. But one of their manager analysts has prepared some information relative to fat retention and put it in a sworn declaration, which I intend to offer into the record, and he will be available for questions and cross-examination by telephone.

I understand a speaker phone can be put right here and he can answer those questions, which would serve all of the needs of 5 U.S.C. Section 556. I will have that document available for distribution tomorrow and we can address any procedural issues at that time.

JUDGE PALMER: All right. Do you want to think about it overnight, about the use -- what he wants to do is use a speaker phone to examine a witness that he has that can't make it to the hearing.

We haven't done that in the past at these hearings, but the use of -- speaker phones have been used in other kinds of hearings that

we conduct. I don't know if there is a problem or not.

MR. STEVENS: I think we are willing to think about it. On the other hand, we have some thoughts we want to put on the record at this point.

I think the main point is the rules of practice don't provide for such a thing. We all want to hear the witnesses; certainly the Government wants the hearing to be open and available for anyone to testify. There does seem to be a particular problem with the availability of this witness to show at the hearing. I understand the declaration, I think that that is something we can receive as part of the record, the declaration.

The cross-examination is problematical, in the sense that -- I think everybody realizes we are not going to finish this hearing in one week.

If the witness is available at some future time, maybe that obviates a need for a declaration, if we are going to have some future session of this, John.

MR. VETNE: That is what we

don't know. That is why I propose to provide the declaration tomorrow.

MR. STEVENS: But these issues about -- there is no precedent for this. The witness won't be here on the stand, so that -- I don't know if demeanor is a big issue, but certainly, you know, the record should reflect the cross-examination of people who might examine in such a way over the phone or in a different way if the person is actually here.

I want to be fair -- you know, we want to be fair to you, we want to be fair to your witness. But I think in the interest of all the parties, maybe some of the other representatives here have a thought on this as to whether he -- now, the other part of this, of course, is if we start establishing a precedent of people being able to testify, say declaration, testify by cross-examination, the next step may be for them to totally testify by telephone or by -- and I don't think we want to get into that, because this is a public hearing. and everyone is here, and everyone is participating; and I think that is, you know, it has been described to me as a can of worms we

don't want to open, because that makes the hearing then open to people who aren't here.

JUDGE PALMER: I agree. I hear you very well. Why don't we think about it. Mr. Vetne. There is going to be another session sometime in April, I am going to find out when. Maybe he can appear at that one, it may be better.

MR. VETNE: Maybe. I think it is a good idea to sleep on it rather than shoot from the hip.

MR. STEVENS: Do we have to have this thing available tomorrow or not?

MR. VETNE: No, it is Wednesday.

JUDGE PALMER: Let's close down. we will be back here tomorrow at 9:00, and we are now going off the record.

(Thereupon, the proceedings were adjourned at 5:04 o'clock p.m.)

C E R T I F I C A T E

STATE OF OHIO,)
) SS:
SUMMIT COUNTY,)

I, Binnie Purser Martino, a Registered diplomate Reporter, Certified Realtime Reporter and Notary Public within and for the State of Ohio, duly commissioned and qualified, do hereby certify that these proceedings were taken by me and reduced to Stenotypy, afterwards prepared and produced by means of Computer-Aided Transcription and that the foregoing is a true and correct transcription of the proceedings so taken as aforesaid.

I do further certify that these proceedings were taken at the time and place in the foregoing caption specified.

I do further certify that I am not a relative, employee of or attorney for any party or counsel, or otherwise financially interested in this action.

I do further certify that I am not, nor is the court reporting firm with which I am affiliated, under a contract as defined in Civil Rule 28(D).

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal of office at Akron. Ohio on this 6th day of March, 2007.

Binnie Purser Martino, RDR. CRR

My commission expires June 26, 2009.

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