VOLUME III

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

Wednesday, February 28, 2007

9 09 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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On Behalf of the United States Department of Agriculture:

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and

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I N D E X

I N D E X (CONTINUED)

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E X H I B I T S

	MARKED	RECEIVED
Exhibit No 14	520	585
Exhibit No 15, 15-A. 15-B	586	722
Exhibit No 16	655	--
Exhibit No 17	655	672
Exhibit No 18	722	750
Exhibit No 19	732	750

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JUDGE PALMER: You are still under oath. Mr. Galarneau. Let's start the third day of this hearing. Mr. Galarneau is giving direct testimony, and I believe he is available for cross, unless there are some additions to his direct testimony. Who would like to question? Mr. Yale?

CROSS-EXAMINATION

BY MR. YALE:

Q. Good morning.

A. Good morning.

Q. First off, I want to share appreciation for putting together a mass balance, it is nice to see that as part of the record. I just have a few questions.

The price that you account for a pay for the milk that goes into that plant, at least in recent years, okay, based on pricing, the amount that you pay for the milk that goes into that plant is less than the price that is paid to the producers who supplied that milk; is that true?

A. It depends on the utilization of the plant at that particular month. But I would expect generally, yes.

Q. There are some times with the variations in

the timing of the pricing that the Class II or something could get higher, is that what you are saying, or does that plant have other allocations, other than the II and IV?

A. And some III.

Q. It does have some III?

A. If we sell cream to a cheese plant.

Q. Okay. Now, if -- and I realize that Michigan Milk is a major contributor to the Producer Settlement Fund, I don't want to diminish that. If there were no Producer Settlement Fund that would provide that blended price, the plant would be paying the same price. basically, for the milk as it is today, because it would be based on some kind of an end product pricing, one where you can sell your finished product for, right?

A. I am not certain what you are trying to ask here.

Q. Well, let's state the question differently. If you sold -- for the moment, let's assume that there is no market pooling. Okay? And that your plant buys milk and the producers get what you pay for the milk. Okay? And there is no contribution from the pool for any difference

between whatever that utilization is and a blend price. Okay?

A. You are looking at strictly the plant operations and not the company's operation?

Q. Just the plant operations, right, not the company's, because I understand as a co-op, you do your own pooling and blending internally, right?

So for the moment, we are just looking at the plant, and there is no pooling. And the price that -- the value of that milk that you would pay for that milk would be not much unlike what you presented in your mass balance, right?

A. Absolutely.

Q. It would be much different?

A. No, it would be very similar.

Q. Very similar to that?

A. If all I made was butter and powder, then it would be very similar to that. Assuming I was able to buy all the milk that I purchased at class, which is not a good assumption.

Q. Which means that the way you are able to have that milk available to that plant is because -- on a long-term basis, is because the producers are going to be receiving more for

that milk than what the plant is capable of paying, either through the pool or --

A. It is generally through the pool, right. the Class I pooling.

Q. Okay. So this is a policy question that I just raise out. The standard -- if the -- let me back up.

The plant in this regard then, again. forgetting your company and the pool, the plant in that regard receives a benefit from the market-wide pooling because of the fact that the producer of the milk that goes into that plant is able to participate in higher value uses elsewhere, right, because it helps it attract and make milk available to that plant?

A. Well, with our plants, sir, they are balancing plants.

Q. That's right.

A. We make butter powder generally because we have to in order to balance the ups and downs in the weekly, monthly, seasonal flows of milk made by the Class I market.

Q. So you are saying without having to balance, you would not have the plant?

A. Not to make butter powder, not in Michigan.

Q. I want to change subjects and ask another question. What is the moisture, typical moisture content of nonfat dry milk to be produced at that plant, do you know?
A. Yes. I do. I have it listed on Attachment C as nonfat dry milk, 3.3 percent moisture.
Q. That is fairly standard in the industry?
A. I don't know about the industry. But that is what we are able to produce at our plants.
Q. Now, when nonfat dry milk is sold, is it sold on a dry matter basis, or is it sold on a basis of approximately 3 percent moisture?
A. It is sold on a price per pound powder.
Q. Powder. And is there a --
A. Grade A nonfat dry milk must be less than 4 percent moisture.

MR. YALE: Okay. I don't have any other questions. Thank you.

JUDGE PALMER: Very well. More questions? Yes, sir, Mr. Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. On page 2 of your statement, Exhibit 13. you provide some information regarding the shrink between the farm and the plant, correct?

A. That's correct. And the Attachment A shows an example of several months' worth of experience.

Q. I take it that -- is it your view that y'all are doing the best job you can. but there is just some inevitability to this kind of shrinkage?

A. Absolutely. As a matter of fact, we do monitor this farm-to-plant shrink and whenever it starts to get out of line on a route basis, we investigate the farms on the route and find out what is going on and try to make corrections.

Q. The reason you do that is because if you don't get the milk, you can't turn it into some useful product and it is just a loss to you?

A. That's correct.

Q. Now, this specific figure that you provided is that your loss typically averages about .3 percent by weight, correct?

A. Yes.

Q. Now. I believe the record will establish that the current make allowances assume in their formulas a .25 percent farm-to-plant loss. You take that as a given.

Am I correct that your figure would suggest that that adjustment is certainly appropriate. and, if anything, a little on the low side?

A. Well, as far as plant to shrink, yes.

Q. As far as farm-to-plant shrink?

A. Farm-to-plant shrink, yes. But overall. I think my analysis shows that the current yield factor is just about right, nonfat and butter. Class IV pricing.

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

JUDGE PALMER: Thank you.

Mr. Schad.

CROSS-EXAMINATION

BY MR. SCHAD:

Q. Good morning, Clay, this is Dennis Schad from Land O'Lakes.

A. Good morning.

Q. Notwithstanding your last statement, that you believe that the current shrink factors are appropriate and yield factors in the Class IV formulas, there have been people here who have talked about opening up the Class IV yield factors and looking at buttermilk again.

And I would just like to ask a couple of

questions.

The first one, I guess the questions would be, what factors would you -- if the Government believes that they should do that again, after what they gave us in the final and recommended decisions for the 2000 hearing, if the Government does believe they should open that up. I am wondering about the factors that you think the Government might want to look at before.

And one of the things I would like to look at, have you point out is, in your buttermilk powder, what is the fat percentage?

A. Ours typically is about 6.6 percent.

Q. Is it noted on your yield factor?

A. Yes, it is, on schedule -- Attachment C.

Q. Thank you. Attachment C, 6.6 percent. Would it be fair to say that if the Government wanted to open up buttermilk as a factor, that it should take into account the fact that buttermilk powder has a higher fat percentage than nonfat dry milk?

A. That would be my belief.

JUDGE PALMER: I missed that. Did you say buttermilk powder has a higher --

MR. SCHAD: -- higher content than nonfat dry.

JUDGE PALMER: Okay. I didn't hear that. I wasn't sure if I heard "does" or "doesn't." but it does have.

BY MR. SCHAD:

Q. Just as, going to your Attachment C, what is your average fat percentage in nonfat dry milk?

A. .72 percent.

Q. Okay. Thank you. Other things that the department may want to look at, if they open up this buttermilk issue again, is price. Is there a NASS price for buttermilk powder?

A. No.

Q. Is there -- could you describe, you know. the price discovery mechanism, if you will, for buttermilk powder?

A. I don't know if I can answer that question. Dennis.

Q. To the best of your ability, Clay.

A. Buttermilk pricing generally follows nonfat at something less than the nonfat pricing. unless there is an unusually high butterfat price, then buttermilk powder might pick up a

premium for the butterfat value, occasionally. but those instances are rare, and generally that is usually a 20 to 25 percent discount off the nonfat price for buttermilk powder.

Q. In the final decision and the recommended decision, the department went out -- well. actually, everyone seemed to have a different price. The department liked the Western price series. I think that some other folks liked the Central States price series, which is reported in Dairy Market News. And I was referring to that as a price discovery.

Is what is reported in Dairy Market News a weighted average price?

A. No.

Q. Can you give me your idea of how that price is determined?

A. I think we have some people here from the AMS, don't we? It may be more appropriate to ask them. It is generally a range.

Q. Okay. Thank you. And it is not a weighted average price?

A. And the price that I used in my schedule. Attachment C, I went back to 1999 when we first started recording NASS numbers and picked up the

Central States average for each month and looked at what the average prices were and came up with 99 percent of the nonfat, applicable NASS nonfat price, and that's what I have used in my schedule

But I think it is interesting, that that is just a simple average, and it doesn't match our experience for the price that we received for buttermilk powder That is generally because when you have a higher price for buttermilk, you are not selling any, because you don't have any

And when there are lower prices, then you have a lot more to sell and that is why the prices are lower

So I would like to have used a weighted average Unfortunately, I have no way of determining weighted average, other than maybe our own numbers

Q Thank you very much And the last factor I would assume that the department would want to look at is the cost of production for buttermilk powder

Are you here today -- can you tell us, you know, what your cost per pound for buttermilk powder is?

A. I wish I could. I just know that it is more than nonfat. The dryers run slower on buttermilk powder and they foul sooner, so there is more cleaning that would be necessary if you were running buttermilk powder, at shorter intervals, runs.

And the moisture has to be driven out in order to make it a transferable product and get it into bags. So there is more cost involved. there is more cost in collecting buttermilk powder. Not so much the powder, I mean, but collecting the buttermilk solids from buttermilk and then condensing them. You only get buttermilk when you churn butter.

If you are churning maybe once or twice a day, then you are just collecting small amounts of buttermilk, so you end up with short, expensive runs.

Q. So in short, there is no price series for buttermilk, there is no evidence for the cost of producing buttermilk powder, and the product is different than nonfat in this composition?

A. There is no NASS price series. There are prices out there.

MR. SCHAD: Thank you very

much.

JUDGE PALMER: Mr. Yale?

CROSS-EXAMINATION

BY MR. YALE:

Q. I want to follow up with a couple of these questions. This last one, when we talked about the buttermilk, you participated, I believe, in the -- or not you, but MMPA powder plant participated in the Cornell study that Dr. Stephenson did that was part of the record in the make allowance hearing; is that correct?

A. I don't know how you would know that.

Q. Didn't you call and complain about a price?

A. Actually, I did.

Q. Okay. That is how I know about it.

A. Then apparently Cornell wasn't discreet.

Q. I didn't get it from him.

A. Oh.

JUDGE PALMER: I wouldn't want to do a Scooter Libby trial here.

MR. YALE: It would be nice to have reporters to these so that we could even worry about that issue.

BY MR. YALE:

Q. Forgetting that for the moment, the

question comes on the recording of those costs. Did those include the costs associated with handling the buttermilk, or did you separate that out with your costs?

A. No, those were added.

Q. Okay.

A. They are included in total plant costs

Q. Now, a follow-up of Mr. Rosenbaum.

The farm weights are the weights that are pooled on the order, right?

A. Yes.

Q. Now, does Michigan Milk, the haulers, the farm-to-plant haulers for Michigan Milk, are those independent haulers, or are those employees of Michigan Milk?

A. They are independent haulers

Q Okay And they negotiate their prices and the like with the producers?

A. Yes.

Q. Now, the study you had did not represent all of your plants and all of your deliveries. did it? Did that represent all of your plants. I mean, all the deliveries --

A. Are you referring to farm -- to plant shrink?

Q. Farm-to-plant shrink, yes. Or is that just a representative sample?

A. No. Actually, on Attachment A, it represents 73 percent of our milk, which goes to customers that scale. There are apparently 27 percent of our milk that go to customers that don't have scales.

Q. Now, have you done any analysis to look at the shrink as it regards the size of the farms on the trial?

A. I haven't. Maybe somebody in our organization has, but I am not aware of their results.

Q. The process of weighing for weight purposes of milk at the farm, how is that generally done with Michigan Milk?

A. They load the milk into the truck and there are stick weights.

Q. So it is like a dipstick --

A. Exactly.

Q. -- that the hauler looks at?

A. Yeah. So if it was at, you know, the 1 inch line, and he goes to the next farm, after unloading the milk into the truck, it is to the 2 inch line, then that 1 inch of milk is

gradated to equal so many pounds.
Q. So he weighs it on the stick on his truck as opposed to the farm tank?
A. I believe so.
Q. Now, is the hauler paid on the weight that is picked up at the farm?
A. I don't know what prices the farmers negotiate with their haulers.
Q. You don't know whether --
A. Whether it is a straight fee per load or based on a hundredweight.
Q. You don't know that per hundredweight is a basis?
A. No, I don't.
Q. You would agree, I take it -- let me ask you this. Withdraw that and let's start over.
Have you ever participated or seen how the weighing is done and the reading of the sticks?
A. No. I actually haven't.
Q. Now, in Michigan, the haulers, do they have to be certified weighers and testers?
A. I don't know the answer to that.
Q. Have you done any analysis in terms of what the samples that come out of the farm tanks, as they compare to the samples at the plants for

butterfat, for example?

A. Are you referring to our pay test versus what the plants receive?

Q. Yes.

A. Yes.

Q. And how does the pay test to the plant test agree?

A. On butterfat?

Q. Yes.

A. We have had a lot of difficulty in that area, because we haven't been able to get good plant samples, at least at our plants, because we haven't had a whole lot of need to.

The plants pay for the milk based on farm weight and test, and we are going to process whatever we are given. That is our job as the co-op. And whether or not I had a test at the plant that was different doesn't matter.

Q. And the same thing with -- so on the other components as well, you don't have, like, a plant test as compared to the producer test for the protein or the other solids?

A. Receiving?

Q. Yes.

A. We do, but because we haven't had accurate

sampling methods, in order to get a good sample. you want to agitate the load before you took your sample. The time it would take to agitate it, versus -- given the fact that we are going to accept it anyway, it was a waste of time and money.

But now with new technology becoming available to get online drip samplers from loads, we do have that recently installed in our Ovid plant, and we would like to get it installed in our Constantine plant, and hopefully, within a year now and collecting some data, we will get that information.

Q. And it is on those tests that the bulk of the money that the producers receive is based on, right, on the solids tests, the component test? At the end of the day, producers receive a component price plus a PPD?

A. That's correct.

Q. And the bulk of the money that is in the check traditionally is in the component prices?

A. They get paid the blend, plus a premium.

Q. Is that the way Michigan Milk pays?

A. Well, you start with the Class III price and the components. When you add it all up.

they get paid the blend.
Q. I mean, do you pay your producers a blend. or do you pay them a component price plus a PPD?
A. We pay them a component price plus a PPD, which equals the blend, plus our company over-order premiums.
Q. I understand that. We are not going to talk about negative PPDs.
A. Well, we have got time.
Q. No, we don't. If somebody else thinks it is relevant, they can certainly do it. I am not going to go down that line.
Now, I mentioned before, that value that the farm tests at the farm site, that is what you use when you do your pooling within Order 33, right?
A. I am sorry, I don't understand your question.
Q. The farm weights and tests is the values that you report to the Market Administrator for the Producer Settlement Fund accounting in the order in which you sell your milk, right?
A. Yes.
Q. And based on what you are saying, is that that is overstated by the amount that you have

in your chart of .25 to .30, something like that. shrink. right?

A. To the best of my knowledge.

Q. Now, again, the over-order premium structure for nonmanufacturing plants in your market, do you include a service charge for paying on farm weights and tests?

A. Do we charge our customers for --

Q. Do you have a fee or a discount, or do you charge -- I am not charged for farm weight. Do you have a charge that they pay on plant weights?

A. If the customer chooses to pay on their own plant weights, as opposed to the farm weight, yes. we would charge them.

Q. Is that a fixed rate per hundredweight?

A. That is negotiated by our Milk Sales Department, and that would by Carl Rasch, and I am not familiar with the current fee structure. But I am sure it would be in relation to this type of shrink and then what some average value of that milk was.

Q. Now, you don't represent all the milk that goes into Order 33; is that right?

A. That's correct.

Q. And there are loads of milk that are pooled on that in which they are full tankers picked up at the farms, right?
A. Pardon me?
Q. Full tankers are picked up at a given farm. Full tanker loads of milk are picked up at one farm?
A. Oh, sure.
Q. I think, by your testimony, you haven't done an analysis to look at the size of the farms and any comparison in terms of size?
A. I am not aware of that data.
Q. Now, let's take an assumption for a moment.
A. I could tell you that I am reasonably certain that some of those farms would be in this 73 percent number.
Q. Why do you say that?
A. Well, because I know some of those farms go to our plants and our plants are included in the 73 percent.
Q. Those may be different and the others higher, right? It is a weighted average?
A. It is a weighted average, right.
Q. I went down that line with Bob Wellington. But for the moment, assume that there are

farms in which full tanker loads are picked up at the farm and they are scale weighted at the farm for the weight.

A. That would be rare, scale weighted at the farm.

Q. We will talk about that later on. I am not going to ask -- but you have farms that are scale weighted and that is their farm weight. And they -- on their negotiations and their analysis with their buyers is that there is no shrink, that there are overages and underages to the point that in any given month, there is no shrink, okay?

A. You are referring to something that I am not familiar with then.

Q. Well, I am asking you to assume this for the moment. We will get the evidence in. I am not asking you to put that evidence in. We will put that evidence in.

Take the position that there are producers that are delivering at accurate farm weights and tests and there are no shrink. That is the test that they put in the pool?

A. I am not aware that that would be done in our order.

Q. I ask you to assume that it is for the moment.
A. Okay.
Q. Let me represent to you that you have producers in Indiana that do this on a routine basis and Ohio and Michigan.
A. Okay.
Q. And if you want some day, I will give you a tour and take you to the farms and show you how it is done.
A. That will have to be your testimony
Q. I understand. Assume for the moment that it does exist. They are putting in accurate weights and tests in which there is no shrink. and it is being pooled with producers which there is shrink.
A Hmm
Q Okay They are, in a sense, subsidizing the producers that are experiencing this shrink. right, because they are paying for milk that was not put into the pool?
A. Also based on your assumption that you are asking me here, is that those are large farms.
Q. Yes.
A. And we probably paid them a high volume

premium.

Q. Do you guys pay high volume premium? I don't know.

A. Yes, we do. And so a lot of our farmers would think they are subsidizing the --

Q. I understand that. But the point is, based strictly on the issue of weights, if you have a group of farmers that are delivering to the plants on absolutely accurate weights which the plants receive with being delivered and you have some that are not, and it is all getting pooled. then those who are not delivering the full value that they are getting paid for are, in fact. receiving a contribution from those who are delivering all that they are being paid for, is that a true statement?

A. Well, assuming there isn't compensation in the value of the volume premium.

Q. Does Order 33 have a volume premium in its structure?

A. You were asking me about our members.

Q. Yes, your members.

A. And under the assumption that you provided.

Q. I am talking about within the pool, the total Order 33 pool.

A. Then I don't know the answer to that.

MR. YALE: Thank you.

JUDGE PALMER: Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Marvin Beshore. Good morning. Clay.

A. Good morning.

Q. On Attachment A, just to be clear, these calculations represent farm weights determined by dipstick readings, less plant scale weights, is that --

A. Whichever plant received the milk.

Q. Okay. But the loss on Attachment A is based on the plant scale weights?

A. That's correct.

Q. The farm dipstick weights minus the plant scale weights?

A. Yeah, unless Ben is going to provide evidence that there are some. But then they would have less shrink, but this is still the weighted average, regardless of whether some loads had zero shrink.

Q. And when you say 73 percent of MMPA milk is scaled, I think you indicated that was at the receiving plant?

A. Yes.
Q. And this just reflects those volumes. Attachment A, these tables just reflect those scaled receipt volumes?
A. Right. That of all of our milk. 73 percent of it goes over scales.
Q. With respect to Attachment C, your testimony says that Attachment C multiplies MMPA's typical yields for butter and NFDM and buttermilk. Did you calculate the typical yields?
A. Yes. these were the averages for 2006.
Q. When you calculate those yields, what is the -- what is the volume of milk going into the plant?
A. How much milk did our plants receive?
Q. Well, how is that determined?
A. The amount of milk going in is based on farm weight and test.

MR. BESHORE: Okay. Thank you.

JUDGE PALMER: Any more questions? Mr. Vetne?

CROSS-EXAMINATION

BY MR. VETNE:
Q. Good morning.

A. Good morning.
Q. John Vetne. Just a couple of questions to follow up, to cross.
You answered some questions in the hypothetical concerning what payment would be made for milk received by the manufacturing plants if there were no pool. Do you recall those questions?
A. I may need some help.
Q. Okay. And I think your answer was that you would still pay using the same approach, that is, payments based on what you can receive from the marketplace, minus your cost of processing the products?
A. Sure.
Q. Okay. I mean, is that your recollection of the dialogue between you and Ben?
A. I guess you would have to remind me of the specific question.
Q. Okay. When you were asked those questions. the assumption was that there would -- there is no pool, nothing was stated about what the price relationship would be, you were asked to draw no conclusions, what the price relationship would be between manufacturing classes and Class I or

Class II. Do you have any comments on, if there is no pool, whether that relationship would be the same as it is under Federal regulation?

A. If there is no Federal Order pool, there will be changes.

Q. There would be. So the dynamics of competition in the absence of a pool were not factored into your answer; is that correct?

A. That's correct.

Q. Okay. Got that one. You were asked a question which was premised on your plants receiving -- your manufacturing plants receiving a benefit as a result of a presence of a pool. that is, the plants are able to draw. Do you recall that question?

A. Yes.

Q. Okay. Do those plants, in fact, not provide -- strike that.

Those plants, in fact, do provide a benefit to the market by providing an outlet for milk, so you are able to serve the Class I market and return higher prices from the Class I market to your farmers, as well as other farmers?

A. I was going to add the last part if you didn't. John, that we provide a tremendous

marketing advantage for the members in the greater Michigan, Indiana, Ohio area.

Q. Now, the question of farm-to-plant shrink. In the market with which you are familiar, are there a variety of sizes of trucks that pick up milk from farms?

A. Absolutely.

Q. Okay. And are you able to comment upon whether, in a market like that, one would expect to experience a greater amount of shrinkage where there are pickups in smaller trucks than pickups in larger trucks, farm-to-plant shrinkage?

A. I am not prepared to answer that question I have no specific knowledge in that area.

Q. Okay. Shrinkage, as you explained yesterday or in your testimony, occurs because of, among other things, adhesion of milk, and fat in particular, to surfaces.

A. Right.

Q. Isn't it reasonable that there would be more surface exposed when you have multiple trucks?

A. I would tend to agree with that

Q. And what about the -- is there any

contribution to shrinkage based on the number of stops that a truck might make, number of farms that a truck might pick up from or from which a truck might pick up?

A. Other than the earlier reference I think you were making, the size of the trucks. I am not aware of how that -- the cumulative effect of that.

MR. VETNE: Thank you.

JUDGE PALMER: Any questions?

Mr. Schaefer.

CROSS-EXAMINATION

BY MR. SCHAEFER:

Q. Good morning, Clay. Yesterday, I think, if I recall correctly, you mentioned that the current formula for nonfat dry milk does not include any allowance for buttermilk powder?

A. I may have.

Q. In that case, do you happen to recall the decision that was published in November of 1999. which would have been the final decision that implemented order reform, and in that decision there was a specific reference to an adjustment that was made to the formula from a factor, in this case. a divisor of .96, I believe it was.

and they changed that factor to 1.02 to account for buttermilk powder, and then again in the final decision for the hearing in 2000, which was published in 2002, that factor was adjusted to 1 and then there was an adjustment for shrinkage?

A. As you explain it, it is coming back to me. But if I actually remembered that, no. But by analysis, is that it is trying to show that it didn't really matter how you got to the answer, you ended up at the right place.

Q. Okay. Thank you. You also mentioned this morning then that you used Dairy Market News' Central States information to calculate your -- some of your values in here?

A. For the buttermilk price.

Q. Do you regularly use the information from Dairy Market News in your business?

A. Yes.

MR. SCHAEFER: Thank you very much.

JUDGE PALMER: I am not seeing any show of an indication from anyone that they wish to cross-examine the witness at all. So thank you very much. sir.

MR. STEVENS: Your Honor. I have to plug in a minute here. Your Honor. I just want to check, has his statement been admitted?

JUDGE PALMER: Very good.

MR. STEVENS: I know it is identified.

JUDGE PALMER: I have it as received. But we will say it one more time. It is received, yes, sir.

MR. STEVENS: Okay, good.

JUDGE PALMER: Thank you very much. Let's take a short recess for five minutes.

(Thereupon, Exhibit 14 was marked for purposes of identification.)

(Thereupon, a recess was taken.)

JUDGE PALMER: If Mr. Squire would come forward.

ALLEN SQUIRE

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

JUDGE PALMER: Mr. Squire has been sworn and we have marked his statement for identification as Exhibit 14. Mr. Yale.

MR. YALE: Yes, and his name

is in the record, Allen Squire. Mr. Squire. I know you have a statement. If you have a statement, why don't you read your statement into the record and then I will ask questions that are raised in that. Okay? Why don't you go ahead and read the statement, then I will ask questions.

STATEMENT FOR THE RECORD OF ALLEN SQUIRE

MR. SQUIRE: My name is Al Squire. I am a dairy producer from Hagerman, New Mexico. My wife Linda and I own and manage South Wind Dairy. South Wind Dairy milks approximately 3800 cows and has been operated continuously since 1994, when we started with about 1100 cows. We ship our milk through DFA and the Greater Southwest Agency. South Wind Dairy is a member of Dairy Producers of New Mexico and my testimony is given today on behalf of Dairy Producers of New Mexico.

Dairy Producers of New Mexico is a not-for-profit trade association of producers in New Mexico and West Texas. It advocates the interests of its producer members before legislative, judicial and agency proceedings. DPNM represents approximately 80 percent of the

dairy producers in our region. We serve as a liaison for national, state and local issues. provide educational services for our New Mexico dairy farmers and act as a source of information for our communities, regulators and legislators. Dairies that join DPNM do so on a voluntary basis and pay membership dues. As a producer-only organization, we are one of the few groups that speak on behalf of only producers.

Dairy Producers of New Mexico has been very active in the debate on national dairy policy, especially on matters that impact the prices received by dairy farmers. For example, DPNM was very active in the rule-making required by the 1996 FAIR Act, particularly in the establishment of pricing formulas for Class III and Class IV milk.

Dairy Producers of New Mexico is a chief proponent of several proposals before the department. In addition, other parties have joined in their support of our proposals. They are Select Milk Producers, Lone Star Milk Producers, Zia Milk Producers and Continental Dairy Producers. While we are pleased to have

the support of these cooperatives for our proposals, my statements here today have not been reviewed or endorsed by any of them.

Several Lone Star, Select and Zia members are also members of DPNM. DPNM also has many DFA shippers as our members. While DFA has not formally joined in support of our proposals, we do gratefully acknowledge their support of some of our proposals.

For example, DFA Proposal 5 is the same as one portion of our Proposal 6 addressing a mathematical error in the calculation of butterfat shrink. Similarly, we share common ground with one of DFA's proposals. In the case of the use or nonuse of barrel cheese in the formula, if our proposal to replace NASS with CME is not accepted, we support DFA's proposal to eliminate barrels from the formulas.

History of DPNM's positions. DPNM believes that dairy regulation must result in pricing that is fair to all producers of all sizes and all geographic regions of the country. End product pricing became the formula, we expected a fair and full disclosure on formulas. We proposed the use of CME pricing in 2000, and

we believe that the past few years have shown that the CME provides the best measure of commodity prices.

I would like to describe the dairy industry in West Texas and New Mexico briefly.

Milk production in the State of New Mexico has grown from 600 million pounds a year in 1980 to 7.6 billion pounds in 2006. Our 360.000 milking cows are managed by 172 producers, ranking New Mexico seventh in the nation in milk production with 4 percent of the national milk production.

New Mexico ranks first in herd size per farm, with more than 2000 milking cows per farm. The dairy industry impacts the New Mexico economy in three ways. It has a direct impact in the economy as processing plants demand and buy milk or meat animals directly from the dairy farmers. It has an indirect impact by purchasing labor, feed, energy, livestock, real estate, supplies from local linked industries to produce a final product of meat or milk.

And it has an induced impact by the consumptive effect of people employed in the dairy industry and people in all other allied

industries.

According to a forthcoming analysis of the economic impact of the dairy industry in New Mexico, dairying results in over $1 billion in cash receipts for producers and accounts for 1600 direct jobs. The total economic impact reaches $2.64 billion in total economic activity and directly or indirectly contributes to over 15.000 jobs in the state.

Accordingly, it is in the interest of New Mexico to see that its dairy industry is not negatively impacted by changes to the manufacturing price formulas. According to New Mexico State University, "Milk cash receipts are the most important income in New Mexico dairy farms, which may account for as much as about 95 percent of the gross income of dairy farms. Therefore, the price farmers receive for their milk has a substantial influence in the overall economic impact of the dairy industry to the New Mexico economy."

It is not in the written statement. but on a personal note here, I would like to interject that when we moved to the Roswell area in the early '90s, it was still an economically

depreciating area that began in the late '60s with the Walker Air Base leaving, losing nearly 20,000 jobs at the time. There were empty buildings, empty homes everywhere.

Throughout the '90s, as we watched the dairy industry grow, the town began to revitalize, and during the period of time that the dairy industry has grown as it has to this day, the housing market has increased, there are new hotels, there are new restaurants, there are actually places where people can go and shop in town. So it has been a tremendous boost.

The only thing during that time that we have seen has been the dairy industry has been a major factor in that growth. The Levi's plant left and moved south of the border. Nova Bus plant left, moved south of the border. So a lot of people there really depend upon the dairy industry.

We bought a house in '91, when we built our dairy and moved to the dairy in '94. We barely got the money back that we put into our house in '91. So the housing market is not similar to what it was in California or Ohio or many other places. So we have seen a direct

impact of the dairy industry on the local economy.

Texas has a similar impact on its economy as a result of dairy farming. The State of Texas produced 6.44 billion pounds of milk. which is 3.6 percent of the national milk production in 2005. Milk production in Texas has experienced an increase of 78 percent in the last 26 years. Today, six out of the top ten dairy counties in Texas are located in the Northern High Plains of West Texas, accounting for 31 percent of Texas milk production. The total cash receipts of Texas dairies in 2005 was $1.031 billion, of which 95 percent was due to the sale of milk.

I would like to follow with our proposals.

Dairy Producers' proposals can be broadly described as, number 1, using the CME spot prices to replace the NASS surveyed prices in the pricing formula; number 2, correction of mathematical error in the butterfat shrink portion of the formula; number 3, adjust the fields in formulas to reflect current manufacturing efficiencies; and 4, adjust make

allowances to conform with Cornell's reported survey results.

Details and data in support of each of these proposals will be provided by other witnesses. I would like to remind you that I am not a technical witness, and I will defer any questions about the specifics of the proposals to these other witnesses.

We have positions on other proposals. We oppose Proposal 1, as it conflicts with our Proposal 3, to set make allowances based upon the Cornell study. Other witnesses will have the specifics on that proposal. Dairy Producers of New Mexico opposes the use of California plant costs for setting make allowances in the rest of the country.

What it costs to produce cheese in California is irrelevant to the cost to produce it elsewhere. It would be like setting salaries based upon the cost of living in New York City or San Francisco and applying those to places like Roswell. New Mexico or Strongsville. Ohio.

We oppose Proposal 2. This proposal is a backdoor way of significantly raising make allowances based on older, less efficient plants

in a few milk marketing orders. The focus should be on the efficient. More importantly. the complaint has been that the NASS survey price limits processors the ability to pass on costs. By adopting our proposal to use the CME. the need for such high make allowances is unnecessary.

We support Proposal 5 through our Proposal 6. Proposal 5 by DFA is nearly identical to our Proposal 6.

We oppose Proposal 9. As USDA has stated, there is no presentation of data to show the value of whey cream or how it is used. Other witnesses will address the technical aspects of our opposition.

We oppose Proposal 10. For similar reasons in opposing IDFA's Proposal 10, we oppose Agri-Mark's Proposal 10.

We oppose Proposal 11 and 12. The need for a barrel adjustment is unnecessary with the use of a CME block price in place of the NASS survey. In the event that the department does not accept our proposal to replace NASS survey with CME, we would support Proposal 13 by DFA and NDA.

We oppose Proposal 14. The problems with NASS survey usage are several. including a lag between the CME and incorporation into formulas and the issue of circularity in the formulas. This proposal only addresses the lag and not the other. Replacement of NASS with CME solves both and makes a simpler program.

We have no position on Proposal 16. We have not had sufficient time to analyze and discuss 16 to take a position at this time.

We oppose Proposal 17. Energy costs are a key component in producing milk. We use it to power our milkers, cool our milk, irrigate our fields, harvest our crops, feed our cattle, handle our animal waste and haul our milk. The only way we have to recoup higher energy costs is from the buyers of our milk. There is no other avenue.

Proposal 17 not only blocks that potential, but automatically shifts the higher cost of energy at plants back onto the producers. Producers should not be made to assume the risk of energy cost increases at the plant. They should get it from the market. If current formulas keep that from happening, then

we need to fix the formulas.

We do not have a position on Proposal 18. During the FAIR Act reform, DPNM was a leader in the request for the use of a competitive price formula for setting values. It is the only formula that can capture farm economic factors. Unfortunately, there is an insufficient supply of unregulated milk. We will look to see what the evidence is and may take a position later in the proceedings.

We do not have a position on Proposal 20. This has come too late for us to analyze and discuss a position. Adoption of our Proposal 15 will make such proposal unnecessary.

Additional arguments regarding our positions on these proposals will be included in our post-hearing brief.

DIRECT EXAMINATION

BY MR. YALE:

Q. First off, I have got just a couple of questions to make sure that we clarify what was spoken is correct. If you would look at page 2 of your testimony, and you had the name of Continental, you said Continental Dairy Producers, and what is written there is

Continental --
A. -- Dairy Products
Q. That is the correct name, right?
A That's correct
Q. And then if you would look over on page 5, down there at the bottom, I think you read it right, but it was typed wrong But we oppose Proposal 10, and for similar reasons in opposing IDFA's Proposal 10, it should be Proposal 9, the one that you just stated above; is that right? You see that down there, about the third from the bottom paragraph?
A. Okay. We oppose --
Q. -- Proposal 9, which was just discussed in the paragraph above.
A. Okay. It says Proposal 10.
Q. You read it correctly.
A. But it is 9.
Q. It is 9.
A. Okay.
Q. Very good. Mr. Squire, let me -- you talk about New Mexico. Where did you begin your career in the dairy industry?
A. I grew up on a small dairy farm in Geauga County. That is about 30 miles east of

Cleveland.
Q. Okay. And where did you get your education, formal, after high school?
A. After high school, I attended Ohio State University in dairy science, and then proceeded to go to veterinary school at Ohio State.
Q. And where did you practice veterinary?
A. As I left Ohio State's vet school. I was able to get a job in southern California, in Chino, California.
Q. And at that time was that a major dairy area?
A. That was, at that time was considered to be the most populated two counties of cows in the United States. Riverside and San Bernardino counties.
Q. And how long did you work there?
A. I practiced in the Chino area from 1975 until approximately 1981.
Q. Okay. And then what did you do?
A. After my wife and I got married, we got a little homesick and we moved back to Northeast Ohio. And when I left high school, one of the comments I made was I wanted to go to vet school, because I didn't see the dairy industry

growing in Northeast Ohio and, in particular. where we grew up.

And so when I came back, there were very few dairies left in that area. I missed my calculations by 20 years.

Q. So that didn't work out, so did you do anything else?

A. Well, during the '80s, we were doing veterinary work and embryo transfer work in the State of Ohio, and traveling most of the State of Ohio.

In 1988, as I can remember, we had a terrible drought in this area, and we learned quickly that embryo transfer work was a luxury and not a necessity, and so our business dried up just like the weather did. And we decided it was time to start looking elsewhere if we wanted to stay involved in the dairy industry.

Q. And that is what brought you out to --

A. And coincidentally, it worked that some former friends and clients of mine were moving into the Roswell, New Mexico area, and I was contacted to see if I would do veterinary work in that area.

And we subsequently started, I got licensed

in New Mexico and started doing veterinary work in the State of New Mexico. I had clients in the Albuquerque area, Clovis area and Roswell area. And subsequent to that, I invested in a partnership in a developing dairy, it was called Shawnee Dairy, and that began in 1989.

Q. And then eventually you acquired the dairy you have today?

A. Well. Shawnee Dairy had nine partners. For anybody that has been in dairy partnerships, you realize that is almost unworkable, nine partners and nine wives.

(Laughter.)

A. So it was interesting. And I learned soon that we needed to be on our own, and we were able to sell our share of that dairy and get involved in another dairy that was our own.

Q. Now, in this moving that you did from Ohio to California back to Ohio to New Mexico, did you discern any differences in cost of living and the like in those communities? I mean, were they the same, you know, Northeast Ohio was the same cost of living as it was in California when you lived there?

A. At the time we were living in California.

it was a higher cost of living. When we came back to Ohio, in the early '80s, it was actually much lower cost of living, with the exception of the heating in the wintertime.

Q. Now, in the area that you dairy. are there other dairy farms nearby?

A. Yes, there are approximately 40 in what we call the Lower Pecos Valley.

Q. And are you in regular contact with those other dairymen?

A. Routinely we contact most of them

Q. How would you describe the economic health or situation for dairy farmers in that region today?

A. Right today?

Q. Yes.

A. I guess I would describe it right today as a disaster waiting to happen, and part of it is already happening.

Q. And by "a disaster," what do you mean?

A. Our costs have escalated unbelievably within the last few years, and our milk price. obviously it goes up and down, but it doesn't cover costs.

Q. It doesn't go up enough?

A. It doesn't go up enough when it goes up.
Q. Has the recent -- there has been a lot of national press both in the trade and in the general public press, talking about ethanol and its impact on feed costs. Does that have an impact in that region?
A. Ethanol is having an impact nationally. Some farmers contract their grains for a year. some don't. I will give you an example of one very small, but very direct impact.

We contracted the majority of our grains to cover us through the year, but we didn't cover a hundred percent of our corn.

And the difference in cost right now on the corn of contract versus noncontract is over $60 a ton. which translates into $1500 a truckload. And we get a truckload every day.

So had I not been contracted. I would be spending a seriously higher level of money just to buy the grains that we are feeding. Of course, all the other grains follow as well.
Q. To get kind of a concept of what that $60 a ton means, what is a typical -- before your contracted grain, what is the range of the cost of that grain?

A. Oh, generally in the past few years, we have bought between 100 and $120 per ton. Now it is approaching $200.

Q. And is most of this grain imported into your region?

A. A hundred percent of it is imported.

Q. So do these higher costs also include the cost of hauling that grain to your --

A. That is certainly within the pricing mechanism.

Q. Okay.

A. Probably the other more slightly indirect cost that we have associated with the ethanol situation, are the value of our bull calves.

JUDGE PALMER: What is that?

THE WITNESS: Bull calves.

JUDGE PALMER: Thank you.

THE WITNESS: A year ago, most dairymen were getting between 200 and $250 for their bull calves. Currently they are worth between $20 and $30. When you multiply that by a couple of thousand calves, it is one more element of the perfect storm that we are beginning to endure.

BY MR. YALE:

Q. How do you connect ethanol with bull calves?

A. When the guys price the bull calves, they look at the finished product at the market, and they calculate the cost of corn to produce that calf and then they tell you how much they will pay you on day one on that calf, or if you raise him to 300 pounds, how much they will pay you at that point.

Q. And because of the higher corn prices, means the value of bull calves has gone down?

A. Right. And to translate that, that is 30 to 40 cents a hundredweight.

Q. On your milk production?

A. Correct.

Q. Now, as a result, though, of those lower bull calf prices, you have not seen a corresponding increase in the meat prices to cover that cost? Has there been any adjustment in meat prices at the consumer level or anything to raise that up so that they can pay you more?

A. Nothing that we have seen.

Q. Now, you talked about the changes in the Roswell area of the dairy. Have you had a

chance on a regular basis to get into the panhandle area of Texas, by any chance, to see what is happening there?

A. I haven't spent a lot of time traveling there. But I have heard of the growth that has occurred there.

Q. Now, you mentioned earlier, you said that there was a disaster about to happen and maybe in some cases is.

Can you describe any specific situations that you are aware of in terms of particular farms or something that may be started to close down or having some difficulties, that you see happening in your area?

A. Well, I know of several producers Certainly, I am not going to name who they are --

Q. I am not asking for names or locations.

A. -- that have used up their equity so rapidly within the last year, some of them the last year and a half, that they borrowed everything they can borrow. They have borrowed a hundred percent of the value of their cows. their feed, their land, and there is nothing left.

Q. Now, is it common for dairy farmers in the area to have high debt load?
A. It is fairly common for the majority of the farms there to have a high debt load.
Q. And then just to reiterate there what you said at the end, you are not here to present technical support for any of the proposals; is that right?
A. That's correct.
MR. YALE: Very well. He is ready for cross-examination.
JUDGE PALMER: I actually have a series of questions, if you don't mind, sir. I try to -- one of my functions is to have a complete record. And you never know where these transcripts are going to go.
And if this case is ever reviewed by an appellate court, a question that would probably come to their mind is why are we now having so much dairy farming going on in the West, when it used to be up in Minnesota. Wisconsin, where they have grass growing and abundant supply of water and your area is more arid and there is not as much grass growing and so forth and so on.

Can you explain that a little bit for us? Why there was the problem with the Ohio dairies, for example, the Minnesota, Wisconsin and why dairying has switched and moved out the West, can you give us a little of that?

THE WITNESS: I can give you a few of my views.

JUDGE PALMER: Yes.

THE WITNESS: I have read some of the press in Ohio. At some times we've actually looked at relocating back to Ohio.

Everybody likes the small 50 to 75 cow family dairy, mom and pop and the kids all work on the farm. And it is a really good way of life. that is the way I grew up. You run them on the pasture, the cows are running out all summer.

One of the problems that we have run into, though, is that the costs, cost of production and the return has gotten -- the cost of production has gotten so high, and the returns have gotten so low that people -- once generally the dad retires, the kids decide they don't want to work that hard to make nothing, and they go away to town or some other place to

get a better job

So very, very rarely do we see a new 50-cow dairy built anywhere They don't pay. you can't pay for them So what we see around the country are the old places that are closed down

The economies of scale have kind of dictated what we have seen in the West And I guess my personal experiences would go along a little bit with that

When I left home and I went -- decided to become a veterinarian, it was part of my perception that that would be a much nicer life, that I wouldn't have to work 16 to 20 hours a day and wind up not being able to afford a new car when my neighbor could

And that was an interesting decision I made, even when I was still in high school As I got out of that school and I went to California, lo and behold, the clients that I had out there averaged around 500 cows, and this is 30 years ago

But they had a specialization where the owner was the owner, and in a lot of cases, he managed and ran things, but he had people

working for him. And he had a little better life. He was able to get away from the farm.

I guess my viewpoint was more from the veterinary aspect, when I am doing all the dirty jobs on the dairy for the guy and he is off golfing. I thought, maybe that is a little better to be a dairyman now than it would have been to be a vet.

But our perspective on why things have moved that way is the Southwest is, it is, I guess, for lack of a better term, it is easier to build a larger facility. They are easier to manage. And the original California dairies and ones in the Southwest are mostly dry lot, open dairies. It is more efficient to spread the costs of production over a lot of animals. and --

JUDGE PALMER: Why is it easier. though, in the Southwest than, say, up in Ohio or Minnesota, Wisconsin?

THE WITNESS: One of the biggest problems we have in the Upper Midwest is the weather. You can't take cows up here and put them on a dry lot, because it won't be a dry lot very long. We have to build facilities. And

generally the accountants tell me that is at least $2 a hundredweight cost factor associated with building in the Upper Midwest.

And as we have seen in a lot of the opposition to the dairies that have been built up here, it comes not only from the small dairy farms, but also from people that view that the animals are not well taken care of, that they don't get an opportunity to feel the sun on their back and the grass under their hooves, I guess is what I have read in the paper.

I think the major thing we have seen. though, is that it is just -- we are seeing a newer, easier way to milk cows and a more efficient manner to do it. We don't have the high overhead cost of the facilities.

JUDGE PALMER: Now, your facilities in New Mexico, and I guess this would be true of California, Texas, the cows, from what you have just said, when you said grass for their hooves, what have you, they are more likely to be indoors to be protected from the sun and the weather.

THE WITNESS: Actually, not. We have dry lots and we have shades for the cows.

JUDGE PALMER: What is a dry lot, sir?

THE WITNESS: It is a corral, a dirt lot, surrounded by cable fence.

When they built new dairies over the last 20, 30 years, you build with a lot of slope to get rid of water. You put up shades, you put up wind breaks if the local conditions dictate it. And now they are building free stalls in a lot of the California dairies and in some of the Texas, Kansas, Oklahoma.

JUDGE PALMER: What is a free stall?

THE WITNESS: It is enclosed, where the cows stay in. They have a stall that is groomed where they can lay down.

JUDGE PALMER: Somebody moves them into the stall, I guess?

THE WITNESS: Well, they have a barn where they can run around free, meaning they can roam around freely within the barn. And they can go out and eat or they can go lay down and they can stay clean at the same time.

JUDGE PALMER: If you did this up in the Midwest. Minnesota, Wisconsin or Ohio, it

would cost more to build the facility and a bigger problem to maintain it?

THE WITNESS: Well, it costs -- there are maintenance costs associated with it. There are extra labor costs associated with it. and the construction costs itself are considerable.

You can do it. But it is -- as we are seeing. I mean, we are seeing large existing producers build bigger and we have seen people move into the Upper Midwest, basically because of proximity to milk markets and feed.

JUDGE PALMER: And your big cost problem is being away from the feed out in New Mexico?

THE WITNESS: At this point, it is being away from the majority of our protein and concentrates.

JUDGE PALMER: All right. Well. thank you. Questions for the witness? Yes, sir, Mr. Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Good morning. You talked a minute ago about bull calves. So I wanted to ask a couple

of questions about that, if I could.

If I understood you correctly, you were saying that — well, first of all, bull calves. that is something you sell, I take it?

A. Right.

Q. And that the price is dictated essentially by the beef price, minus the estimated cost of feed, did I hear that correctly?

A. That is generally the way it is assembled. that's right.

Q. Okay. So the buyer in this scenario is someone who is going to ultimately sell that calf for — as beef once it grows to some particular size, correct?

A. That's correct.

Q. And so what he can afford to pay you is basically a factor of what he can get out of the marketplace for the beef, minus what it is going to take to bulk up that calf after he buys it from you; is that right?

A. That's correct.

Q. And in this case then, that cost is the cost of the feed that he will have to incur. correct?

A. Right.

Q. And if the market price for the beef goes up, he can afford to pay you more, correct?
A. That's correct.
Q. And as the market price for the cost of feed goes down, if that were to happen, he could afford to pay you more; is that correct?
A. That's correct.
Q. If the market price for feed goes up, he can afford to pay you less, correct?
A. That's correct.
Q. That is how that marketplace has worked out as you have experienced it, correct?
A. That's correct.
Q. Let me just switch topics a little bit. The USDA has done an Preliminary Economic Analysis of the effect of various proposals. Have you reviewed that?
A. I briefly reviewed it. I don't have it in front of me.
Q. I just have a couple of questions. Do you have a copy with you? If not, I have an extra one I can give to you.
A. No.
Q. I have handed you a copy of what has been marked as Exhibit 7, and if you just could take

a look at page -- it is going to be pages 5 and 6. This is the result of some modeling that a U.S. economist did of the effect of various proposals.

And they label these as scenarios, and then they describe what the scenario is that they are modeling. So you have to flip back and forth a little bit.

But I want to ask you first about Scenario E, if you see that at the top of the page, page 5, you see there the Scenario E?

A. Okay.

Q. And that carries over, then, to page 6. You can see that Scenario E continues on that page. That is all part of Table 3, do you see that?

A. Yes.

Q. Okay. And then if you flip over to page 11, there is a description of what Scenario E is, and it is the proposal to change the butterfat yield factor to 1.211. Do you see that?

A. Okay.

Q. And the -- which is one of the proposals from your organization, correct?

A. That's correct.
Q. Now, the bottom line economic impact that the USDA economists calculated for this proposal was actually a negative $12 million a year to producers, to farmers. You can see that on page 6, the row that is called "U.S. Producer Revenue."
Now, you know, given the fact that you are representing producer interests, obviously. I have a question whether you have done a calculation that disagrees with that analysis. or do you have a view as to that analysis?
A. Actually, I am not qualified at this point to comment on that. This is information that has been given to us by our experts.
Q. Okay. But do you have a number to substitute for that negative $12 million?
A. No. I don't.
Q. And similarly, I note that with respect to Scenario F, which is described on page 11 as the proposal to use the CME pricing series for cheese, butter and nonfat dry milk, that also shows a slightly negative effect on producer revenue, a million dollars a year. And I am wondering whether you have -- do you challenge

that analysis or have a contrary analysis as to the economic effect of that proposal?

A. On briefly reviewing your analysis, the thing I noticed is that if we increase producer income, we eventually create more milk and we decrease producer prices.

The main reason I am sitting up here today is I am going to tell you that 50 percent of the milk in this country is produced by people that ship at least a semi load a day. If we kill all the milk production in this country, you guys won't have any jobs to do.

Q. Okay. But my question was whether or not you have done any analysis on that --

A. No.

Q. -- that would challenge the $1 million loss. I take it the answer is, you haven't done that?

A. Correct.

Q. Now, as we have discussed, one of your proposals is to use the CME pricing series for cheese, butter and nonfat dry milk rather than the NASS survey as is currently used; is that correct?

A. That's correct

Q. Now, if I were to tell you only five loads of nonfat dry milk traded on the CME last year. would that give you some pause as to the utility of that price discovery series for purposes of setting national milk prices?

A. I guess I am unqualified to really comment on that as well.

Q. Do you audit -- are your books audited for any reason?

A. We have prepared financial statements. My books, my personal and business?

Q. Yes, your dairy.

A. Yes.

Q. And does some outside auditor come in to audit them for any reason?

A. They are unaudited by an outside interest. We hire an accounting firm.

Q. Okay. Do you have any interests in any processing facilities, you personally?

A. Not personally.

MR. ROSENBAUM: That is all I have. Thanks.

JUDGE PALMER: Questions? Mr. Vetne

CROSS-EXAMINATION

BY MR. VETNE:

Q. Good morning, Mr. Squire, I am John Vetne. I represent Agri-Mark and others.

What is your position, if any, with Dairy Producers of New Mexico?

A. I am simply a board member and currently serving a two-year term as Treasurer.

Q. Board member and Treasurer. You indicate on page 2 of your testimony that several Lone Star, Select and Zia members are also members of Dairy Producers of New Mexico.

I will start going backwards. Zia, is Zia primarily a co-op with membership in New Mexico and West Texas?

A. I believe that's correct.

Q. Do you know what proportion of Zia members are also members of Dairy Producers of New Mexico?

A. I don't know that right now.

Q. Same question with respect to Select. Basically a New Mexico and West Texas cooperative?

A. It is.

Q. Do you know what proportion of Select

members are members of the Dairy Producers of New Mexico?
A. I believe we get a hundred percent dues from Select.
Q. Does Select cooperative pay dues on behalf of its members to Dairy Producers of New Mexico?
A. I believe it is paid through the organization.
Q. And with respect to Lone Star, what is the geographical distribution of those producers or members of Lone Star?
A. I think it is a similar area. I think it goes up into Kansas, perhaps, a little bit.
Q. So New Mexico, West Texas -- what happened to Oklahoma?
A. The Southwest.
Q. Okay, Oklahoma and up to Kansas. Okay. Do you know what proportion of Lone Star members are members of the Dairy Producers of New Mexico?
A. I don't.
Q. Of the managing board of Dairy Producers of New Mexico, what are the cooperative affiliations of those board members?
A. We have board members that are DFA

shippers, we have board members that are independent and we have board members that are. I believe, they are Select shippers as well.

Q. How many people on your board?

A. I think we have nine.

Q. Of those nine, how many are members of Select?

A. You know, without the names in front of me. I can't tell you for sure.

Q. Okay. Of those nine, how many are independent?

A. One or two.

Q. Okay. You are a member of DFA?

A. That's correct.

Q. Other than you, how many of the board members are members of DFA?

A. There are several. I don't know the exact count.

Q. In your testimony you suggest that adoption of the CME as the reference price for purposes of Federal Orders, would address the problem of circularity. Am I correct in my understanding of your proposal and its intent?

A. That was what I commented on.

Q. Okay. Is someone going to testify on

behalf of Dairy Producers of New Mexico to describe to us how that would occur?

A. I think you would have to ask our counsel.

JUDGE PALMER: Mr. Yale?

MR. YALE: The answer is yes. we will have witnesses on that.

BY MR. VETNE:

Q. So you are not prepared to address the economics of how adopting a CME reference price would disassociate the regulated price from the competitive factors that drive NASS survey prices?

A. That's correct.

Q. You also made reference in your testimony to Greater Southwest Agency. What is the Greater Southwest Agency?

A. It is a common marketing agency of DFA, Select and Lone Star.

Q. Okay. Is Zia a member of the Greater Southwest Agency or marketing --

A. I believe so.

Q. Do you know what portion of the south, of the milk pooled in the Southwest marketing area. is represented by the Southwest Agency?

A. I think the vast majority of it. I can't

give you exact numbers.
Q. Okay. I recall testimony from the last make allowance hearing --
JUDGE PALMER: We have -- he doesn't know, he gave you his answer.
BY MR. VETNE:
Q. By "vast majority," do you mean 90 percent or more?
A. I am not sure.
Q. Do the participants in that common marketing agency have some blending of proceeds and expenses and costs among the parties?
A. It is my understanding that they work together that way.
Q. To what plants is your own farm milk primarily delivered?
A. Generally the local milk goes to the Leprino Cheese.
Q. Located in?
A. Roswell.
Q. And you are located south of that?
A. That's correct.
Q. Let's see. I think you've farmed in New Mexico longer than Leprino Cheese has operated a plant in New Mexico?

A. That is probably true.
Q. Prior to Leprino's opening. where did your milk go?
A. Actually, Leprino was in -- I guess I didn't understand the question. Leprino was in operation, may have been a plant that was owned by AMPI at the time, but they bought the AMPI.
Q. Oh, there was a plant?
A. Correct.
Q. Have you ever experienced a lack of local capacity for milk production at your farm so that you had to haul it or somebody had to haul it to a distant buyer elsewhere?
A. I think that has been experienced over the last -- over the last years by either ourselves or someone else.
Q. Okay. On those occasions, have your revenues been reduced because of the extra haul or has your cooperative borne that cost?
A. It is all within the co-op.
Q. The revenues received by your farm, and that is also true of your neighbors, are a product of the mixed uses of Class I. II, III and IV milk in the Southwest market; am I correct?

A. Right.
Q. And with blend prices derived from those four classes -- those three classes prior to 2000 -- milk production in New Mexico has almost doubled in ten years; is that correct?
A. That is probably true.
Q. Okay. You testified in apparent agreement with the proposition that milk production responds to milk prices. Am I correct that you agree with that?
A. Yes, that is true.
Q. Do you see a problem for addressing national milk policy with a policy that has stimulated double production in New Mexico over ten years and has resulted in reduced or stagnated production in other parts of the country?
A. I am not sure I understand your question. Do I see a problem with that?
Q. The producers in the Upper Midwest, like producers in New Mexico, receive a price that is based on a blend of uses; producers in the Northeast and the Southeast, similarly.
Producers in those areas have not doubled their production. My question to you is, do you

see a problem in the system, because we are addressing the system of prices here, whereby the producer response in New Mexico is one of doubled production and in other places production has gone down or stagnant?

A. I would have to say that it is a fairly natural progression of what we have been seeing. Because as people in the Upper Midwest and other areas haven't been able to make ends meet and they have sold out, their cows are going somewhere.

And quite frequently, the cows will go toward the Southwest.

Q They will go there because the revenue produced makes it more profitable to increase production than it does other places, correct?

A That is accurate

Q Now, apart from your particular farm, there has been a problem in recent years in the Southwest, panhandle area and New Mexico with having adequate capacity to process or manufacture all the milk that is produced in the region, correct?

A. That's right.

Q. Okay. And that capacity has been addressed

by or is being addressed by building new plants to produce more manufactured products, correct?
A. That's correct.
Q. And when you were in California, California -- are you aware that California experienced the same problem over a course of years, that production was increasing faster than capacity available to receive the milk?
A. I am not aware of that. But if you say so. that is fine.
Q. You weren't aware of that when you were there. In a transition from page 3 to 4 of your testimony, you referred to milk cash receipts. and I guess you are relying on somebody else here. What you found for as much as 95 percent of the gross income in dairy farms.
Let me ask you about that remaining 5 percent, in your experience. On your farm, what percentage of cash receipts is derived from dairy farm operations, other than the sale of milk, such as sale of cull cows, sale of bull calves, sale of heifers, sale of anything else that you produce?
A. I don't have the statistics with me. I would just be pulling that out of air.

Q. You do sell cull cows, right?
A. Correct.
Q. Which are dependent on meat prices?
A. Correct.
Q. The meat prices go up, a greater share of your income comes from the sale of cull cows?
A. Yeah.
Q. The same thing is true of cows that are sold and heifers that are sold, it depends on the market for heifers for people that are expanding production, correct?
A. Right. Frequently, a cull cow will actually be shown as a loss instead of income It just depends how you handle it on your statement.
Q. Well, it's shown as a loss, but you get money for cull cows?
A. But you have to buy one to replace her. So she is a loss.
Q. Yes. So you buy a producing cow, which is a capital investment, to replace a cull cow. which is sold, it is the end of its depreciation cycle, correct?
A. That's correct
Q. Can you think of any other sources of

income on your farm, nonmilk income, other than those that I mentioned?

A. That is certainly the majority of income.

Q. New Mexico is proximate to a good supply of high quality alfalfa, is that not correct?

A. It has been.

Q. It has been. New Mexico grows alfalfa in the high plains and gets alfalfa from neighboring states?

A. That's correct.

Q. Describe to me what you do in deciding what mix of feeds to use for your dairy herd. Let me start with this: You have options, correct?

A. Correct.

Q. You can have different portions of your feed and grain in hay, alfalfa, whatever. What goes into your decision-making in how you create that feed mix?

A. Well, we consult with a nutritionist, and try to create a balanced ration based on what our goals are. You can feed more grains and get lower butterfat -- with feeding higher grain levels, higher concentrate levels in your ration, you would get more milk and less butterfat test percentage.

And if you decrease your concentrate use. you would wind up with less milk, but a higher butterfat percentage in the milk.

Q. The butterfat is derived from what kind of feed input?

A. It takes a balance. But generally more from roughages.

Q. On your operation, do you purchase premixed 16 percent protein feed?

A. No.

Q. You create your own ration?

A. That's correct.

Q. And do you adjust that ration periodically. if not daily?

A. No, periodically, as needed.

Q. You look at it on a weekly or monthly basis?

A. Depending on how we contract and how the prices are.

Q. Okay. Is somebody in your organization a specialist responsible for making feed ration decisions like that?

A. As I say, I consult with a nutritionist for any changes.

Q. Is that a private contractor or --

A. Right.
Q. And that private contractor is a consultant to other dairy farms in your region also?
A. Other dairy farms in the Southwest.
Q. And does that private contractor also consult with other animal farm operations?
A. Other than dairies?
Q. Other than dairy, yes.
A. I am not sure. I don't think so, but I am not sure.
Q. So that nutritionist is focused on feed for purposes of maximizing milk production, to your knowledge?
A. Maximizing milk production or maximizing profitability.
Q. Okay. There are times when it may be more profitable to get less milk, but with substantially lower component of a very high feed input?
A. Correct.

MR. VETNE: Okay. Thank you.

JUDGE PALMER: Other questions? Yes, sir

CROSS-EXAMINATION

BY MR. SMITH:

Q. Good morning, Mr. Squire. I am Dan Smith. I represent the Maine Dairy Industry Association, so my perspective is the Northeast. I have a series of questions to try to get your sense of the comparative advantages between the Far West, the Midwest where you were raised and the Northeast.

I would just like to start with a little background. In your testimony on page 3, you indicate that milk production went from 600 million pounds to 7.6 billion pounds over the period from -- 25-year period, roughly, from 1980.

And I just would be interested in knowing what the market, the perceived market was that producers who moved to Roswell had in mind in making the decision to farm there.

A. The perceived milk market?

Q. Yes. When you decided to locate your farm. what was your understanding of who was going to be receiving your milk?

A. At the time that we set up, it would have been in the early '90s. At that time, there was

AMPI and MID-AM were the two co-ops. And AMPI had decided not to take any more milk in that area. MID-AM had come in at that time, and was providing a market for milk.

I can't tell you right now as to where they were planning on shipping at that time.

Q. Was the perception the milk would move east or into California?

A. The perception was that it was going east into Texas.

Q. To try to take advantage of the Texas market?

A. At the time that we were setting up. Texas was losing producers because of various environmental constraints, and there were some of the people that were -- that would have located in Texas that located in New Mexico.

Q. So you are kind of right in the middle of that 25-year period in 1994.

Was there a steady progression of increase in the 7 billion pounds of milk, or was there a substantial increase for some period of time and it has flattened off or is it accelerating? How would you describe, from your perspective, of milk production before and after?

A My perspective is that in the early '80s, a group of dairymen set up in Dona Ana County near Las Cruces, it is what we call Dairy Row on 1-25 and 1-10

And at that same time two to three dairymen moved into the Roswell area These were guys that had come from southern California

I know of very little growth that occurred between then and the end of the '80s In the late '80s, there was another small wave of dairymen

And one thing you have to understand is when you go and build a new place, you might start out with -- when we started out, we were milking 1100 cows And that doesn't particularly cash flow well when you have all of the infrastructure and the overhead So you have to add cows to dilute out the cost of production

And most people -- it depends on how well capitalized you are when you start If you start and you can afford to grow, then generally you will grow to your most efficient size So there was some internal growth, I guess I would say, rather than new dairy construction, kind of

along through that time frame.

Probably we were one of the last new dairies built in '94, in the Roswell area. Subsequent to that, the majority of the growth had been in the Portales and Clovis and some in the Lovington area.

Over the last few years, growth in New Mexico has essentially stopped. It may even be reversing at this moment. But the vast majority of the growth has been in the high plains of Texas.

Q. So still looking east for markets, rather than west?

A. I believe so.

Q. Can you pin down a little bit tighter when the production stopped growing and when it might have begun to reverse?

A. Well, it is doing that as we speak.

Q. Reversing?

A. It is stopping. There has been no new construction, other than a pen or two for guys. I guess like adding a few free stalls on if you are in the Midwest.

Q. The last five years --

A. We have not seen a new dairy in our area

since '97 or '98, somewhere in that.

There were maybe one or two dairies in that time frame. But basically it has matured out. We have grown to equal the feeds that are available locally. So it is no longer economically viable to import extra feed.

Q. On page 3, you also refer to there being 172 producers for the 7.6 billion pounds of milk. So it is roughly 2000 cows a farm on average?

A. That's correct.

Q. So is that, would you say, a fair average. or is it maybe somewhat distorted that there are a number of smaller farms and a number of larger farms, or is there an even spread, would you say?

A. It is probably fairly even.

Q. You are at the 3800-cow level. Are there a number or some producers in the 5- and 10- and even 15,000-cow range at the higher end?

A. I can't think of producers in New Mexico that are built that large. We have some 4000-cow dairies around, and there are probably some that are larger. But the vast majority of the big dairies, as we call them, are in Texas

now.

Q. And "the big dairies," by that you mean --

A. Five or 10 or 15,000, as you were saying.

Q. So is the decision in your neighborhood not to grow to that size a reflection of local costs? Back up, I will ask the question a different way.

Referring to what you said before, how is the decision being made in New Mexico not to grow to that next perceived size that captures the economies of scale as opposed to in Texas where they are making that decision?

A. Well, local feed costs are part of it. Our dairies have matured out, and when you grow to a certain size, you can't just add on more. because you have run out of room.

Q. From your original plan?

A. Right.

Q. Of the 172 producers, are they -- do they come from the Midwest, California, is there some geographic pattern to the settlement?

A. Probably the majority of the new producers that have moved into New Mexico over the last 25 years have come from California.

Q. The access to capital to make this

substantial investment, generally -- I am not asking, you know, obviously, from your experience, but just generally, what is the source of capital that most farmers have used in building their farms?

A. Well, one of the things that people that came from California with, you know, is a reasonable bankroll, if it had property.

The other is just banking, I mean, the banking affiliations that they come with.

Q. So would you say, just in ballpark figures. their equity position going in reflects, when you say, the source of capital from California being selling their properties there allowed them to move to New Mexico with --

A. In some cases, that is certainly true.

Q. And generally, what other basis for the starting capital would they have had?

A. Well, if they had been dairying in another area and just chose to sell, they may not have gotten inflated Chino style prices for their land. They might have just had their cow equity and whatever they built up over the years.

Q. Built up. In terms of comparative advantages, the judge was asking you some

questions comparing the Midwest with the Far West. And where does manure management as a cost for a feedlot operation factor into that relevant equation, if in the Midwest or the Northeast you can spread, how does that work on a feedlot operation, in terms of cost as an offset for not having to have housing? Relatively speaking, how does that factor into your cost equation?

A. One of the things with dry lot dairies is we usually depend on the sun to do a lot of drying for us. And the major cost in hauling manure is hauling water. I know that people in the Midwest, if they have to haul manure very far, they are putting wheels under water and it costs quite a lot.

In our case, we are surrounded by farmland, and we utilize the manure as a nutrient to grow our crops. and it is just daily management. But it would be less expensive, because we are handling a lot of our manure in dry or in very close proximity.

Q. So that is not necessarily a comparative disadvantage to a feedlot operation in the Southwest?

A. I don't believe so, unless it rains.
Q. Are there any regulation issues that have emerged with regard to manure management on that scale? Or has that not come up as an issue?
A. Well, regulation is always an issue. And we have -- we are probably as regulated as anybody is. We can't let a drop of water run off the premises.

We all have -- or a large portion of people have comprehensive nutrient management plans to utilize the nutrients from the manure in a responsible manner. In our case, we try to turn it into crops.
Q. And you have the land base to accomplish that?
A. Well, we certainly have some. We would always like to have more.
Q. In terms of some of the costs you mentioned before that are becoming problems, fuel and access to feed, if you look out to the next five or ten years in a planning sense, as opposed to just current cash flow sense, what is your -- what planning have you done in thinking projection-wise in terms of increases in your costs relative to them, that might be a concern

for the pricing series, minimum pricing series that comes out of the classified pricing?

A. Could you restate your question?

Q. Yes. Do you perceive feed costs staying elevated or do you see, you know, fluctuations of feed costs more in a commodity sense, so that you would factor in the volatility, but not necessarily an increase over time, as opposed to a steady increase, which way do you plan on feed costs?

A. We generally plan that the American farmer will respond to high prices and create low prices out of that.

(Laughter.)

A. That is one of the things we hope for. The ringer in that is the ethanol industry, and that is a totally different buyer in the market. And I think in the future, it is going to make everybody need to adapt a little more rapidly.

Q. How about with fuel costs, do you see the current or last year's spike to be an anomaly. or do you see, given your reliance on fuel to move feed, do you see that as an escalating cost?

A. No, we see it as probably an escalating

cost going into the future.

Q. And more generally, in terms of the producer price volatility off the pricing series and as well fuel and feed, the department has reported figures for '04 in your market of around $11 a hundred and in '06 $14 a hundredweight. Is that a reasonable, from your experience, is that a reasonable calculation to use for --

A. Of what our milk price was?

Q. Yes, a mailbox price.

A. That is probably reasonable.

Q. So for a $3 swing in price over that two-year period, you mentioned, I think in your direct testimony, that one response to that price signal is the standard, go to the bank and find financing for your operating costs.

Is that the most primary response of farmers in your area, have access, starting with a strong equity position, to be able to do that?

I am trying to turn it off. Excuse me.

JUDGE PALMER: They are tricky sometimes.

BY MR. SMITH:

Q. I am challenged, but I can turn off a

phone, I thought. There we go. Sorry.

A. What was your question again?

Q. The first response that you mentioned to decreased prices and perhaps price volatility is access to financing to carry you over the low points. And correct me if I am wrong. I understood you to say that a number of farmers have availed themselves of that to the extent that they are able.

If that is the case, what would be the next reaction to a price signal, a reduced price signal going forward?

A. Basically to a price squeeze, is what you are saying?

Q. Yes, to the next price squeeze, assuming it is coming.

A. The next reaction -- it is not coming; it is here -- is the banks are going to call the notes. You know, if you as a producer have $5 million in equity and you have used up all of that trying to keep up and pay your bills -- because if you don't pay your bills, nobody will service you, you won't have feed to feed your cows. You have to pay your bills. About the only people that you can work with are the

banks.

After a while, they kind of tend to lose their sense of humor, and I am sure they have magical figures and numbers that they shoot for; but once you hit a certain point and it doesn't look like you are going back, they are going to close you down.

Q. So in the Northeast, we generally work off a rule of thumb, a third, a third, a third. A third of the producers generally equity position to weather storms, a third in the middle. incremental, and a third in a generally challenged position. Is that a relative ballpark for your community as well?

A. Going into the future?

Q. Yes.

A. I would be guessing. But I would say it is probably more like a half.

Q. Half and half?

A. Are going to have serious problems.

Q. Two other price responses in my neighborhood, number one, despite the prevailing understanding that if prices go down. milk production will go down, farmers tend to put on more cows.

Was that your experience in the Midwest on a smaller family-scaled operation?

A. It is really my experience anywhere. As milk prices go down, you put on more cows to cover.

Q. Produce more milk.

A. And if milk prices go up, you put on more cows.

Q. Produce more milk.

A. Right.

Q. So on a 75-cow operation, farmers might tend to put on five, ten, as many as 25 cows. On a 2000-cow operation, what is the equivalent. where is that number between investing in new cows for a cash flow, versus just staying the course? What is the number?

Is there some -- I am sure there is no magical number. But there does seem to be that equation, between 5 to 75, but no more than a hundred. At that point, you are just going down. So at 2000 cows, how many --

JUDGE PALMER: You are beginning to testify.

MR. SMITH: I am just trying to create a frame of reference for the question.

THE WITNESS: I guess I am not understanding your line of questioning. You are asking me how much would you expand if you expanded as a result?

BY MR. SMITH:

Q. Right. You wouldn't put on one cow, which at a 50-cow operation, might have a substantial impact on your cash flow.

A. What you look at is if you have an equity position to allow you to do it, and if you have the ability to milk the cows through the barn. then you will add the cows. And that is to get through rough times or to make a little more money when you do have some good times.

Q. But might you put on a hundred cows at once?

A. One or 200 cows if you were to add. But it is all a function of what you are working with. If your parlor is already full, you are not going to put on any cows.

Q. Off-farm income is an important component in the Northeast. Is that something that on that scale of operation that can come into the operation?

A. Not at all. I do feel sorry for the guys

in the Midwest that are losing money, they can make their wife go out and work and get a job. so they have insurance coverage. And they can work harder, and they can actually make it through some tough times.

But there is no way we can swim fast enough to get above this thing if it starts going backwards.

Q. Are there any other opportunities to augment your income than what we have talked about on that scale operation?

A. Not really.

Q. Okay.

MR. SMITH: Thank you.

JUDGE PALMER: Other questions? Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good morning, Mr. Squire, my name is Marvin Beshore, I am representing DFA and Dairylea at this hearing. Just a couple of quick questions.

With respect to the circularity problem that you have identified in terms of NASS prices, your proposed remedy for that is to go to CME prices, correct?

A. That's correct.

Q. If that were not adopted, but there were another -- adopted, but there were another proposal, such as number 20 proposed by Dairylea, which you indicated you have not had the opportunity to fully analyze, which addressed the circularity problem, would you be willing to take a look at that, or want to take a look at that to try to avoid the circularity problem?

A. I think anything that would be in our best interest, we would be interested in looking at that.

Q. Okay. Your comments on the energy adjuster. Proposal 17 of the National Milk Producers Federation, you know, you indicated that you were opposed to having energy costs passed back, built into the make allowance with that energy adjuster.

Have you thought about the fact that, with volatility in energy prices, that proposal is one of the few that is on the table here which would allow producer prices to increase when there are declines in energy prices? Do you follow me?

A. I follow you. I don't think that is the trend of the future, but I think I understand what you are saying.

Q. You don't think that energy prices are going to go down?

A. I don't think for any prolonged period of time.

Q. Okay. But if they did, you will understand that that proposal would increase the prices back to the farm?

A. Correct.

MR. BESHORE: Okay. Thank you.

JUDGE PALMER: Yes, sir.

Mr. Wellington.

CROSS-EXAMINATION

BY MR. WELLINGTON:

Q. Bob Wellington from Agri-Mark. I just have a question or two.

Back at the previous make allowance hearing, there was a dairy farmer from your region, I don't know whether it was New Mexico or West Texas, that says that he was receiving a price for his milk that was about a dollar to a dollar 50 below the Class III price. Is that a price level that you are receiving?

A. That is frequently what happens.
Q. Is that what has happened in the last year. it has been significantly below the Class III price?
A. I would say that is probably true.
Q. And it could be as much as a dollar or more?
A. Right.
MR. WELLINGTON: Okay. Thank you.
JUDGE PALMER: Anyone else? Okay. You are excused, sir, thank you very much for your testimony. It was helpful. Thank you.
MR. STEVENS: Your Honor, may I inquire?
JUDGE PALMER: Are we off the record? Do you need the witness?
MR. STEVENS: It is just a question of the statement. It is not entered into evidence. I know we read it into the record.
JUDGE PALMER: We will receive it into evidence. I will do that. You are right.
MR. STEVENS: Number 14.
(Thereupon, Exhibit 14 was received into evidence.)

JUDGE PALMER: All right. We have a bit of time yet before the recess. We have a number of witnesses -- let's go off the record now.

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

(Thereupon, Exhibits 15, 15-A and 15-B were marked for purposes of identification.)

KENNETH W. BAILEY

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

JUDGE PALMER: Mr. Kenneth Bailey is the witness, and we have marked his statement for identification as Exhibit 15. There is a one-page document called "Figure 1. Pennsylvania Milk Margin" that we have marked as 15-A, and there has been a document consisting of one, two -- four pages, of relevant data that we are marking as 15-B.

Mr. Yale, if you would proceed.

MR. YALE: Sure.

DIRECT EXAMINATION

BY MR. YALE:

Q. Dr. Bailey, what is the education that you

have received relevant to dairy economics?
A. I received a B.S. degree in ag business from the University of Arkansas, and an M.S. in agricultural economics from the University of Missouri, and a Ph.D. in agricultural economics from the University of Minnesota.
Q. And where are you currently employed?
A. Penn State University.
Q. And what position do you hold there?
A. Associate Professor.
Q. And do you have any particular focus in your dairy economics that you practice?
A. I focus on policy analysis, market price forecasting.
Q. Okay. And would you describe some of the things you have been doing in that regard in terms of market price forecasting?
A. Right now we are under a cooperative agreement with AERS developing a dairy database for the industry, a monthly and weekly dairy industry database.

We are trying to do a mass balance component analysis to look at all supply and the uses of fat and protein each month. We develop a dairy database for trade, and we are right now

developing a monthly price forecasting model.

Q. Okay. And attached to Exhibit 15. the last page is an abbreviated CV; is that correct?

A. That's correct.

MR. YALE: Your Honor, we would request that Dr. Bailey be considered an expert in pricing.

JUDGE PALMER: He will be.

BY MR. YALE:

Q. You have a prepared statement?

A. Yes, I do.

Q. If you want to make that available. Thank you.

STATEMENT FOR THE RECORD OF KENNETH W. BAILEY

MR. BAILEY: My name is Kenneth Bailey, and my address is 208c Armsby Building. The following analysis is given on my own personal knowledge and experience. I am an Associate Professor at the Pennsylvania State University. I specialize in dairy marketing and policy analysis and conduct research on dairy trade, policy analysis and the price analysis of dairy markets. Attached is my abbreviated curriculum vitae, which accurately summarizes my education and employment. My presence here

today does not reflect the opinions or views of the Pennsylvania State University.

I used a Penn State monthly dairy industry model to evaluate proposed changes to federal milk marketing orders. The model starts the forecast of commodities prices, such as block barrel cheese and butter prices at the Chicago Mercantile Exchange, and Western prices for nonfat dry milk and dry whey as reported by USDA, and forecasts NASS survey prices, both two- and four-week prices, via estimated linkage equations.

From there the model simulates component prices, Federal Order prices and the all-milk price. The model also has equations that forecast the milk supply, both cow numbers and yield, as well as Federal Order pools. While the model is dynamic on the supply side. at this point, it does not have demand equations, nor does it simultaneously simulate prices. Thus, it is more appropriate for short-term policy analysis and forecasting.

The baseline used in this study was estimated for the period February 2007 to December 2008. The baseline assumed that make

allowances per the interim final rule published by USDA on December 26, 2006, would be used starting in March 2007 The baseline uses a forecast for Western nonfat dry milk prices, and then forecasts dry whey prices via a price linkage equation Forecast prices for Grade AA butter and block cheese at the CME were forecasted based on CME futures contracts as of February 23rd, 2006 Feed prices, particularly corn and soybean prices, were forecasted based on the Chicago Board of Trade contract prices as of February 23rd, 2007

This provides a timely forecast that employs all current information and assumes a proper relationship between milk and feed prices

The method of analysis used in this study compares all changes to the baseline Thus changes in Federal Orders are simulated over the period March 2007 through December 2008 and then compared to the baseline The monthly difference, called the change from the baseline. would then be attributable to the change made in the Federal Orders

The next sentence, I have a

correction which I would like to read. Ten scenarios were analyzed in this report using Scenarios A through G and I through K, outlined in the USDA Preliminary Economic Analysis. See page 2 of the USDA report for a summary. In this report, all changes were computed relative to the baseline over the monthly period March 2007 through December 2008 and are presented in Tables 1 through 8 in the attachment.

Scenario A. Make allowances were adjusted to reflect updated California manufacturing costs, see Table 4 of the USDA report. The make allowances used were as follows: Cheese, 0.1711; nonfat dry milk, ,01662; dry whey, 0.1956, and butter, 0.1216. With the exception of dry whey, make allowances are expected to rise under this scenario. Analysis of Scenario A indicates that protein and nonfat solids prices would fall by 1 cent per pound in both 2007 and 2008. That would result in a drop in Federal Order prices of 1 to 8 cents per hundredweight relative to the baseline.

Class II and IV prices change the most. Lower Federal Order prices reduced

average uniform prices by 4 cents per hundredweight in both 2007 and 2008 and reduced the value of all 10 federal pools by $43 and $47 million relative to the baseline in 2007 and 2008.

Scenario B. This proposal removed the barrel cheese price from the NASS cheese survey. USDA estimated this would reduce the NASS cheese price by an average of 0.0087 per pound on average. This scenario was simulated by reducing CME-NASS price linkage equation by 0.0087 per pound. The results indicate that protein prices would fall by 2 and 3 cents per pound in 2007 and 2008, respectively, relative to the baseline. This would reduce both the Class I mover and Class III prices by 5 and 7 cents per hundredweight in 2007 and 9 and 8 cents per hundredweight in 2008, relative to the baseline.

Uniform Federal Order prices would drop roughly 4 and 6 cents per hundredweight respectively relative to the baseline in 2007 and 2008. The value of all 10 Federal Orders would decline by $55 and $80 million in 2007 and 8, relative to the baseline.

Scenario C. This scenario altered the protein price equation used in Federal Orders. The protein yield factor was changed from 1.383 to 1.405. The butter yield factor in the protein price equation changed from 1.572 to 1.653. and the butterfat recovery factor was changed from 0.9 to 0.94. This scenario increased the protein price 7 and 8 cents per pound in 2007 and 2008, respectively, relative to the baseline. It increased the Class I mover and the Class III price by 16 and 20 cents per hundredweight in '07, and 25 cents per hundredweight in '08, respectively, relative to the baseline. This scenario increased the uniform blend price an average 13 and 18 cents per hundredweight in 2007 and 2008 relative to the baseline. These higher blend prices increased the pool values an additional 166 and 236 million in 2007 and 2008 relative to the baseline.

Scenario D. This scenario included all the changes in Scenario C and added a few more changes. It increased the butterfat yield factor in the butterfat price equation from 1.2 to 1.22 and increased the nonfat solids yield

factor from 0.99 to 1.02. The higher butterfat yield factor slightly reduced the protein price. That said, protein, butterfat and nonfat solids prices were 2 to 6 cents per pound higher in 2007 and 2008 relative to the baseline. As a result, all class prices rose 20 and 36 cents per hundredweight in 2007 and 2008 relative to the baseline.

Uniform prices were 25 and 28 cents per hundredweight higher in 2007 and 2008 respectively, relative to the baseline. Finally, all 10 pools rose in value by 301 and 359 million in 2007 and 2008, relative to the baseline.

Scenario E. This scenario raised the yield factor in the butterfat price formula from 1.2 to 1.211. This raised the butterfat price a penny a pound and lowered the protein price a penny a pound in 2007 and 2008 relative to the baseline. This resulted in slightly higher class prices of 2 to 4 cents per hundredweight in 2007 and zero to 5 cents per hundredweight in 2008. It also raised uniform prices by 2 cents per hundredweight in both 2007 and 2008 relative to the baseline and increased pool values by $20

and $19 million relative to the baseline in 2007 and 2008.

Scenario F. There was a slight error in this paragraph. I will let you know. Scenario F. Chicago Mercantile Exchange prices replaced NASS survey prices in this scenario for cheese, butter and nonfat dry milk. Dry whey prices would remain unchanged. This analysis followed the USDA study and made the following changes in the price linkage equations: CME prices were higher on average by $0.0056 per pound for cheese, $0.0183 per pound for butter and $0.0397 per pound for nonfat dry milk. We simply added these fixed differentials to the intercept term in our CME-NASS price linkage equations.

The results indicate that the rise in butter prices offset the increase in cheese prices in the protein price equation. Thus. butterfat prices rose 2 cents per pound in both 2007 and 2008, but protein prices were unchanged in 2007 and fell a penny a pound in 2008 relative to the baseline.

Nonfat solids prices rose, rose 3 and 4 cents per pound in 2007 and 2008 relative to

the baseline. There were significant increases in all class prices, particularly Class II and IV prices. Uniform blend prices rose 19 and 16 cents per hundredweight in 2007 and 2008, relative to the baseline, and total pool values rose $217 and $208 million in 2007 and 2008. relative to the baseline.

Scenario G. This scenario replaced the manufacturing make allowances in the interim order with the weighted average total costs presented in the Cornell study: $0.1108 for butter. $0.1410 for nonfat dry milk. $0.1638 for cheese and $0.1498 for dry whey. These make allowances are lower than what is in the baseline. The results indicate that the lower make allowances would raise butter, other dairy solids and nonfat solid component prices relative to the baseline, by 1 to 5 cents per pound in 2007 and 2008.

Federal Order prices rose 15 and 26 cents per hundredweight in 2007 and 17 to 32 cents per hundredweight in 2008, relative to the baseline. The average uniform price in 2007 and 2008 rose 22 and 27 cents per hundredweight respectively, relative to the baseline. This

added $269 and $348 million to Federal Order pools in 2007 and 2008 respectively.

Scenario I. This scenario eliminated the 3-cent barrel price adjustment in the NASS cheese prices used in the protein price formula. USDA estimated this would lower the NASS cheese price by $0.0169 per pound. This change was added to the CME-NASS cheese price linkage equation in the model. Predictably, this lowered the protein price 5 cents per pound relative to the baseline, and lowered the Class I mover and the Class III prices relative to baseline.

Uniform blend prices fell 8 cents and 12 cents per hundredweight relative to the baseline in 2007 and 2008. Pool values fell 103 and 154 million relative to the baseline in 2007 and 2008.

Scenario J. This scenario used the NMPF, or National Milk Producer Federation, energy cost adjuster. The changes to the make allowances are contained in Table 13 of the USDA study. Only the changes for 2007 and 2008 were used. The results indicate that adoption of the energy adjuster would have had minimal impacts

on component and class prices in 2007 and 2008. Overall uniform blend prices would have fallen 4 to 5 cents per hundredweight in 2007 and 2008 relative to the baseline, and Federal Order pool values would have declined just 54 and 66 million relative to the baseline in 2007 and 2008 respectively.

Scenario K. This scenario combined Scenario D, yield factor changes, F, CME prices. and G, make allowance changes, into one Scenario K as outlined in Appendix B to the USDA study. "Effects of Combined Proposals from Dairy Producers of New Mexico. Class III and IV Price Formulas."

This scenario raised component prices 4 to 8 cents per pound in 2007 and 5 to 9 cents per pound in 2008, all relative to the baseline. Class price changes were at 52 to 83 cents per hundredweight in 2007 relative to the baseline. with Class II and IV prices rising the most. Class price changes were 63 to 97 cents per hundredweight in 2008 with Class II and IV prices again rising the most, relative to the baseline.

Average uniform prices rose 66 cents

per hundredweight in 2007 and 72 cents per hundredweight in 2008 relative to the baseline. Pool values rose 792 million in 2007, and 919 million in 2008.

USDA provided an impact study of proposed changes in Class III and IV formulas as discussed earlier. That study, "Preliminary Economic Analysis of Class III and IV Prices." used the USDA baseline and econometric model of the U.S. dairy industry. The baseline, "USDA Agricultural Baseline Projections to 2015." was published by the World Agricultural Outlook Board on February 2006.

I will assert that USDA's baseline and study of Class III and IV formulas did not adequately account for the unprecedented rise in feed costs that is currently underway. One could argue that this should make little difference when analyzing policy changes over a five- to ten-year period of time. But it is an issue when one considers that USDA changes to pricing formulas could adversely affect hundreds of dairy farmers over a one- or two-year period of time.

Thus accounting for the financial

condition of dairy farms at the time of the policy change and assessing the impact of that policy change on dairy farms is extremely relevant when contemplating changes to pricing formulas

The National Agricultural Statistics Service reports monthly prices for corn and soybeans that are used in their calculation of the milk feed price ratio Corn and soybeans form the basis of energy and protein in a dairy feed ration It also determines prices for other concentrates, since prices are linked through substitution Since feed costs account for roughly half a dairy farm's production costs and concentrates are a significant portion of those costs, corn and soybean prices are very important to dairy farmers

An alternative to the USDA milk/feed price ratio is to construct a milk margin that compares the milk price to the cost of feed required to produce a hundred pounds of milk The Pennsylvania all-milk price was compared to the feed requirements of a cow producing an average 65 pounds of milk per day over the period January 2001 through January 2007 A

static feed ration was developed by Penn State nutritionists that was composed of corn, soybean meal, haylage and other concentrates Penn State maintains a list of local feed costs The difference between the milk price and the feed cost is the milk margin A forecast of this margin was done by using the milk futures at the CME and an estimated Pennsylvania basis in order to forecast the Pennsylvania all-milk price The feed costs were forecasted by estimating corn and soybean prices in relation to these feed ingredient prices The results of this historical comparison and the forecast are provided in Figure 1

The results indicate that 2006 was a bad year for cash flow, since it was below the five-year average of 2002 to 2006 Milk and feed costs were forecasted for 2007, using the futures prices at the CME and Chicago Board of Trade The outlook for 2007 is that dairy cash flow will improve, given current milk and feed price projections from the futures markets, but will not be as good as margins in 2004 and 2005

The average NASS price of corn and soybeans between January 2000, when USDA began

using make allowances and multiple component pricing formulas, and August of 2006 was $2.10 and $5.61 per bushel respectively. Corn prices then rose to $3.23 per bushel in January 2007, a 54 percent rise, and soybeans rose $6.42 per bushel, a 14 percent rise. I should say it rose to 6.24 per bushel, a 14 percent rise.

The Chicago Board of Trade reported settlement prices for corn and soybean futures contracts as of February 23rd, 2007 as follows: Corn will rise to $4.52 per bushel by July, and soybean prices will rise to $8.32 per bushel by November of 2007. These prices and the forecasts used in this study illustrate the unprecedented rise in feed costs that dairy farmers are now experiencing.

I will argue that USDA's economic impact study of the Class III and IV formulas do not account for this record rise in feed prices and their resulting impact on the milk supply. This is a critical issue if USDA adopts a change in formulas that will reduce producer incomes. Any reduced income would come on top of poor cash flows in 2006 and higher make allowances recently adopted by USDA.

JUDGE PALMER: I think that is a good time for us to take a break. We will return at 1:00.

(Thereupon, a luncheon recess was taken at 12:02 p.m., with the proceedings to be continued at 1:00 p.m.)

AFTERNOON SESSION

1:13 p.m.

JUDGE PALMER: You just finished giving your prepared statement, Mr. Bailey. Mr. Yale will have some questions.

MR. YALE: Yes, I do, just a few here.

CONTINUED DIRECT EXAMINATION

BY MR. YALE:

Q. Dr. Bailey, in your analysis that you did, are you providing any testimony, an explanation of any of the proposals that are before the Secretary, are you explaining any -- I mean. providing any -- let me back up.

What was the scope of the project that you did?

A. Basically I took the USDA study and simply analyzed the proposals that USDA summarized. USDA did a very good job of summarizing all the proposals and ran scenarios, and I simply took those scenarios as USDA described them and ran them through my model and provided the impact from the model.

Q. And you are not testifying really for or against any of the proposals; you are just

simply providing the information to the department, indicating the impact of the various scenarios that the department identified; is that correct?

A. Correct. I am not taking a position on any of the proposals. I am simply providing a short-run one- and two-year assessment of their summaries.

Q. Now, you are aware, because you have read it, that Dr. McDowell and Dr. Cessna had provided an economic impact analysis and then an appendix to that that has been presented and made a part of the record, right? You are aware of those?

A. Correct.

Q. And you have read those?

A. Correct.

Q. Are you saying that is a bad project or that those numbers are unreliable or not to use them? What is your view of that study?

A. I am familiar with the model, because I spent some time studying it. From an economist's perspective, the department has a very good intermediate run model. It is well specified and I like it. It describes the dairy

industry after a period of time, a period of adjustment has occurred. So it takes an intermediate run or five-year analysis where all the equilibrium changes have occurred. So I think for that purposes, it is an annual recursive model that looks out, it reaches an equilibrium after probably five years, and it is very good looking at it. That is why, no doubt. they average it over a period of time.

I simply have a different model. It is a short-run monthly dynamic model, it takes a much shorter run assessment.

Q. And is that an appropriate analysis for purposes of determining the impact of a particular proposal to use your short-run in conjunction with the intermediate-run?

A. Yes, I think they complement each other very well because, obviously, as the industry would like to know what are the long-run implications of policies changes, but at the same time, many people in the industry would like to know, well, what is going to happen between now and then? So I can provide a more short-run.

My model endogenizes -- or, I'm sorry, my

model includes the supply side, so it uses a distributed lag model, so we can simulate milk production monthly over a one- and two-year period of time. However, it does not have the demand side as the department's model has. Nor does it have the price adjustment in the years two, three and four that the department has.

Q. I just kind of want to look at your statement. At page 4, you make a statement, if you are looking at the second from the bottom paragraph on that page, it starts. "I will assert."

You have this phrase, "could adversely affect hundreds of dairy farmers over a one- or two-year period of time -- adversely affect hundreds of dairy farmers over a one- or two-year period of time."

Now, how do you define "adverse"? What is the threshold, just a little bit of loss of income or is it the total loss of the farm? What is an adverse impact when you are talking about hundreds?

A. Well, I should rewrite that and say thousands because, obviously, you have multiple thousands of dairy farms across the country.

They are all being affected by these high feed prices, as indicated by my study.

So I would change it from hundreds to thousands, adversely in the sense that one can get an idea of the cash flow situation, but -- the aggregate average cash flow situation, by looking at Figure 1 in my report. And one can get a picture that this cash flow situation was deteriorating all throughout 2006, so when you run into 2007, your short-term debt, your intermediate term debt could possibly be piling up.

By adversely, I mean producers are -- I don't have statistical evidence of that, other than what I have in Figure 1. But I would say if they were in a difficult financial situation already, because of the milk/feed relationship. then adding -- then making an administrative change that would reduce the cash flow even further would be what I would define as an adverse consequence.

Q. Okay.

A. Adverse could mean putting some people out of business.

Q. I want to turn, I think -- is this 15-B?

JUDGE PALMER: A.

BY MR. YALE:

Q. This is 15-A. If you could look at 15-A. this is the same Figure 1 that was actually in the testimony, right?

A. That's correct.

Q. It has been enlarged so we can read it a little bit more carefully.

When you talk about dollars per hundredweight, what is that referencing? What number is that referencing there when -- I guess that would be the Y axis on your chart.

A. The Y axis, dollars per hundredweight, is simply the difference between the Pennsylvania all-milk price, minus the feed costs for producing that milk.

In other words, we could take the feed costs for a cow producing 65 pounds, we then say that is the cost per day of producing 65 pounds. We divide that by 65 to get the cost per day per pound, multiply it by a hundred, to get the cost of feed to produce a hundred pounds of milk.

The difference between the Pennsylvania all-milk price and the feed cost to produce a hundred pounds of milk is what is on the Y axis

It is a measure of gross margin, from a business perspective.

Q. So for example there, the purple circle there on the left between 13 and 14, that represents the gross margin for the year 2005 for the month of January, on the left?

A. Yes, that's correct. That is the dollars left over to pay for labor, vet expenses. interest, depreciation, all other nonfeed related costs.

Q. And were all of these numbers -- this chart, is this prepared using the types of tools that agricultural economists traditionally use? Is there anything different or unusual about the analysis you did?

A. No, it is simply myself as an agricultural economist and Ginnie Ishler, Virginia Ishler, I-s-h-l-e-r, who manages the Penn State Dairy. which is used to make the best ice cream in the world.

Q. And the point of this is to show -- is not necessarily to show actual cash flow to the farm, but to show available -- in some way measure the type of financial stress that the farms are experiencing? I mean, is that a fair

statement?

A. Well, any business, if you look at any financial profit and loss statement, you have your sales, minus your major costs, and that is your gross margin. And your gross margin is what is left over to pay all the other expenses.

And on a dairy farm, feed is half of your production cost. It is the single largest expense you face. And it is also very, very volatile. So when you take a volatile milk price and a less volatile -- but a volatile feed price, the difference between the two is what is left over to pay your other expenses. Your labor, your vet, all those expenses are less likely to rise through the year as -- and energy costs are less, are not as volatile. But it is a measure of funds available to cash flow your business.

And if you look at the green line, and you see that it is below the five-year average, you have month after month much less funds available to pay your bills and there is a cumulative impact of that.

Q. Okay. That was my next question then. It does accumulate. If there is a loss, it does

accumulate?

A. Absolutely, as in any business.

Q. And how is this -- how does this improve the impact of pricing on farmers, compared to the traditional milk/feed ratio?

A. I don't know when this occurred. But 25 years ago or so, USDA came up with a number of indexes to measure the relationship between livestock prices and feed. And for dairy, we have this milk/feed ratio, and I have read the definition hundreds of times, and can in my mind conceptualize what it means.

But generally economists note that if it exceeds some level of 3 or 2.75, whatever that is, that the milk supply begins to expand, if it falls much below some level of 2.50. that the milk supply contracts. I don't like that index. It is not intuitive to me as an economist. As someone who has run a business, I don't know really what it means.

That is why we put together this index. because farmers can relate to it, and any businessperson can relate to the gross margin.

Q. Now, so this would be a useful tool for the department to look at the impact at the farm

level of the various proposals?

A. I think that it paints a picture of currently the health of the dairy producers in our industry as USDA is considering these regulations.

Q. Now, you just talked about feed, and I want to go to one final point here.

Is that in the definition -- or I am sorry. in your direct testimony, you made a comment that you thought that there was a major issue with the department's level or using the February 2006 baseline as opposed to the February 2007, because it does not include this change, dramatic change in feed prices.

And the argument is that it is just a baseline, and since all we are looking at is changes off the baseline, what difference does it make where we draw the baseline to measure the changes. So why is it important then that this extra cost of the feed be in the baseline to make that analysis?

A. It is true the USDA has a very good intermediate run model. The baseline that they used did not account for the rise in feed prices. The new baseline accounts for it a

little bit more.

It is true they are looking at changes from the baseline. They take those changes and average them over nine years, and if you are looking at a five-year equilibrium condition. then that is true.

But what I am more concerned with as an extension agent -- extension person in Pennsylvania talking to real, live dairy farmers, is how are we going to get from where we are now, to any new change that USDA makes. So I am just trying to say that USDA needs to take into consideration the fact that their baseline does not account for that if you make any change in Class III and IV formulas that would reduce producer income; that that reduction is on top of the change in the make allowances that is going to be announced in a day or so and the higher feed prices.

I think it is the condition in which that announcement would be made is the critical issue.

MR. YALE: Okay. Your Honor. I have no other direct questions, and Dr. Bailey is available for cross-examination.

JUDGE PALMER: Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Good afternoon, Dr. Bailey. Your report has been marked as Exhibit 15, and I wanted to start --

JUDGE PALMER: I don't know how aware Dr. Bailey is of who is here.

MR. ROSENBAUM: We have met before. Steve Rosenbaum of the International Dairy Foods Association.

BY MR. ROSENBAUM:

Q. Dr. Bailey, on your report, Exhibit 15, you make the statement on page 1, second paragraph that the model you used here does not have demand equations; is that correct?

A. That's correct.

Q. Now, do you have a copy of the USDA baseline that has been marked as Exhibit 8 in this proceeding? It is called --

A. The actual USDA baseline? No.

Q. Well, it is called a national econometric model documentation.

A. I have the documentation, yes. It is not the baseline, it is the documentation you are

referring to.

Q. Yes. I appreciate that clarification.

And if you would turn with me to page 5, there is a Table 3 which shows per capita demand and related equations. Do you see that?

A. Yes, I do.

Q. And listed there are equations with respect to U.S. fluid milk, butter, American cheese. other cheese, nonfat dry milk, dry whey, canned milk, going to the next page, dry whole milk, frozen products, retail ice cream price, other Class II solids.

Now, do you understand these to be demand side equations that are part of the USDA model?

A. Yes. I do.

Q. And am I correct from your testimony that you do not include anything equivalent to any of those parameters in your model; is that right?

A. That's correct.

Q. Now, let's assume that one of the scenarios that we are looking at would reduce the minimum price of milk. Okay?

All other things equal, I assume that if one were to include a demand side consideration, you would think that that would result in higher

demand, correct?
A. Well, it is the magnitude is the issue. But, yes, if the price was dropped, and you have a negative price elasticity, the demand would go up, the magnitude of which is conditioned on the size of the elasticity.
Q. The impact of including demand equations, would be that with respect to scenarios that you calculate a negative number for, that number would be less negative if one were to include the demand side; is that fair? Not asking you to quantify the effect. I am asking you to tell me whether that is directionally the effect.
A. State the question real quick again.
Q. Yes. Some of the scenarios that you have analyzed result in lower producer income. correct?
A. Yes, correct.
Q. And I am asking whether it is the case that if one includes demand equations in the model, those become less negative?
A. Not necessarily. Because what is good about the department's model is that they account for supply, so in this case, supply would go down. They account for demand, which

drives how milk is allocated in different classes.

I would argue that the bigger effect would be on the pooling side, on the Class IV. So if the price fell, the milk supply would eventually slow down. If the milk supply slowed down. there would be less allocated to Class IV, more to the others, so the pooling would actually offset some of that by improving the pooled price.

Q. Okay.

A. But by itself, yes, if price goes down. demand would go up to help offset that. But given these elasticities, it would have minimal effect on the pooling.

Q. When you say "minimum effect on the pooling," what do you mean by that?

A. As I look at these elasticities, the fluid in Class I. Class II, basically the Class I, the cheese have very low elasticities. And the way that the USDA model works, the thing I like about it is it projects the milk supply, the milk supply goes out and is consumed initially for fluid. The balance that is left over is for manufacturing.

I like the way Howard specified that.

It is then allocated to cheese, which is Class III and Class IV. Class IV is a residual calculation in Howard's model. I spoke with him about it. I like that feature.

What that means is that the milk supply grows significantly. All that extra milk ends up in Class IV, irrespective -- now, if the price in general goes up and demand is going to increase for some of these things, that might determine which class it goes into. But given the inelastic nature of these elasticities. I would say the bigger, overrunning concern is the milk supply and whether the balance ends up going into or out of Class IV. That is where the big prices are driven, not necessarily any re-allocation, based on these demand elasticities.

Q. But you are assuming that, for a number of scenarios, that the price paid to farmers will go down, correct?

A. I think in their model, the price is solved. It depends on --

Q. I am talking about your model.

A. Okay. My model, correct.

Q. You are assuming that the price paid to farmers would go down, correct?
A. I did a number of scenarios, some of which went up and down.
Q. Some of your scenarios, the price goes down, correct?
A. Correct.
Q. In that scenario, you have agreed with me that the impact of including demand side considerations would be to reduce the -- in absolute dollars, would be to reduce the negative impact, correct?
A. It could reduce it a little bit, yes.
Q. Now, you mentioned that -- I think you said both orally and a minute ago, that your model does not simulate prices or simultaneously simulate prices.

And I think perhaps in your testimony, you say the model doesn't have price adjustments in years two and three. Are those the same things. are those different ways of describing the same thing?
A. Yes. In this model, we don't simultaneously solve for price. The USDA model does, and most of that price adjustment -- not

speaking on behalf of the USDA, but I imagine it occurs in year two, three and four.

Q. What price is it that the USDA model is solving for that your model doesn't? The price of what, of finished products?

A. I believe the USDA models and, again. I will let them tell you, but I believe they solve for the commodity prices and then the commodity price is solved, then drives the farm price and the farm price recursively solves the milk supply. In other words, the following year.

Q. So your model assumes what, constant or unaffected commodity prices?

A. I assume that -- the big driver in all this is what happens to the milk supply. And the milk supply in the USDA model changes the following year. This is a short-run model, so we assume the supply doesn't change. We look at just the price impacts in year one.

Q. Your model has forecasts of commodity prices as described on the second page -- in the second paragraph of page 1, correct?

A. Correct.

Q. And if I understand what you are saying, those prices remain the same, as you say, remain

completely unchanged, as you are then trying to model what the effect is of the various scenarios; is that right?

A. Correct, correct.

Q. Now, let's take -- one of the scenarios you model. and I am going to take this out of order for the moment, although I may come back and do some of these more in order.

But one of the items that you model is the effect of -- let's say of Scenario G, which is the model that replaces the manufacturing make allowances in the interim order with what you claim are the weighted average total costs for the Cornell study, correct?

A. Correct.

Q. Now, and you depict that that would result in an extra $269 million in Federal Order pools in 2007 and an extra $348 million in 2008. correct?

A. Correct.

Q. Let me take an extreme example to see how your model works. Let's assume that your model was projecting what the impact would be of reducing all make allowances to zero.

Would your model, if you did that, create a

dollar figure as to the extra money that would go into the Federal Order pools under that scenario?

A. Yes.

Q. Does your model assume that requiring plants to pay extra in this scenario. $269 million a year in 2007 and $348 million in 2008, does your model assume that such additional payments would have no impact on processing plants' ability to continue to process the same quantity of product?

A. The model, as I said, is a short-run model. The reason I included 2008 is because I would view both 2007 and 2008 to be short-run impacts that don't take into consideration price moderations due to changes in supply and demand.

The reason I included 2008 is because you can pick which year you want to look at as the short run. because 2007. we began with March. so it is not a complete year. So either one of them could be considered a short-run one-year analysis that it would not have -- it has some supply effect, but it doesn't have the return change to price.

Q. I mean, one of the key considerations here

has to be providing processing plants a sufficient make allowance to cover their costs. correct?

A. Correct.

Q. And you have done no analysis, and your model incorporates no analysis of the extent to which plants could, in fact, be required to make the kinds of additional payments set forth in Scenario G and still be able to cover their costs, correct?

A. I simply, as I stated earlier, took the USDA scenarios as USDA defined them and ran them through the model. So that wasn't my objective. I simply did a short-run one-year analysis of the USDA scenarios.

Q. The answer to my question is, your model simply assumes that the manufacturing capacity would remain unchanged, regardless of the fact that manufacturers would, in this scenario, have to pay a quarter billion dollars or a third of a billion dollars a year more in minimum milk prices; is that right?

A. Well, I think not only does the model assume that, but I think if you went to Scenario G in my opinion and ran it into real life, given

what Cornell presented at their conference. I would imagine that the plant capacity would be maintained in the current year.

Q. Well, that depends, of course, upon how one properly interprets that data, right? I mean. USDA didn't go and --

A. They did a study, they showed that the costs and the more efficient, larger plants could cover their costs. The smaller, less efficient plants could not.

Q. Take a look at Scenario K, for example. On Scenario K, you are proposing a situation under which manufacturing plants are required to pay $800 to $900 million more a year to farmers, correct?

A. No, that is not correct. I didn't propose anything. I simply took Scenario K from the USDA's Appendix B and ran it through a model and did a short-run assessment and came up with that number.

Q. Your assessment is that if Scenario K were adopted, and Scenario K is one of the scenarios under consideration, the effect would be roughly 8 or $900 million a year more to be paid to dairy farmers, correct?

A. Yes, that's correct.
Q. And, once again, that model for that scenario assumes that the processing plants could continue to process exactly as much product as they now process, even though they would have to make -- come up with close to a billion dollars a year in extra money to farmers?
A. I don't know that it assumes that. It simply takes the formulas that we all know are there, and it changes them and recalculates them. given a static price. It doesn't endogenize firm behavior in that regard.
Q. Endogenize, meaning it doesn't incorporate?
A. I am sorry, it doesn't incorporate firm behavior in that way.
Q. Where are your equations, by the way?
A. Would you like them?
Q. I don't know. If you have them.
A. I have many equations. The equations that I have, I went to USDA's AMS has an excellent Web site. Agricultural Marketing Service of USDA, and they have an excellent Web site with all the formulas for the class prices in there.
The changes to those formulas are made --

are made off of this appendix. The other equations, the so-called linkage equations and the milk supply equation, I did estimate those. We are trying to get a journal article published at the moment in the second revision. that has a fully simultaneous short-run monthly dairy disequilibrium model. So we have those equations available.

Q. Where are they? I mean, you are the witness here. You have mentioned estimated linkage equations. Obviously, that has some bearing on your work. So do you have that to hand out to us right now?

A. No, I don't have it. But I can make that available. There are linkage equations, simply looking at the monthly relationship between the CME, Chicago Mercantile Exchange prices and reported NASS prices, where we did a simple OLS. or ordinary least squares, regression between those two, and then we have on the supply side a 12-month distributed lag model for supply.

And it would have been helpful if I had included that as an appendix.

Q. Let's go back to look at some of the earlier scenarios. Let's start with Scenario B.

Now, this proposal you discuss on the second page of your testimony, Exhibit 15. as being the proposal to remove the barrel cheese price from the NASS cheese survey, correct?

A. (Witness nodding head up and down.)

Q. Do you have a view as to why dairy farmers would favor this proposal?

A. I can't speak of their view. But my view is that as I look at the weekly markets, the block is the leader, the price leader. Barrels, the margin changes weekly, but it is basically the block is the leader.

And so when I do all my analysis. I start with the blocks as the price leader. And barrels and mozzarellas and all the other cheeses follow.

Q. By your analysis, the impact of removing the barrel cheese price from the NASS cheese survey would reduce farmer income by $55 million in 2007 and $80 million in 2008, correct?

A. In this scenario, I took the USDA change in the NASS survey price that they gave, and I used that figure of negative 0.0087, and I have used it in this study.

Q. And the result is as I have just described.

correct?

A. The result is Scenario B in my analysis.

Q. And the result is, as I said, minus $55 million a year in 2007 and minus $80 million in 2008, correct? I am looking at page 2 of your report.

A. That's correct.

Q. Now, so I mean, do you have a position whether this is a good idea to remove the barrel cheese price from the NASS cheese survey?

A. Again, I am not taking a position on any of this. I simply ran the scenarios that USDA laid out and did a very good job of summarizing and put them into the model.

Q. So you are not saying this is a good idea or a bad idea?

A. No. I am not taking a position.

Q. From a farmer income perspective, it is a negative. though. That much you can tell us. correct?

A. I ran it through my scenario and that -- assuming that USDA -- and I am assuming that they did that correctly with that price difference over that period of time would have reduced the pool value $55 million in 2007, or

$80 million in 2008.
Q. Okay. Stepping outside this particular hearing, are you generally in favor of looking at those barrels and blocks, because both provide useful price discovery information?
A. You are asking me as an economist do I think that using both blocks and barrels is useful information?
Q. Yes, from a price discovery perspective.
A. From a price discovery perspective, if you are looking at the Chicago Mercantile Exchange. more information is usually better. But I typically look at the blocks as the leader.
Q. I take it you have not yourself replicated the $0.0087 per pound effect that USDA believes would result from the removal of the barrel cheese price?
A. No, in all of these scenarios laid out. I simply took the USDA numbers and ran them through my model to complement their study with a short-run perspective. If I had done that and came up with a different number, it would not have complemented the USDA study.
Q. Now, Scenario C is one that addresses yield factors, correct?

A. Correct.
Q. Now, assume -- and I will state the obvious. The higher the yield factor, the more pounds of finished product one is allegedly able to produce from a hundred pounds of milk. correct?
A. Correct.
Q. Now, let's assume that one was an operating cooperative, meaning one had a processing plant. And that, in fact, that plant's yields were exactly as in the current formula.
The impact of Scenario C would be to cause that -- as a stand-alone proposition. Scenario C would cause that plant to lose money, correct?
A. Any plant that doesn't meet national industry standards is going to lose money. So in that scenario, they would lose money.
Q. They would lose money as a result of the change in the yield factors, under what --
A. They would lose money, because they are not competitive.
Q. Okay. Well, okay. But they would be in a scenario in which they would be forced to pass on at minimum milk prices an amount of money that would leave them without enough money to

cover their cost to manufacture, correct?
A. They could make more money by improving their yield.
Q. I am asking you to assume that the yield is what it is, and that is the best they can achieve.
A. If you regulated that change, it would require them to pay more.
Q. Now, let's assume that you are a cooperative that, in fact, has no manufacturing facilities. Would Scenario C benefit such a cooperative by increasing the minimum milk price?
A. Members of the cooperative would be -- in the short run would be facing that higher price. They would be receiving a higher price for their milk.
Q. So the impact would be disparate on a plant that had no manufacturing facilities -- strike that again. The impact would be disparate on the cooperative that had no manufacturing facilities, versus one that had manufacturing facilities, correct?
A. I don't agree with that. If I had a plant, a cooperative plant that exceeded the yields on

this, they would be making more money. It would just be a matter of reallocating the earnings that the plant receives and the price that the farmer receives.

Q. If it is a plant that doesn't have the yield factors that you are suggesting?

A. Then again, they are not competitive in the industry.

Q. Well, that assumes, of course, that these yield factors are correct. Nonetheless, the impact clearly on any cooperative that has a processing facility at or below current yields. this scenario is one that affects it negatively. correct?

A. It is hard to state that, because the farmers own the plant, and the expectation is the plant is going to make a certain profit. And the farmers are going to get paid a certain price, and the price they get paid is regulated. to some extent, here in this hearing, and that they are anticipating having the plant so that they can have a capital retain at the end of the year.

If their yield factor is too low, there will not only not be a capital retain, but there

could be a surcharge on top of that.

So it is hard for me to imagine that changing this for that particular plant would harm them when you look at the combination of anticipated capital retains, plus milk prices. That is a zero sum gain for the producer.

Q. You are assuming that, what, the cooperative is only processing its own milk in its plant?

A. Assuming that the producer is invested in that plant so that they can make a return on their investment.

Q. Yes, but if they are processing milk that is not entirely their own and they are being required to pay a minimum milk price based upon a yield factor they cannot achieve, they are obviously worse off. It is not a wash to them, right?

A. It has nothing to do with this regulated pricing then.

Q. Well, it is if it is a wrong price, right?

A. I would say that if their members invested in a plant that is not achieving industry averages, any way you look at it, they are going to lose.

Q. To take our extreme example, if you had to make allowance of zero, okay, the effect would not be the same on a cooperative that owned processing plants and a cooperative that didn't own processing plants, correct?

A. Because one made a good decision and sold it to somebody else that could do that. But you can't have a scenario where this is a zero make allowance.

Q. Well, if you have a make allowance that is irrationally low -- let's not make it zero -- irrationally low compared to what actual costs are, you can drive that processing plant into a negative situation, correct?

A. And then there wouldn't be a processing plant. It would go somewhere else and be processed somewhere else.

Q. There might not be a processing plant at all. right. in this extreme scenario?

A. In that extreme, unlikely scenario, yes.

Q. Well, if you set a make allowance that is below true average cost, you are going to force disinvestment from the industry, aren't you?

A. Well, we haven't seen that. We have seen a lot of investment in the cheese business.

Q. In the Federal Order system overall. compared to California, Idaho?
A. Well, I could take you out to Idaho and Texas and places like that and you can see that there are investments being made. And cheese production this past year has been up.
Q. What has milk production been, by the way?
A. It has gone up 2.7 percent.
Q. Does that indicate to you that there is some insufficiency in the current price being paid to dairy farmers?
A. There is generally a one-year lag between earnings and milk production. That is based upon my analysis, using a distributed lag model. So 2004 and 2005 from my chart shows that earnings were good, people took those earnings. began to invest it and the investment showed up the year -- the following year, in 2006.
Q. What has the long-term trend been in milk production in this country?
A. It has been up.
Q. When was the last time it was down?
A. The rate of increase fluctuates from year to year.
Q. When is the last time it has been down?

A. I think it was 2004 or 2005 it slowed down.
Q. What is the last time it was down?
A. Oh, a negative growth?
Q. Yes.
A. I don't have that figure in front of me.
Q. By the way, we had testimony this morning from someone from New Mexico about the conditions there. Assume with me that milk production in New Mexico in 2006 was up over 9 percent. What conclusions do you draw from that?
A. I would conclude as an economist that 2004 and 2005 were a good year. People wanted to take their management expertise and their earnings and instead of paying taxes, roll it into a better investment, and they expanded their facilities. It takes time to build facilities, source cows, put that all together. and when they rolled into 2006, the milk supply expanded.

That, by the way, follows the USDA model. They have a recursive, a lag in their milk supply on yield. I can show you that in the documentation. And that follows a market reality.

Q. Is, in fact, the lower prices experienced in 2004 attributable in a significant part to the expanded production resulting from the high prices in 2004 and 2005?

A. I think you need to restate that. You mean that the low prices in 2006?

Q. If I didn't say that, that is what I meant to say.

A. We had high prices in 2004 and 2005.

Q. I may have misstated it. Apparently I did misstate it, so I will start again.

Prices declined in 2006, correct?

A. Yes.

Q. And do you attribute that substantially to production increases that resulted from the relatively high prices in 2004 and 2005?

A. It is a mixture of between supply and demand and market expectations. With the milk supply growing at the rapid rate it was, prices began to decline.

However, as we saw, sales were very good. both domestic sales and export sales. And we also had a slight problem with the fact that the NASS, the NASS survey was not picking up the very high nonfat dry milk prices that were being

experienced and that wasn't showing up in the producer of milk check.

But there was some, in the early part of the year, prices were low in response, in part, because of that surge in milk production.

Q. Okay. Scenario F, this is a scenario in which your analysis of the effect and USDA's analysis of the effect are really quite radically different. I think this is by far the most extreme case of that, where USDA shows that on average, there would only be a million dollars negative impact on producer revenues from replacing the NASS survey prices with the CME.

If you have Exhibit 7, which is the preliminary economic analysis of USDA. I am looking at Table 3 on page 6.

Now, in fairness, they have a separate line item for Federal Order cash receipts, which they show a positive 33 million. So perhaps that's the number that most corresponds to your numbers. But still, your numbers are, rather than 33 million, it is 217 million for 2007 and 206 million for 2008. Do you see that?

A. Yes.

Q. Do you have an explanation for why there is such a huge difference between your analysis of what the effect would be and their analysis?
A. Well, again, I am not going to speak for the USDA study. I can tell you what we did. simply took the -- the USDA said that the changes, if you adopted the CME prices, they would have raised the commodity prices on average historically by that much. And I simply took --
Q. I am sorry, by the .56 cents per pound for cheese, et cetera?
A. Correct. There is probably a table that has that in there in the USDA study. I took those and I included them into my linkage equations, so there was an immediate one-year impact from that.
If I was to look at the USDA study. I would imagine that meant, that probably meant in their model, that the milk supply would respond in year two, three and four, and that the higher milk supply would result in more milk flowing into Class IV uses, and that the average price would begin to decline at a period of time.
Q. I wonder if I could have you look at

Exhibit 7-A, because I don't think that is the explanation. Do you have the USDA Appendix A. the detail tables? Exhibit 7-A is the appendix to Exhibit 7, which is the USDA economic analysis.

JUDGE PALMER: What page?

MR. ROSENBAUM: Page 18.

JUDGE PALMER: Page 18.

BY MR. ROSENBAUM:

Q. Page 18 is Table A-9, and this is USDA's assessment of the effect on Federal Order cash receipts for each of the scenarios. Do you see that? And that phraseology, I take it. "Federal Order cash receipts" is the equivalent of your phraseology "total pool values"?

A. Yes.

Q. We are comparing apples to apples?

A. Yes.

Q. I want to make sure of that. What you will see under the "Total" row, I guess you would call it, or section, if you go down to Scenario F, which is the one we are talking about. USDA shows a $49 million impact in year one and a $32 million --

A. I am on page 18, A-9. Am I on the right

page?
Q. Yes.
A. I have Class IV.
Q. "Total" is underneath that.
A. That is for all Federal cash order receipts.
Q. I am looking at the "Total" portion of this page. And you will see for Scenario F, USDA is projecting a $49 million impact for 2007 and a $32 million impact for 2008, which is, you know, less than a quarter of the impact you are projecting for 2007, and less than a sixth of the impact you are projecting for 2008.

I am just wondering whether -- well, first of all, have you done this comparison yourself before right now, the impacts that USDA was projecting in the first two years, versus your projections?
A. I didn't see this appendix. But I did look at their analysis. In some cases, there were differences.
Q. You saw Exhibit 7, but not Exhibit 7-A, is that what you are saying?
A. Yes. But, again, it doesn't matter. This is a very simple thing to model. You simply

take the change they gave and you put it into the price linkage equation, and you end up with a higher cheese, butter, nonfat price. You run it through the model and get the one-year impact.

Q. How do you explain the vast disparity between USDA's assessment of the impact of this change and your own?

A. I can't explain what USDA did. I can just explain what I did. You could ask them.

Q. Okay. If you could look back at your report and, actually, probably it would be easiest to look at what was marked as Exhibit 15-A, which is that color X, Y axis.

(Witness complies with the request.)

Q. My understanding is that many Pennsylvania dairy farmers grow their own feed or a substantial portion of their own feed; is that correct?

A. It depends. Some of them raise all their forage, some of them raise some of their corn.

Q. How is that accounted for in this, if at all?

A. We look at market value for all commodities. So if you raise it yourself, it is

worth -- you could take it out of the grain enterprise and put it in the dairy enterprise.

Q. So you are assuming that a farmer growing its own feed -- well, you are treating a farmer who grows his own feed exactly as a farmer who doesn't grow any of his own feed, is that what you are saying?

A. Correct.

Q. And does the fact that they are growing their own feed, is that an indicator that they think they can do better doing that than buying feed on the open market?

A. We have a situation in Pennsylvania where some producers raise some of their own corn, and typically, some of that could be above market costs. Why they do it, they have the land, they may not know what their cost of production is.

Most all of our producers, and I don't know of anyone who doesn't, must supplement their grain with purchases of either hay or concentrates, other concentrates. So even if you raise your own corn, you may not raise it all. You may have to buy hay, you may have to buy soybean meal, roasted beans, distillers grains and all of those other by-products. So

virtually everybody -- I don't know of anyone that raises their own feed entirely. Everybody is paying more.

Q. Does this chart have built into it any assumption as to increased milk production per cow over time, or are you assuming constant?

A. We are assuming 65 pounds a day.

Q. Meaning that you are not accounting at all for average increases in milk production per cow over time?

A. No.

Q. And is the average number of cows per farm increasing in Pennsylvania?

A. I haven't looked at it over time. But our average cow numbers right now, if you use the USDA numbers, is 60 cows per farm.

Q. And do you know whether that is an increase?

A. It is hard to imagine it is an increase. We have relatively small farms. I would guess that our farm numbers have gone up over time. But in general, we have a small farm -- we have a population of many small farms in Pennsylvania.

Q. When you say your farm numbers have gone up

over time, what do you mean?
A. I mean I am sure the size of our farms have gone up. But at much less than the national rate.
Q. If I understand your chart correctly, you are predicting that for 2007, the milk averages will exceed the five-year average; is that right?
A. Yes, it would. If you took the futures prices, it would be slightly above the five-year average, and that there would be some by midyear that producers would be able to recover some of their losses from the previous year.
Q. And this Exhibit 15-A is under the assumption that there are no changes in the Federal Order system; is that right?
A. Yes. We just simply took a historical basis between the Pennsylvania all-milk price and the Class III futures.
Q. And the way to see the extent to which you are projecting in 2007 with no change in the Federal Order system what milk margins will be in 2007 versus the five-year average. one simply compares this red line with the, what do you call those, squares, to the black line that has

no other markings on it?
A. I wanted a benchmark of what was the average gross margin for our industry over a period of time. And that is how I calculated the black line. And I figured that over time you would want to at least return that.
Q. And the five years is what, what five years?
A. I think it is 2002 to 2005. It is in my written testimony here. Or 2002 to 2006.
Q. So the black line is the milk margin for the 2002 to 2006 period on average, and the red line is what you are projecting that margin to be for 2007, assuming no change in the current Federal Orders?
A. That's correct.
Q. And the margin is, as you defined it, how much money the farmer has left over after accounting for what?
A. Their feed costs.
MR. ROSENBAUM: I think that is all I have for right now, Your Honor.
JUDGE PALMER: Questions? Yes. Mr. Schad. Do you need a break, incidentally. How about you. Binnie? Okay.

CROSS-EXAMINATION

BY MR. SCHAD:

Q. Good afternoon, Ken. My name is Dennis Schad, I work for Land O'Lakes, I am here representing Land O'Lakes, and I would like to stipulate that Penn State has farms that are a member of Land O'Lakes and we may agree that when it is not making the dairy -- the milk from those dairy farms are not making the best ice cream and dairy products at the Penn State creamery, it is making the best butter.

With that said --

JUDGE PALMER: With that said, you have secured your salary for a while.

THE WITNESS: Well, we also make butter at Penn State creamery. We do appreciate our cooperative relationship with Land O'Lakes.

BY MR. SCHAD:

Q. Good. Thank you. Let me see, let's first talk about your testimony. Well, I guess, first of all, let's clear up a few things. Are you here today representing any party or parties?

A. No. I was hired by Yale Law Firm to do an economic analysis of these various scenarios, and they asked if I would come and testify. I

agreed to do that, as long as I didn't take a position on any of the issues.

Q. That was my second question. You have not taken a position on any issues.

Okay. Let's go -- when you describe your baseline for 2007, am I correct in saying that you went to -- you took estimates of the Western dry milk price, the whey price, which is a function of that powder price, and CME future cheese and butter prices; is that correct?

A. That's correct.

Q. Why did you not use the CME powder price as an index for your baseline?

A. As part of my ongoing -- as part of my ongoing responsibility at Penn State, twice a month. I am updating my situation outlook. I talk to industry people globally on what the powder price is. That is where I get my forecast on powder, by talking to people abroad. because the world markets are setting the powder price right now.

One of the things that came to my attention is that there is a -- historically, there has been a relationship between the price of powder and the price of dry whey. Because the dry

whey, while used for livestock feed abroad, it is priced in relation to the protein content.

I did a regression and found a high degree of correlation, and so starting with this study, I began to then take my projection of the nonfat dry milk price and plug it into the price linkage equation to get the forecast for dry whey.

Q. My question was about the dry milk price. You used NASS for the butter and the cheese. Is the -- I am sorry, you used the CME, correct. You used CME futures for your projection of what the baseline for cheese and butter would be.

Why not the CME powder price? Is the CME powder price a good price to use?

A. I typically don't use the -- I don't usually look at the CME powder price. I haven't correlated that to the Western price. But I like to use the East Coast price for powder. because they are so high. I don't know why. But I typically look towards the Western price as a price leader for our markets, that is what I typically look at.

Q. Your baseline, you also forecast class prices, and normally a calculation for class

prices would be the NASS price. Are you using these prices as a proxy for NASS, or are you doing a calculation which translates these prices to NASS prices?

A. The latter is correct. We are in the process of building this simultaneous model. The starting point for the prices will be the CME price for Grade AA butter and block cheese. the Western price of nonfat and the Western price of dry whey.

We would then take those and put them into our price linkage equation. Because it is a monthly model, we project a two-week and four-week NASS survey prices. We do look at time. It is not perfect. But at least we are looking at the relationship between those, the commodity prices and the NASS survey. That gives us the NASS survey. So we did do an econometric estimation of those linkages.

Q. We both had a lot of words. I had a lot of words in my question and you in your answer. So you do estimate the NASS prices from these four prices that you talked about?

A. Correct.

Q. Why don't you talk about your feed cost

analysis and the conclusions that you might bring around that.

I guess my question -- I asked this question yesterday. Is it your opinion that the Federal Order system should act as a price or an income support system for dairy farmers?

A. I think the Federal Orders are acting as a mechanism for setting prices. But I never said I would think it would be used as an income enhancement for producers. It should be setting the terms of trade, trying to replicate the free market, which, as an economist, is what we always look to as a best measure of setting prices.

Q. So it is under your -- you would not expect the USDA, the Secretary in making a Federal Order rule, you know, to be concerned more than 608C(18) relative to the prices received by dairy farmers?

A. I think the USDA should take into consideration what producers, their financial situation and what they are getting for their milk, obviously. They are obviously looking at the processors as well

Q. I am sorry, I am getting a contradiction

there.

Then USDA should be setting prices in a way to make sure that all dairy farmers are making a living and making a profit?

A. I never said that.

Q. Okay. Then I misunderstood what you said.

A. USDA, when they are setting their prices, should take into consideration the economic climate in which they are making that assessment.

JUDGE PALMER: Let me see if I can help. You are saying that USDA isn't necessarily supporting prices, but they are -- this mechanism lends some predictability to the way milk is marketed? Is that right?

THE WITNESS: I think that USDA should look at both processors and farmers in setting their prices, and that I am providing some information to USDA about the economic conditions that those producers are under right now. I don't think that enough people appreciate the adverse conditions that these producers are now operating under.

BY MR. SCHAD:

Q. You are aware that USDA and the Congress of

the United States set up a program that gives direct payments to dairy farmers, the MILC program?

A. Correct.

Q. Should the Congress look at the fact that folks who are using corn as a feed, rather than the ethanol use, should the Congress take into consideration that disparate prices or the increase in prices for corn and soybean in the feed rations and maybe have a program like MILC that would directly pay farmers, rather than doing something that may distort market prices as a consideration of high corn prices?

A. I am going to go back to my original statement, that I am here to basically analyze the USDA options, provide an objective assessment of that and not take a position on public policy issues.

Q. Okay. I went to your Web site and there were two things I downloaded from that.

A. I hope it wasn't a Powerpoint presentation.

JUDGE PALMER: I have two documents. The first one starts, "Ag Economist Ken Bailey testifies against raising make allowance." et cetera, by Sherry Bunting. We

will mark that for identification as Exhibit 16.

And the other one I have been handed is Dairy Outlook, Kenneth W. Bailey, The Pennsylvania State University, on top it's February 2007. Department of Agricultural Economics and Rural Sociology, Current Market Conditions. We will mark that as 17.

(Thereupon, Exhibits 16 and 17 were marked for purposes of identification.)

BY MR. SCHAD:

Q. I have handed you two documents. I downloaded them from your Web site. I wouldn't normally ask you to respond to a newspaper article from the Farmshine, but since it was on your Web site, I am assuming you endorse everything that's said in there, and if not, please --

JUDGE PALMER: Before we -- who is working with Professor Bailey? That's Mr. Yale here? Before we get too far into this, the professor has been very clear that he is not testifying to give a position at this hearing. You can understand that for a number of reasons, number one, he has his situation at the

university, where they don't take these positions, and it is a different kind of work that you have to do, on one hand, you are plugging in some numbers. It is another thing to sit back and get into philosophical considerations about how dairy prices, milk prices should be affected by Government regulation.

Just quickly glancing at these articles, he may have been somewhat in a different position when he wrote -- he didn't even write these articles. One was a report. And I don't know that he should be cross-examined on these things when he is not testifying on these things.

MR. YALE: I mean, we were going to let him -- see where he went. Ryan and I were sitting here watching this, deciding when to object, and we wanted to see what he was going to do with them. The first article, if you read it, is basically quoting out of the transcript that was filed on the Web site.

JUDGE PALMER: That is what troubled me right away.

MR. YALE: But it is not any

quotes other than what is there. And if you are on a side, it would look like he was supporting this position, because it appeared to say that the thing was a bad thing for producers.

Now, as far as the outlook. I would object. It is simply indicating what is going on. I don't know where he wants to go with the questions. That is why we were waiting to hear where they go.

We would object to anything that has him try to espouse a position, because he is not espousing a position. And it is very objective work, somebody else can go out and replicate it on an objective basis. Even the analysis of the proposals come out of what USDA did in their scenarios. He didn't make anything else up. He didn't come up with any other numbers or anything else. He used what they used. All we were trying to do was to fill that gap from the present to the long-term.

JUDGE PALMER: You are standing. so I presume you have something to say on this too?

MR. VETNE: I think I should, right?

MR. SCHAD: Yes.

MR. VETNE: Your Honor, I represent Land O'Lakes, among others.

Exhibit 17 is a Dairy Outlook report authored by the witness.

JUDGE PALMER: Right.

MR. VETNE: Which is published on the Web site. The witness is an economist. he described himself as working on programs in the past and future, predicting economic impacts in the future, based on what is going on now.

That is part of what this hearing is about. A component of his testimony involves the economic future of dairy farmers, based on feed prices, and analysis of what revenue to dairy farmers would be produced, based on various proposals.

What he has written and analyzed in the past certainly deals -- and he has been received as an expert. An expert is -- one is entitled to draw from an expert's other writings to see if they relate to -- the witness can always say, "This doesn't relate to the issue." or, "This calls for me to make -- take sides, and I decline to do that."

But let's not muzzle him before he gets a chance to respond or before Mr. Schad gets a chance to ask questions.

JUDGE PALMER: We are not muzzling him. I don't want more material in the record that is going to confuse rather than clarify. The one I first saw was 16. I was looking at that, and as Mr. Yale said, that is testimony of a previous hearing.

MR. VETNE: Which is perfectly fine. It is quoting Dr. Bailey, and it is relevant -- excuse me, we are dealing with make allowances in this hearing. We dealt with make allowances in prior hearings. That is the issue in this proceeding, and that is the focus of Ken Bailey's testimony.

MR. BESHORE: With respect to the newspaper article, I think it is completely inappropriate.

JUDGE PALMER: Which one is that. the Dairy Outlook?

MR. BESHORE: No, the first one. Sixteen, which is a reprint of a newspaper article. If Mr. Vetne or Mr. Schad wish to examine Dr. Bailey with respect to the testimony

that he provided at a prior hearing, we should have -- they should present the transcript and ask him about it.

But to put in the record, to load the record with a newspaper article reporting a prior transcript, I think it is, you know, just a joke.

JUDGE PALMER: You know what I am going to do, I am going to sustain the objection. This will go with the record marked as 16 as an offer of proof.

MR. VETNE: The objection is only as to Exhibit 16?

JUDGE PALMER: Well, right at this point. Exhibit 16. Seventeen I have to think about a little more. I didn't read it.

MR. YALE: Your Honor, it looks like it is just one of his reports that he put on the Web. Let's have him identify it and make sure it's not the --

JUDGE PALMER: Let's see what happens with 17.

MR. VETNE: With respect to 16. which is the entire article, I am assuming, perhaps I am wrong, that you are not barring

Mr. Schad from asking Dr. Bailey concerning statements he has made in the past which Mr. Bailey may or may not authenticate as having been made by him in the past?

JUDGE PALMER: I don't know. We'll see where that goes; but as far as the article itself, it is a newspaper article and I am not going to receive it. But we will let it go into the record as an offer of proof. Go ahead, Mr. Schad.

MR. SCHAD: Sorry for the delay.

BY MR. SCHAD:

Q. What I really want to talk about is the effects of make allowance changes in Pennsylvania. Basically I am bringing that up. And did you say, quote, in this or any other article. "We are in the unique situation here in Pennsylvania in the Mid-Atlantic States where more and more of our milk is funneled into fluid and Class II uses. The real focus for USDA was cheese processors. Yes, we have cheese processors in Vermont and New York and of course the Upper Midwest."

Did you make a statement like that?

A. Yes.
Q. Could you explain what you were trying to say?
A. I think that pretty much explains it.
Q. Okay.
A. I can get statistics, but as you know, more and more of our milk is being marketed through DMS, and I felt as an extension of economists in my role, that that was a logical, a logical decision that was made to -- we have balancing plants, obviously, some Class III and IV. Class IV particularly, which you are aware of. But more and more of our milk is going to Class I and II uses, in Pennsylvania.

This is an interview from a newspaper reporter from Farmshine that goes to our Pennsylvania farmers. So I was speaking as an extension economist.

Q. Thank you. I guess the question becomes -- the question is statistics.

Are you aware in the 2005 NASS report for total butter production in the United States. that Pennsylvania was ranked third?
A. I don't remember that. But --
Q. Okay. And that it produced 5.5 percent of

the nation's butter, with four plants reporting?
A. That is a Class IV use.
Q. That is a Class IV use.
A. And you also make skim milk powder.
Q. I am going on to that. Are you aware that Pennsylvania produces 7.3 percent of the nation's nonfat dry milk?
A. Yes.
Q. Yes, you are aware of that?
A. I am aware when you make butter, you make skim milk powder. I witnessed them making it at your plant, you were there. We were both there in the plant.
Q. What I am trying to point out is that Pennsylvania is an important processor of these commodities. I am trying to basically impeach the idea that all of our milk is going to Class I and Class II.
JUDGE PALMER: I don't think he has testified about that. That is what I am -- I know we give a lot of latitude in these hearings.
The gentleman has come in with not an easy topic. You take a econometric study, he is trying to give a shorter version of what might

happen in the next two years, and that is complicated enough. Now we bring in all this other stuff about what he thinks about butter production in Pennsylvania, and I don't -- it is just confusing the record.

THE WITNESS: If I could answer one thing, I think that he is getting at, if I can jump ahead, Mr. Schad.

JUDGE PALMER: All right.

THE WITNESS: Is that we do have balancing functions in Pennsylvania. Class IV. Land O'Lakes has a Class IV balancing plant, and so you are going to say -- so you would argue that you have higher energy costs, higher cost of producing that.

I would argue that you have a very large, efficient plant. You are selling a branded butter product in retail markets that I hope you would get a premium for. As I look at the weekly AMS, Ag Marketing Services, statistics for nonfat dry milk, you are getting a huge -- somebody is getting a huge premium on buttermilk and nonfat dry milk on the Eastern Seaboard. So whether that goes to Dairy America or Land O'Lakes, it is not my business. But

someone is getting that money. And that should certainly help offset any higher make allowances.

JUDGE PALMER: You got an answer.

BY MR. SCHAD:

Q. Are the marketing and packaging costs of consumer butter included in the manufacturing cost survey?

A. I don't know. I doubt it is. I don't know. I am not aware of the requirements for the NASS survey.

Q. Would you agree with me that the manufacturing costs for the -- for this hearing and for other hearings for butter have been defined as the NASS product, which is butter packaged in 68-pound boxes or 50 kg boxes?

A. I don't know.

Q. Would that change -- I mean, the make allowances are about commodity products, not consumer products, would you agree with that statement?

A. Yes, if I had a plant that was selling directly to a retail store, if I was selling that commodity, nonfat dry milk, at very nice premiums, there are premiums for nonfat dry milk

the last two years. I can bring out the reports and show you.

Someone is paying them, unless the statistics are wrong.

Q. You have evidence that the price for, the going price in the Northeast for nonfat dry milk is that much different than the NASS survey price?

A. Yes. I mean, the Western prices for nonfat dry milk reported by AMS are, you know, 80 to a dollar ten every week. When I look at the same AMS price for the Eastern Seaboard, price reported by the AMS, it is in the teens. So maybe I'm getting wrong -- that is not NASS data, but the NASS is somehow not picking that up.

But somebody that is selling the product in the open market is getting that money. It may not be the plant, but someone is getting it. I think it should be the plant, but that is a business arrangement I am not aware of.

MR. SCHAD: Okay. Thank you very much.

JUDGE PALMER: I take it since 17 wasn't referred to, it is being withdrawn?

Seventeen, that was the other one, the Dairy Outlook. No questions were asked. Is that being withdrawn?

MR. VETNE: I think the examiner was confused about whether it was rejected offhand.

JUDGE PALMER: Did you want to talk about this?

MR. SCHAD: Yes, just one question. It refers again to the other one.

JUDGE PALMER: Seventeen?

MR. SCHAD: Yes.

BY MR. SCHAD:

Q. You at one point make the point that make allowances, you really ought to look at make allowances in the light of what producer prices are. Basically at some point I -- would you agree to that, that the department should make a make allowance decision based on what the producer return for milk is?

A. I think that when the department makes a regulated decision on prices, they should take into consideration all factors, including the feed situation and the producer income situation, yes

Q. The only point I was trying to make with the Dairy Outlook is on page 7, that your projection for the Class III price for 2006 is $11.89 and your projection for 2007 is $14.83; is that true? Does that represent your projections as presented in the Dairy Outlook?
A. I updated my forecast from two weeks ago when this came out. At the time, that was my forecast.
Q. There is roughly a $3 change from year to year in the Class III prices. Does that kind of change in producer prices, it will come from a higher cheese price, does that allow the department to look at make allowances in a different light than they did last time around. when you predicted, when you talked about $11 Class III prices?
A. I am not quite sure I understand the question.

But my assessment is that, I just over the noon hour had an Outlook conference, and I told the producers, yes, the Class III prices are rising, because the implied cheese price is rising. But you also have to look at the feed cost situation, because feed costs are rising

astronomically.

So you must take into consideration the income over feed costs, what you need to look at to make business decisions. I have evidence here in Exhibit 15-A that, all else the same. you will end up slightly above the five-year average.

But the producer's question was, "When is it going to show up in our milk check?" It is a matter of timing. You have had 12 months of poor economic returns, cash flow was bad, debts are building, short-term payments to creditors for feed is building, producers are not seeing the higher milk prices.

So I am not going to come here and argue they are not under economic stress. They are under economic stress, and right now, they are going to be paying -- they will be receiving a lower Class III price because of the make allowance issue.

I am simply trying to bring that up as an issue at this hearing, that it be taken into consideration.

Q. Have you or Penn State ever done any processors' cost to manufacture?

A. No.
Q. Would you think that that is a proper thing for Penn State to do?
A. Well, this Penn State economist read Cornell's study and saw how processor costs declined as plant capacity expands. And I look at those processor costs and they seemed to be in line at the time with the make allowances that we had. So I guess I took that into consideration.
Q. Are you aware that in the last two years. Pennsylvania has lost a Class IV plant. Eagle Family Foods, lost a Class III plant. Saputo Cheese in Allentown, Pennsylvania, if you look across the border, Kraft in Canton has closed. Hershey Foods has announced that they are going to cut employees by 1500, which the expectation is that they are going to cut back production at their Class II facility in Hershey, Pennsylvania? Does this indicate to you that there is some disequilibrium between prices that are paid for milk relative to a processor?
A. No. I toured the Eagle plant. I don't know what year it was put in, probably sometime after World War II. It was a nice facility to

have. It created employment up in the Wellsboro area. But the fact is, my assessment is they were probably paying very hefty premiums for the milk going into that plant.

The reason they were paying those hefty over-order premiums is because milk is worth more in this part of the country. And if you are not willing to pay for it, then that milk will go somewhere else. In this case, that milk was going for fluid or Class II purposes.

So the bottom line for me is the producers made the milk, it went to its highest and best return, and it probably wasn't in that type of a plant. They relocated their plant to where they can secure a lower cost for that type of manufacturing.

So I think that was just a natural economic transition.

Q. Again, and you would agree -- are you saying that the other closures also is --

A. I am not aware what they are paying or the situation. But we are finding, obviously, we are finding home for our milk, and it is moving into deficit areas, and we have plant capacity, obviously, in Pennsylvania, and it is obviously

important, and I am not arguing that it is not.

MR. SCHAD: Thank you much.

JUDGE PALMER: What do we want to do with 17? He referred to one page. I presume we can receive the document, just so that we can refer to that one page.

MR. VETNE: It was offered.

MR. YALE: We don't object.

MR. VETNE: It was offered.

JUDGE PALMER: We will receive it.

(Thereupon, Exhibit 17 was received into evidence.)

JUDGE PALMER: Let's get somebody else to ask some questions. Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Marvin Beshore, good afternoon, Dr. Bailey. Just first a question or two about Exhibit 15-A. It was an interesting depiction, calculation you have done, and depiction of milk prices and feed costs in Pennsylvania.

I want to be sure the record is clear as to how you calculated the -- I am not going to get these mathematical names right. It is A minus B is what is shown on here, right?

A. Correct.
Q. A being the milk price or a milk price proxy. Okay. Is that the, what, the subtrahend or --
A. Pennsylvania all-milk price.
Q. Is A, okay. So for historically, you used the Pennsylvania all-milk price for the month?
A. Correct.
Q. And in terms of the projections for '07, you used, I think you said, the CME futures with a historical relationship to the Pennsylvania all-milk price?
A. Correct. I did an OLS, ordinary least squares regression between the Pennsylvania all-milk price and the Class III price over the time period January 2001 through December 2006. And then I used the Class III futures to project the Pennsylvania all-milk price with that equation.
Q. Okay. And then what was the relationship?
A. Well, there was a positive coefficient in front of the Class III price. So obviously the Pennsylvania all-milk price is above the Class III by some margin.
Q. Did you derive a fixed margin estimate?

A. There is an intercept and a coefficient. But generally, it is normally $2 to $2.50 per hundredweight, CWT, per hundred pounds of milk.

Q. How about the bottom figure, the minus, the feed cost. What was your data for that?

A. Penn State has a price, a feed price list where they keep track of all their feed prices monthly.

Q. The Penn State Farm?

A. The Penn State Dairy, Virginia Ishler reports those each month. And so she developed a static feed ration for a cow producing 65 pounds. We plugged in the feed costs and we calculated the feed costs per cow per day to produce -- balance for a 65-pound ration with a certain fat and protein level, standard fat and protein levels.

Then we took that cost and we simply translated it into the cost of producing a hundred pounds, and that is the B part, which we subtracted off of the milk price. It wasn't very complicated.

Now, to forecast the feed cost per cow per day, we needed a way to -- we had a ration with roasted soybeans, distillers, some commodities

and some haylage. We kept the forecast, we kept the haylage price constant, but I tried to look at relationships between, historically between some of these commodity prices and CME prices for corn or soybeans. Again, we estimated a linkage equation to see if there was some relationship.

Most of the commodities, there was some relationship, like roasted soybeans goes up and down with the soybean price. So that way, we went to the Chicago Board of Trade and took the corn and soybean futures prices, plugged them into those relationships and forecasted out the ingredient costs for our ration.

There were a couple of things, soy hulls. I think, and maybe distiller's grains that was not related. We kept that the same. That gave us the forecast for the commodity prices, we plugged them into static ration, and we then projected a feed cost per cow per day.

Q. Now, the cost for those feed inputs -- well, first of all, the feed input, would you -- where you are using roasted soybeans and soybean hulls and distiller's grains, would you consider that a typical Pennsylvania ration for dairy

production?

A. I asked Virginia Ishler to give me a ration that a typical -- that would be typical. There is no one typical ration. Rations change every quarter. every year.

But in order to do our economic analysis. we said we want a typical ration that we could leave static for month to month to month, so we could isolate the impact of prices on that milk/feed relationship.

Q. And the prices that went into that were actual cash prices that the Penn State Farm had paid historically for those inputs?

A. Correct. They are basically -- in some cases, they are market prices where you add in trucking, some processing costs, and then Virginia Ishler would then compare that to what feed dealers in the area were paying. Sometimes it is what they actually paid for it. So they have been reporting these prices and comparing it to local feed prices.

Q. Now, was there an alfalfa hay component in a ration, do you recall? I think you mentioned haylage. But I didn't -- I don't know if I heard you mention alfalfa hay.

A. Our ration consisted of haylage, corn silage. corn grain. 48 percent soybean meal. distiller's grains, soy hulls, roasted beans and vitamins.

Q. The alfalfa hay price, how did you derive that?

A. We took what we would pay for -- it is not alfalfa. It is alfalfa haylage.

Q. I am sorry, haylage.

A. We took the price of hay and she has a standard conversion to haylage.

JUDGE PALMER: I am lost.

THE WITNESS: If you harvest the hay in a wet form, and then ensile it into a silo and let it ferment, it becomes a very good source of fermented feed, like corn silage. If you put it in silage, there is anaerobic and aerobic. I don't know what the difference is.

BY MR. BESHORE:

Q. Okay. Now, let me turn to just a couple of questions with respect to subjects that came up when Mr. Rosenbaum was asking you a couple of questions.

You used the phrase twice at least, maybe more than that, when you were being asked about

cheese prices that blocks are the leader, if I got the note right.

Do you recall that?

A. (Witness nodding head up and down.)

Q. Okay. What did you mean by that?

A. Well, I teach a class in commodity price forecasting. We have a theory of one price. So it really doesn't -- from one price will describe all the others. So from one week to the next, there might be some differences, but from month to month, it is either blocks or barrels that are all related. So you pick which one you like the most.

There is a relationship. I think most industry people I talk to are looking at that block cheese price, but obviously there is a relationship over time between that and the barrels. And obviously there is a relationship between that and mozzarella, and other forms.

So we would say over some period of time, a month, a quarter, a year, one price would prevail. I chose the block price. That is what I like to look at.

Q. On your -- is it your observation and your observation in terms of your industry contacts

that you have referenced, that the industry looks at blocks in the fashion that you did?

A. They look at blocks and barrels and that relationship changes from one week to the next. The margin gets squeezed, sometimes inverted. But obviously over some period of time it returns to some equilibrium level between the two.

So in theory, it really doesn't matter which one you pick. But, again, I always look at blocks first and then barrels.

Q. In your view as -- I understand you are not making any policy recommendations here with respect to advocacy of one proposal over the other. But in terms of approaching the issues in the hearing here which involve make allowances for plants and the yield factors and other elements of that equation, would it be your view that the Secretary should -- the USDA should look with equal diligence to yield factors and other elements of the Class III and IV price equation, as much as he does make allowances?

A. Well, yes, I did an analysis of all the options. I think the point of the hearing is to

look at all of those factors. All of those factors, from my analysis, have a direct impact on what a plant pays a farmer for their milk.

MR. BESHORE: Thank you.

JUDGE PALMER: Let's take a recess until -- it is now a little bit before three. Why don't we take a recess until five after three.

(Thereupon, a recess was taken.)

JUDGE PALMER: I think we completed examination by a number of folks. Who else has questions? Anyone else have questions? Yes -- well, we will go to Mr. Galarneau.

MR. GALARNEAU: Very good. Thank you.

CROSS-EXAMINATION

BY MR. GALARNEAU:

Q. It is Clayton Galarneau, with Michigan Milk Producers. I just had maybe one or two quick questions. I believe from my interpretation of your testimony that your models use the baseline, you said, of the futures market from what, February 23rd or something?

A. Um-hum.

Q. If your baseline is using the futures

market, haven't the speculators already speculated on what proposals they believe will be implemented, and if that is the case, when you look at the changes from the baseline, the baseline is already anticipating these changes.

So how much of the changes that you have calculated can we expect to really realize?

A. It is an interesting question. But what I have been doing is almost every two weeks I have been updating my forecasts.

So I don't believe that -- this is after having spent some time in Chicago talking to these traders, that they sit down and talk about yield factors and such as that and build it into their equations. They are looking at the relationship between milk and feed.

And in my opinion, after talking with them, what is driving the price of the Class III futures right now is that constant daily runup in feed costs. That is just going -- every time I look at the feed, it is going up and up and up. They know there has to be some relationship driven by the marketplace, and so I think they are much more focused on that than what the yield factor could be or the outcome of this

hearing.

That is my opinion.

MR. GALARNEAU: All right. Thank you.

JUDGE PALMER: Mr. Vetne?

CROSS-EXAMINATION

BY MR. VETNE:

Q. Good afternoon, I am John Vetne. I represent Agri-Mark and other cooperatives.

In addressing the last question from Mr. Galarneau, the relationship that you are talking about that you believe traders are observing is a direct relationship between future feed costs and future milk prices. As feed prices go up, milk prices also are predicted to go up, is that the relationship you are talking about?

A. Well, what the traders have in mind when they look at the Chicago Board of Trade, they go across the street and trade on the milk futures. they are looking at all that information, and in their mind, they are saying that the market has to rationalize some relationship between those two prices.

Q. Right, you are attributing an inferred

relationship. What is that inferred relationship? That was my question. When feed prices go up in the future, milk prices will also go up in the future, or is it inverse?

A. Well, not necessarily, because the Class III futures assumes an implied cheese and whey price in there. So people trading the futures, they look at the -- they have to first form an expectation on what that whey price is going to do in the future. Then they have to come up with what is the cheese price going to be and that is how they come up with the Class III futures.

Now, as we roll ahead into the marketplace, the question is, and I look at the implied cheese price is expected to be over $1.50. the fact is, in the future when you move ahead, the market fundamentals for American cheese have to be in place to produce the 1.50. If the market fundamentals are not there, then the price could be lower.

If the price is lower, then producers are caught in a milk/feed price squeeze.

Q. I think somewhere I got lost in your response and my question.

All other things being equal, in the mind of this imaginary trader you were talking about. and the relationship focused on feed prices as observed in the futures market, and the response, in that trader's mind, milk prices in the future market, what is the relationship, is it positive, negative?

A. I believe it is positive.

Q. Okay. So as one moves up, you would expect the other to move up?

A. This is in the mind of a futures trader.

Q. Right, so as one moves up, you would expect the other to move up, in the mind of futures trader that you were talking about?

A. Yes, all else the same.

Q. Now, the Penn State monthly dairy industry model that you refer to in the second paragraph, that is a model that you designed or your department designed?

A. I am developing the model, yes.

Q. You are developing the model. Okay. So we should not assume when you say it is a Penn State model, that it has its origins outside of Ken Bailey?

A. Yes. I designed and developed it, and

continue to do so.
Q. The model starts with forecasts of commodity block prices. That is, the model doesn't make forecasts one of its initial inputs, it is somebody else's forecast; is that correct?
A. It is my forecast.
Q. It starts with your forecast?
A. Exactly.
Q. So you make a forecast, and input it into the model?
A. Exactly.
Q. The model doesn't make the forecast?
A. I make the forecast for the commodity price.
Q. How do you employ the commodity price to make the forecast? Is that also in a different model or is that an art more than a science?
A. We are in the process of developing a monthly simultaneous model, and we are initially doing that. Right now, the way I make a forecast is I look at all the market information in my mind, come up with my forecast for the commodity prices, plug it into this model, and then I get the pool values, the class prices and

all that comes out the other end
Q. So it starts with your judgment of the forecast, and that is plugged into the model And then you continue in the same paragraph. "And forecast NASS survey prices " By that, do you mean the model forecasts NASS survey prices, or is this another input by you of your forecasts of NASS survey prices?
A. No. As I explained earlier, and we have those four commodity prices, we can then plug them into the model, and the model has a series of linkage equations that drive the NASS prices
And so that is a formula that we -- an econometric equation that we have.
Q. My question is, does this come from the model, or is it put into the model?
A. It is part of the model. It is a simple intercept and slope times the CME price.
Q. And that is a formula built into the model?
A. Correct.
Q. Okay. So just using verb tense here, when you say. "and forecasts NASS survey prices." it is the model that is doing the forecasting?
A. At that point, yes.
Q. At that point, in that sentence. Okay.

You say, "The model is dynamic on the supply side, but not on the demand side." Does the model employ elasticities for cow numbers and milk production per cow?

A. We use a distributed lag model. If I calculate them, there are dynamic elasticities.

Q. And are the elasticities used in your model on the supply side identified or documented anywhere?

A. No.

Q. They are not?

A. No.

Q. And do you have a number for those elasticities, either cow number or production per cow elasticities?

A. Well, we use a distributed lag model, we use the milk/feed ratio over a 12-month period. So in our journal article, we did a dynamic elasticity. I don't have it on the top of my head, what that is. But it is simpler -- if you had an annual model, you have one price on the right-hand side driving milk production on the left side. It is easier to identify one elasticity.

When you have a dynamic monthly model that

is a distributed lag model, you have the price in this month, last month, on and on and on for 12 months driving the cow numbers, driving the milk yield per cow. So I don't have one elasticity. I have 12 coefficients.

Q. You said "a journal article." Is that described in an article that has been published that you can refer me to?

A. We are in the second draft.

Q. Oh.

A. These things take time.

Q. Okay.

A. I will send you a copy.

Q. Please. You have my e-mail address. I want to ask you some questions about the dynamics that are in there. Before I do that. you weren't here for the USDA economists?

A. No.

Q. Okay. And they talked about the Dairy Programs' model and the USDA baseline. And they described the baseline, which they used and altered for Dairy Programs purposes, as containing observations of market behavior going back to 1980.

So you have milk supply, milk prices, grain

prices, feed prices, Chinese demand for corn. just a whole variety of things which interact.

Does your model contain any supply side input for past market behavior, similar to that?

A. We made the conscious decision to develop a monthly dairy industry model for forecasting purposes and for analysis of Federal Orders, because everything happens on a monthly basis.

Also, we felt -- I felt that the industry has been going through some changes, and has become much more market oriented.

By going to a monthly model, I have more data points; I don't have to go all the way back to the '80s, which in my opinion is irrelevant to what is happening to forecasting things now. The industry has changed dramatically. We are well off of support. My database begins in January 1997.

So we are trying to use more monthly data points to describe the supply and demand market fundamentals.

Q. And does your database since January 1997 include, in a manner similar to the USDA baseline, supplies of different kinds of grain and acreage planted and acreage harvested and

foreign demand and that kind of thing on the supply side for things that are used by dairy farmers?

A. No, we are trying to forecast the milk supply and we have feed and corn and soybean and alfalfa hay prices are exogenous. They are outside of the model, they feed into the model. So we don't have those other things, they are not relevant.

Q. Did you cross-check the price forecasts in your model for 2007 and 2008 to the feed price forecasts against the 2007 and 2008 feed and grain projections in the USDA baseline?

A. I looked at the latest USDA baseline, the one that apparently they did not use.

Q. The one that was published on February 14 of --

A. Yes.

Q. A couple of weeks ago?

A. I looked at the forecast there.

Q. My question is, did you compare your projections against those projections?

A. Yes, I did.

Q. Okay.

A. Mine were much higher. The futures

market's is much higher.

Q. Okay. I don't see -- although you indicate you have a supply dynamic, I don't see in any of the testimony or the two exhibits, subexhibits, supply information, in other words, how much milk is going to be produced and whether. consistent with the USDA baseline model, milk continues to increase at a gradual rate, in spite of projected feed prices.

Is there a milk supply number that came out of your study?

A. Yes. I project milk production for my forecasting. I just didn't include the table. It would have been a good idea to put that in there.

Q. Okay. And in the milk supply that you projected, does milk supply continue to increase, albeit, at a smaller rate?

A. Yes. In fact, the exhibit -- since it is available, Exhibit 17, I used the same model to produce all these tables.

Now. since this Exhibit 17 came out. I decided to update the model one more time for this hearing, so I put in the higher futures prices for milk and feed. But it produces the

same type of forecast. Here, as of my February dairy outlook, I had the '07 milk supply growing 1 percent.

Q. The '07 all-milk or Pennsylvania milk?

A. No. U.S. I looked at U.S. milk production. it is expected to grow -- I forecasted it to grow 1 percent.

Q. And since you tend to focus on the Northeast or Pennsylvania, do you have similar projections for the Northeast region or for Pennsylvania?

A. All the prices determine a national supply and demand. I don't project Pennsylvania or the Northeast. I look at national supply and demand factors.

Q. All right. In several places in your discussion of the scenarios, you use -- in relation to dollars or a description of dollars. you use the words "drop," "decline." "fall." and Mr. Rosenbaum used "price goes down."

In my mind, that suggests less, less than now.

(Laughter.)

Q. Less than now. But that is not the case. All of these descriptions are relative to where

it would otherwise be, so if prices are steadily moving up, supplies are steadily moving up, they would still move up, perhaps, but at a lower rate; am I correct?

A. Mr. Vetne, every statement that used "drop" or "changed" or "rose" or "fell," the words relative to the baseline have been used in every case.

Q. Okay. And relative to the baseline, the baseline is one of a price baseline, not a supply baseline; is that correct?

A. My expert opinion baseline, yes.

Q. Now, when you did, for example, you did a baseline for 2007, projections for 2007 and 2008, and I think what you have is different from the baseline. Do you also have a projected all-milk price line for those years?

A. Yes. The model produces the all-milk price.

Q. Okay. The 2007 USDA baseline projects for 2008 an all-milk price of $14.80. Have you compared that number to your prediction of an all-milk price?

A. No.

Q. You haven't compared it. Have you compared

your number -- now, in the prior baseline release. the one that you referred to. and that USDA Dairy Programs used for 2008, had a projected all-milk price of $14.55, again for 2008. 25 cents less.

Did you compare your predictions against the 2006 baseline that you reference as one of your references?

A. I have my own baseline. So I make my own projections. I am very familiar with the USDA's interagency baseline forecasts. I understand the reason that they have it.

It is basically at that one-year point in time, is an outlook for what they think is going to happen. I am changing my baseline every two weeks. So I don't go back and look at USDA's baseline every time I make a forecast.

Q. Okay. And you did not do so for this purpose, you have --

A. No, I have my analysis.

Q. You have your analysis, you have 2008 data. Okay. Have you looked at, since you talk a lot about price feed ratio and the ratio mix and predictions and so forth, have you looked at the USDA annual projections in the new forecast for

2007, '8, '9, and compared that to projections of increased feed costs to make any judgment on whether the higher prices are sufficient to capture higher feed prices?

A. Well. I have a cooperative agreement with the ERS, Economic Research Service, and so I am familiar with the WASDE, W-A-S-D-E, World Agricultural Supply and Demand Estimates. procedure, which occurs every month. So I read that report, or try to glance at it every month. So I do understand how it works. They also take into consideration feed costs.

Q. My question was whether you have made any judgment on whether the baseline projection of higher milk costs in the future than were projected last year are sufficient to cover higher feed costs, higher than projected last year?

A. The February '06 released baseline obviously had no increased feed cost. The USDA baseline that is put out for policy analytical purposes. that was released February '07, had some increase in feed costs, but nowhere near what we have experienced now. The only WASDE number is simply a forecast.

So in the world of USDA, there is a huge difference between an annual baseline that is used for policy analysis across the department. and the WASDE monthly outlook process. No one is going to say, "Well, we put out our February '07 number, that is it for the year." That is simply for analytical purposes. USDA has a baseline. CBO has a baseline, Congressional Budget Office.

Q. Are you familiar with the ERS Dairy Outlook reports?

A. Yes. I am.

Q. And they are issued monthly?

A. Yes.

Q. Do those reports survey -- predict a function similar to yours, where the prediction is changed based on -- monthly based on more recent information?

A. The USDA participates in an interagency process, so it's not an ERS Dairy Outlook report. The Economic Research Service participates with an interagency group to produce a monthly WASDE world, World Agricultural Supply and Demand Estimates. After the WASDE is released, ERS can publish a

livestock situation outlook report.
Q. That is a monthly publication?
A. Okay. So that -- I am familiar with that publication.
Q. Okay. My question was, does that monthly report come closer to serving the function of a projection based on recent data and change month to month in a way similar to yours?
A. Yes. That is a monthly update of market situation outlook, correct.
Q. Okay. The publication that you cited in the last -- in the resources or references, the last one is the agricultural projections to 2015, the fourth item there, make sure we don't get the wrong one here. That is the one published in February of 2006?
A. Correct. That is an error in my report. Page 6, the last reference should be February -- yes. that should be February '06. Thank you for pointing that out.
Q. Okay. Now, you did review the 2006 release outlook report prior to preparation of this estimate?
A. I reviewed that projection to 2015 a month ago. I mean. two months ago. It was my

understanding that they updated their baseline when they did their analysis for the hearing. But my understanding is that the hearing record shows that, in fact, they used the older baseline.

Q. Because the newer one wasn't available when that analysis was done. That was released just February 15.

A. Yes. I know what you are talking about.

Q. And in reviewing the 2006 baseline release, the one that Dairy Programs used and the one to which you referred, there are a number of observations there and projections based on strong expansion of corn-based ethanol products and assumption that ethanol use will double through 2010, an assumption that corn used to produce ethanol will reduce corn available for feed, but increase distiller's grain available for feed.

When you say that no accounting was made by USDA for ethanol use of corn and increased feed costs, were you thinking that those references were inadequate or nonexistent?

A. Mr. Vetne, the current baseline the USDA is using has a $3 corn price for the current

marketing year, going up to 3.50 next year. If you look at the current market prices and the futures prices, they greatly exceed that, the same as -- the same case for soybeans.

So the feed prices are real. People are paying for them each month on their feed bills and they are much, much higher than what you will find in either of those baselines.

Q. My question did not relate to what is in the current baseline, and I have no quarrel with your testimony that it shows very high costs in the future, as well as current, because current prices are reflected there.

But you did testify that no consideration was made to ethanol use of corn and projecting higher corn prices and feed prices because of that ethanol use, and the references that I have summarized here from the 2006 report specifically isolate that as a very important factor.

So when I hear you testify that no consideration was given, which is a judgment call, I am wondering how you reconcile that judgment with what is actually in there.

A. Well, obviously the USDA was very

insightful on the ethanol issue. I didn't testify about the ethanol issue. My implication wasn't that the department didn't recognize those factors. The implication I was making was simply that the numbers for corn and soybean meal. soybean prices in their baseline don't match current market realities.

Q. Oh. yeah. right. The 2006 baseline doesn't match the 2007 baseline in many respects.

A. Correct.

Q. Do farmers of which you are aware typically contract future prices for their feed needs?

A. I don't think very many in Pennsylvania do. I think more producers out west do this, and I am only basing this on my travels, my discussion with producers.

Most of our producers on the East Coast, many of them don't contract either.

Q. Okay. It is a risk management practice available to farmers, whether they take advantage of it or not, isn't that so?

A. That's correct.

Q. By the way, you referred to NASS monthly reports recording soybean prices. In addition, NASS also provides information on other feed

sources, other than those two, correct? Hay?
A. Yes. NASS has a very, very good site called -- it is called "Quick Stats." You can now download many different sources of data. It is very useful.
Q. Alfalfa is in there?
A. All kinds of crops, all kinds of dairy products, many things, yes.
Q. In addition, the NASS data shows where those crops are being produced, what has been planted, what has been harvested and what is in the ground, right?
A. I am assuming so.
Q. Your static feed ration, have you made any effort to adjust the ration to provide the most cost effective feed source in relation to changing prices of the components of feed going into the ration?
A. No. It would require a monthly linear programming model to do that.
I wanted a static model that used a basic simple ration that would be easily used in Pennsylvania. And the only thing I wanted to change was the commodity feed prices.
Q. Now, let me get back to your intent here.

We had some discussion, you can plug in zero make allowance or 2 cent make allowance or 40 cent make allowance into the program that you used, and you would produce a class price and blend price revenue response for producers. correct?

A. I think you can do that with any model and come up with a ridiculous answer.

Q. But the point is, that is all your model does? Your model -- at least this data, the data presented, doesn't provide anything about supply response to any of those prices?

A. I don't know any model available in the industry today that if you plug in a zero make allowance you asserted, would come up with any kind of structural change that would make sense So I am unaware of any model that will do that

Q Are you aware of any plant in the Northeast that concurrently produces in the long run the products, cheese, butter, powder and nonfat dry milk, at current make allowances? You described one plant moving from the Northeast to elsewhere.

Are you aware that any will be around in the long run under current make allowances?

A. I don't have any of that data. I haven't assessed or analyzed any of the plants.
Q. Okay. Do you know, have you analyzed whether any of the plants in the Northeast are of the size, of the size equivalent to the weighted average make allowance that USDA ended up with?
A. No. I am not familiar. I am assuming that the plants in the Northeast are smaller than the plants out west.
Q. Okay. I mean, you do know something about the size of plants in the Northeast, correct? Is it just an assumption, do you know anything about them?
A. No. I haven't done a statistical analysis of plant size in the Northeast.
Q. Have you made observations at all, number of plants and volume of product produced, for example?
A. I have walked through a lot of them, if that is what you mean.
Q. Have you examined the NASS report of dairy products, which show the number of plants and volume produced on an annual basis?
A. I look at the NASS Dairy Products report

every month.
Q. And that shows you something about the size of plants by region, because it shows volume produced by region and number of plants producing that volume?
A. So it shows trends. What is the question?
Q. The question is, do you know anything about plant size in the Northeast? And you talked about an assumption. My question to follow was --
A. I haven't analyzed the statistics, no.
Q. Okay. Thank you.
MR. STEVENS: Your Honor. I don't want to unnecessarily object, but I think we are going over material that was asked by previous counsel. To the extent that John wants to explore new material, I have no problem with that.
But, you know, we are all here, we are all participating, let's ask new questions. The record is full of answers from other people who have examined this witness.
MR. VETNE: I am going on to something new right now. So you don't have to go on.

MR. STEVENS: Thank you very much.

JUDGE PALMER: I'm glad when I don't have to make a ruling.

MR. VETNE: You don't have to make a ruling. Sometimes the objections are longer than the examination.

BY MR. VETNE:

Q. Dr. Bailey, you wrote a book, of which I have a copy, called Milk Marketing in the United States; is that true?

A. Yes.

Q. And that was published when?

A. A number of years ago.

Q. And it includes a description of the regulated systems, as well as the competitive dynamics of the industry.

In earlier testimony, you came -- you indicated that you would expect the Secretary. when setting prices, to consider setting regulated prices, to consider production costs. feed costs and so forth. Do you recall that statement?

A. Are you talking about from the last hearing or this hearing today?

Q. Today. You said that today.
A. I said that they would take into consideration the economic climate that producers were in.
Q. Economic climate in setting regulated prices. And the economic climate includes production costs?
A. Yes.
Q. And now, were you referring to all class prices in providing that answer?
A. I said that when the Secretary considers changes to Federal Orders --
Q. Yes.
A. -- whatever they are, anything that will affect the earnings for producers, and what processors pay, the Secretary would more than likely -- it would be useful to look at the economic climate for those producers in those orders. yes.
Q. You are aware the Secretary, as he has in the economic analysis of decisions since 2000. has prepared these projections of how policy changes will translate in milk production. And then in the past, the Secretary has looked at available milk supplies in response to policy

changes.

Are you aware in any instance, in studying for your book or other studies, in which the Secretary has looked at production costs first and then with respect to surplus milk price. either altered or changed or restrained a change in the surplus milk price because of something happening on the farm?

A. Are you saying does the Secretary change -- am I aware of any instance where the Secretary has altered or changed the Class IV price in response to the producer situation?

Q. Are you aware in your study of Federal regulation, which were addressed in your book and elsewhere in your classes, are you aware of any instance in which the agency has either increased or decreased Class III or IV prices for reasons of increases or decreases in milk production costs?

A. I am not aware of any specific instance.

Q. Is it not true that surplus milk prices. today Class III and IV, have always been based on an estimate of market clearing prices that processors could afford to pay for milk received for those purposes?

A. I don't like that term, "surplus." It is hard for me to imagine Class III being a surplus market. I don't mean to pick on your choice of language, but there is market supply and demand for dairy products.

Q. I use the term only so I don't have to say Class III and IV each time and then Class III and IV-A during some period of time and then just Class III during some period of time. You know. So please accept my terminology, whether you like it or not.

Are you aware of any instance in which the Secretary has looked first at farm costs and then made an adjustment to those, what I call, surplus milk prices in response?

A. Actually, I think there is plenty of time in the hearing to look at all the factors --

JUDGE PALMER: Wait, we have something from Mr. Yale. Yes, sir?

MR. YALE: You know, he cannot force the witness to use a word.

JUDGE PALMER: I agree. So you are still free to qualify. Go ahead.

BY MR. VETNE:

Q. You are free to change the word and you may

answer. Please don't change the meaning.

Are you aware of any instances, in 70 years since 1937 when the act was created, in which productions costs had driven surplus regulated now Class III and IV prices?

A. As I look at the hearing record, almost every time feed costs are mentioned somewhere in that record. I don't know what the ranking of the, which is considered first or second or third. But it seems to be appearing in all the hearing records.

Q. Are you aware of any instance -- now, with feed costs, what the Secretary looks at ultimately is milk production and available supply for Class I, correct?

A. Yes.

Q. And when production costs have increased or supplies have declined, it has been either the regulated Class I price or the unregulated premiums that have responded to those market conditions, correct?

A. You are talking from a month to month point of view?

Q. From month to month, week to week, year to year.

A. Supply and demand is raising the prices or lower them. yes.

Q. Now, that happens with Class III and IV also. I am talking about the relationship between what farmers are paid and what the Class III and IV price is, this bracket.

If there is a market in which a lot of milk is produced, that spread will be lower, correct?

JUDGE PALMER: I lost it too.

THE WITNESS: I think you are referring to the over-order premium on Class I and you are asking in general, is the over-order premium on Class I rising in a deficit market and shrinking in a surplus market for Class I needs?

BY MR. VETNE:

Q. Yes. That is what I am asking, as well as --

A. I am trying to help you as much as I can here.

Q. And the answer would be?

A. In general, yes. But it depends on the conditions. In general, yes, I would expect that to happen.

Q. And that is also true with respect to not

only the over-order price, but the Class I differential. above the Class III price usually?
A. No, that is not correct at all. The Class I differential is set, is fixed.
Q. You know. I come from before Federal Order Reform. The Class I price, the regulated Class I price, is lower in surplus production markets, like Minnesota, than Florida, correct?
A. I mean, Minnesota is a major Class III market. So they have less Class I sales.
JUDGE PALMER: I really don't know where we are going with this. This is kind of theoretical. He is coming with, you know, some modifications to the econometric study. And the numbers are there, and if there is a question about whether the numbers are right. I can understand it.
But to get off into what happens to Class I prices and surplus markets and other markets, I don't know that we need that.
MR. VETNE: Actually, the inference made, and in fact, expressly stated. was that something about production costs, which vary from place to place, ought to be factored into setting these prices. This witness is

competent to talk about, if he is willing to. the experience of the regulated market, as well as the over-order market in responding to those conditions, not in the surplus price, but in the Class I price and in over-order premiums and in other factors.

JUDGE PALMER: He has not really been presented here to testify about that. He really has been presented just to testify about these numbers that he has put in his modifiers of the econometric study.

MR. VETNE: I wish that were true. But, unfortunately, he made some recommendations to the department on their approach to these prices that went beyond --

JUDGE PALMER: When was that?

MR. VETNE: When he responded to the question that he said that the Secretary should consider before setting these prices what production costs are.

MR. STEVENS: John, he can testify to that. I mean, certainly, anybody in this room can testify to that. And that becomes part of the record, that the department considers in terms of the proposals we are

having here.

But he is not the Secretary of Agriculture. He is testifying about an econometric model that he did, which I guess can be considered alongside the economic model that the department did and talked about here, and that is fine.

The Secretary will take all that into account when he decides upon this record which proposals to grant or deny.

But this witness, you know, is talking about the econometric model. He is not here, I don't believe, to testify for any -- for or against any proposal. He said that. And that is clear on the record. I think everybody in the room heard that, and the record clearly reflects it, John.

So beyond that, I don't know -- I agree with Judge Palmer. I don't know where we are going with all this.

JUDGE PALMER: I don't think he is trying to say production costs should be considered in a certain way. He just said in a general way, "Well, I guess you look at production costs." That's what I thought.

MR. VETNE: Maybe. That is one of the reasons I am asking this question is, his testimony seemed to go beyond the raw numbers of his study, and if the Secretary says to look at the raw numbers but not the doctor's recommendations, that is fine.

MR. STEVENS: To be fair, we are having a discussion here, and I don't want to have a discussion. I want the record to reflect that his testimony, at least as far as I am hearing, is about the econometric model, is about what he did, what the Secretary did with his, shedding some light on how they are the same, how they are different, all fine, all good. in terms of the record.

But in terms of evidence for or against any proposal, I haven't heard any testimony from him about that. And you seem to be cross-examining him about it, and I don't really know -- it is not from his direct testimony, certainly, that this has come about.

MR. VETNE: Certainly not from his direct. It came from answers given to others in cross-examination.

JUDGE PALMER: We try not to

muzzle everybody here. So you ask a question that is probably going afield and he answers it. then we need to spend forever showing that there is disagreement between counsel as to a particular point.

MR. STEVENS: Absolutely.

JUDGE PALMER: I am just going to suggest we kind of move on.

BY MR. VETNE:

Q. Let me ask you this, Dr. Bailey: The economic analysis presented prior to this hearing showed a long-term average impact on production and price and so forth.

In a prior economic analysis, one produced for the hearing decision released in November of last year, there were projections on an annual basis. Here is what this would do next year, the following year and so forth.

Have you compared the results of your model, not the one you did for this hearing, but the way your model functions, with the projections that were annualized in the final economic analysis released in November of last year?

A. Yes. I looked at the baseline. I looked at

the model results, and I looked at the structure of the model.

Q. In looking at that, how does your model function differently in the results for the next two years, short-term, as you call it, from the two-year forecasts or projections in USDA's model released?

MR. STEVENS: I am going to object. We already had this testimony. Your Honor.

JUDGE PALMER: I will overrule it.

MR. VETNE: No, we haven't had this testimony.

MR. STEVENS: Well, we have. The record will show we have, and we will have it twice now, or at least -- or three times.

JUDGE PALMER: Well, we will get it one more time, if that's okay. Go ahead. I don't remember it.

THE WITNESS: The USDA analysis takes an intermediate-run approach to analyzing supply and demand in price changes. It looks at a change from a baseline and then summarizes it over a five-year or ten-year period of time. So it is an intermediate-run solution.

Mine looks at a first-year solution. Between the two of them, you can get an idea of what will happen the first year and then what will happen the five -- fifth year. I was more concerned about what happened the first year. And, no, I did not take my results and compare them to the appendix that had the year-to-year changes.

BY MR. VETNE:

Q. So you don't know how your next-year results would differ from USDA's next-year results?

A. I don't have next-year results. I have first-year results.

Q. First-year results, whether your model would produce a different first-year result as published by USDA in November of last year, would produce a different first-year result than they produced?

A. No, I didn't make that comparison.

MR. VETNE: All right.

JUDGE PALMER: Okay. Other questions?

MR. BESHORE: I have one question.

JUDGE PALMER: One question. Let's see if it is truly one question.

MR. BESHORE: That is a challenge.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Dr. Bailey, assume an unregulated marketplace, and we have raw material suppliers. a manufacturing plant and its customers. If the costs of the manufacturing plant increase, will it respond by increasing the prices of the products which it is producing to its customers. by reducing the prices of the raw materials that it is being provided by its suppliers or some combination of those possibilities?

A. Well, if it was in a competitive market environment, it would be some combination of all that. They will attempt to, in the first instance, to pass it on to their customer, if they can.

But they may be selling a product, a homogeneous product, an undifferentiated product in a national market. They may not have the market power to do that. They may try to force it back on the producer.

But then they might lose that producer. That producer may go to a different market and supply another plant in a different market.

So all of these things happen in a competitive market to arrive at an optimal solution.

MR. BESHORE: Okay. Thank you.

JUDGE PALMER: Anything at this table over here?

MR. SCHAEFER: No.

JUDGE PALMER: Mr. Yale.

REDIRECT EXAMINATION

BY MR. YALE:

Q. I want to clarify some numbers here in the record. I forgot to do it in your testimony.

If you would turn to page 1 under the model analysis, and in the middle of that first paragraph of that section, it talks about forecast prices for Grade AA, and it goes down to futures contracts as of February 23rd, 2006. Is that right, or should that be 2000 --

A. That should be 2007. I apologize.

Q. Okay.

JUDGE PALMER: What page?

MR. YALE: Page 1.

BY MR. YALE:

Q. And then I wrote this down, and I forgot to mention while it was still warm in everybody's mind, but I wanted to make sure this was correct, on page 3, there is Scenario F and then the last full sentence, or last full line of that, it talks about rose 217 and 206 million in 2007. And I believe you gave a different number when you testified.

Do you have any reason to believe that this number -- this is the correct number, is it not?

A. The correct numbers are in the record. 217 and 206.

Q. So if you had said something as you read it differently, what you just said is the correct number?

A. Correct.

Q. And then, finally, I just -- how do you define the word "surplus"?

A. I think surplus means you have an extra pound of milk that doesn't have a customer; and I don't like that term, because since the 1930s. we have defined Class III and Class III and IV products as surplus, yet this surplus production of nonfat dry milk, we have so many customers.

we don't have enough product. So why we keep calling it surplus, as an economist, it doesn't make sense to me.

Q. Because there is a demand for cheese and there is a demand for butter and there is a demand for nonfat dry milk, so there is not surplus?

A. There is such a demand for nonfat dry milk and dry whey that inventory levels are at record lows and we are exporting significantly those products abroad and prices are running up because of that. So surplus should not be -- it is not descriptive of the market conditions.

Q. Okay. And if you were to define "surplus," it would not necessarily be based on the commodity that is made, but based on what the demand is for that commodity or the lack thereof?

A. Exactly. If you have milk and you don't have a customer and you have to put it somewhere, maybe you can call that surplus. But if you talk to people in New Zealand and Australia, they don't have a concept like that. They look at the market customers first, and then they balance their plants to meet the

customer needs. There is no surplus. They don't have enough milk, they are coming here and investing in the United States, because they see opportunity here, and there are customers in the U.S. and there are customers abroad. There is strong demand for the products that we make here in the U.S.

MR. YALE: I have no other questions. Thank you.

JUDGE PALMER: Any other questions at all? Sir, I think you are completed. Thank you very much. Let's go off the record.

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

MR. YALE: We need to move -- I had at the top of my list, to move the exhibits, which would be 15, 15-A and 15-B.

JUDGE PALMER: Yes, they are received. Now let's go off the record for a second.

(Thereupon, Exhibits 15. 15-A and 15-B were received into evidence.)

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

(Thereupon, Exhibit 18 was marked for

purposes of identification.)

BRYAN WOLFE

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

JUDGE PALMER: Is anybody going to help you along? You don't have an attorney? I will do it. Sir, would you give your full name and identification?

MR. WOLFE: My name is Bryan Wolfe.

JUDGE PALMER: And you are here today to testify in respect to which of the proposals?

MR. WOLFE: I am here to give a statement.

JUDGE PALMER: All right. And would you tell us -- oh, it looks like it is in the opening of your statement where you are from and so forth. All right, sir, if you will go ahead. We are going to mark your statement as Exhibit 18 for identification. If you would be so kind now as to read it.

STATEMENT FOR THE RECORD OF BRYAN WOLFE

MR. WOLFE: My name is Bryan Wolfe. I am a dairy farmer from Ashtabula

County, Ohio. I am President of Ashtabula. Lake and Geauga County Farmers Union, I am Vice-President of Ohio Farmers Union.

JUDGE PALMER: Slow down a little bit. You are speeding up.

MR. WOLFE: And executive board member of the National Farm Coalition and a member of the National Family Farm Coalition's Dairy Subcommittee.

Both Ohio Farmers Union and the National Family Farm Coalition have been involved in previous hearings conducted by the USDA's Agricultural Marketing Service. I have been active in promoting the idea of involvement in these hearing processes.

During a recent National Family Farm Coalition Dairy Subcommittee conference call, which included members from all over the country. I was selected to represent the consensus of the members who are boycotting this hearing.

Overall, there is no faith that the interest of dairy farmers will be represented in this hearing process. Some may ask how that can be when large dairy co-ops are regularly part of

the hearing process Cooperatives operate under the Capper-Volstead Act, but sadly, there is absolutely no effective regulatory oversight over cooperatives to assure that the actions of those often massive organizations truly benefit their members Capper-Volstead has become a convenient, meaningless mechanism, utilized by businesses to avoid regulation, often at the expense of farmers and consumers

National Milk Producers Federation regularly participates in these hearings National Milk Producers Federation mission statement says, "The policies of the National Milk are determined by its members from across the nation Therefore, the policy positions expressed by National Milk are the only nationwide expression of dairy farmers and their cooperatives on a national public policy " Is this really true?

National Milk associate members include the Chicago Mercantile Exchange. Dairy Australia. Dean's Foods, Fonterra Cooperative Group, Monsanto, Schreiber Foods Does anyone think these associate members obtain no benefit? The club of insiders is well represented at

every USDA hearing. The interest of the average dairy farmer is ignored.

For example, the USDA gave interested parties an opportunity to submit proposals concerning Class III and Class IV pricing. Some 41 dairy farmers submitted letters to USDA. Thirty-three urged USDA to consider dairy farmers' cost of production. Five others made it clear that the price they were receiving for milk was too low. The remaining three had other ideas to improve farm milk prices. Not one dairy farmer was satisfied with the status quo.

Several grass roots farm organizations also submitted proposals to factor in producers' cost of production and/or use the true value of milk reflected in the retail price as a factor to determine farm milk prices.

USDA/AMS choose to completely ignore the legitimate concerns of real farmers. USDA continues to habitually ignore the mandates of the 1937 Agricultural Marketing Agreement Act. 608C(18). This hearing is an insult and a slap in the face to farmers who submitted letters and proposals to the USDA. It is very difficult for farmers to attend these hearings. What

incentives do we have when USDA steadfastly refuses to listen to our real concerns?

USDA's own data indicates that American dairy farmers on average lost $3.15 per hundredweight in the period of 2000 through 2005. Here we are today to discuss problems brought about because of Federal Order Reform of 2000. Who questions why we have this pricing system in the first place? Who asks who are the real winners?

We know who the real losers are. The losers are the American dairy farmers. Data from AMS economic analysis tells us that under the cooperative Agri-Mark proposal, dairy farmers will lose $11 million, and under DFA's proposal, dairy farmers will lose 47 million.

The Capper-Volstead Act exempts co-ops from antitrust actions, provided. however, that such associations are operated for the mutual benefit of their members thereof. What is the proof of this benefit to the farmers? Many dairy farmers are profoundly dispirited. Families and farms are broken. And the suicide rate for American farmers is at least twice the population norm. Do these

factors have any meaning to the representatives of the powerful in this room today? Do lives and livelihoods have meaning? Hiding behind the statistics and data is no longer possible after a year in which farmers and farm families are being ripped apart by needlessly low farm milk prices. USDA is the vehicle by which the pain is administered through sanitizing hearing process -- a sanitized hearing process.

On May 15, 1862, Abraham Lincoln signed a bill creating the USDA. In an address to Congress. Lincoln said, "The Agricultural Department, under the supervision of its present energetic and faithful head, is rapidly commending itself to the great and vital interest it was created to advance. It is precisely the people's department, in which they feel more directly concerned than in any other. I commend it to the continued attention and fostering of Congress."

Would Lincoln recognize today's USDA as the people's department? Hardly. The bureaucracy and red tape and endless layers upon endless layers of rules, the oblivious attitude toward suffering is more like one might expect

in the People's Republic of China. In my opinion, it is an insult to our democracy and an insult to the memory of Abraham Lincoln.

We recommend this hearing be terminated until the public's interest is placed at the forefront. There is no conflict between dairy farmer's interest and the public's interest. No one's interest is served when the parasites kill the host as in happening today -- or happening in the dairy today.

JUDGE PALMER: Does that complete your statement?

MR. WOLFE: Ohio Farmers Union. National Farmers Union and National Family Farm Coalition supports this statement.

JUDGE PALMER: That completes your statement?

MR. WOLFE: Yes.

JUDGE PALMER: Any questions? Does anybody wish to ask questions? You are going to ask some questions?

MR. SMITH: Yes.

CROSS-EXAMINATION

BY MR. SMITH:

Q. Dan Smith with Maine Dairy Industry

Association. Could you just explain a little bit more about your farming operation, how many cows you are milking, where it is located, just give us a context on the size of your farm and your operation and how long you have been in business?

A. My wife and I bought our farm in April of '80. We started out milking about 30. 35 registered Guernseys. Today we milk about 50 half Guernseys, half Holsteins, and our farm is located in Ashtabula County and we farm about 225 acres.

Q. Are you a first-generation dairy farmer?

A. Yes.

Q. Is your farm income -- is dairying the sole source of your income to you?

A. Not anymore.

Q. What other sources of income do you have?

A. My wife works off the farm. Of course. Government payments. We are in the hay business a little bit. I am a good enough dairyman that I can. out of the 50 head of cows we have. I am usually able to sell replacement heifers every year. This year we have sold 12.

Q. Can you give us a little more detail on the

Government programs that you participate in in terms of what contribution they are making to your farming operation?

A The MLIC payments They don't amount to very much right now, maybe $350 a month And then the last farm bill programs, they probably amount to maybe $2 to $3,000 a year

Q Have you done any updates on your buildings? Have you used any of the Government programs to --

A No

Q Beyond the off-farm income, have you -- do you find your farm looking more towards increasing the debt on your operation now than in the last few years, and if so, when did that occur?

A That has been one of the few things in the last several years that has kept us in business We have been fortunate enough to pay some loans off But we are not doing any improvement or buying any machinery

Q In the years since Federal Order Reform. how many years have you been able to reduce your debt service, going back to 2000, of the six years?

A. I think we have been reducing our debt service the last three years. But as that is happening, there is no new equipment being bought. I mean, everything is just watched real closely.

MR. SMITH: Okay. Thanks.

JUDGE PALMER: Any other questions? Yes, Mr. Yale.

(Thereupon, Exhibit 19 was marked for purposes of identification.)

MR. YALE: What we presented. Your Honor, as Exhibit Number 20, there's really two parts to it. I am --

JUDGE PALMER: I am sorry?

MR. YALE: Well, they got stapled all together. I just want to point out. the first section --

JUDGE PALMER: Do you want to make it 20? My next number is 19.

MR. YALE: I am sorry, I am confused, because it is getting late in the day and I am messing up.

JUDGE PALMER: That is okay.

MR. YALE: Exhibit Number 19, there are two parts to it, I would like to

represent that, first of all, you can see the first part of it is -- it is cost of production. it comes off of the ERS Web site that is available, it is a print-off of a file that is available by state, and it is for a number of states, beginning with, I think it is 2003 through 2000 -- or 2000 -- there are a couple of years. I am trying to look here.

Oh, this is just Vermont and Ohio. And then attached, the second part of it is a printout of the mailbox prices which is available on the USDA AMS Dairy Programs' Web site and that's for the years 2002 through 2006. And the ERS data is for Vermont and Ohio, and it is for the years 2003 through 2007 for each of those two.

And if we could take official notice, I just wanted to have a hard copy as an exhibit.

JUDGE PALMER: Are you going to ask the witness about it?

MR. YALE: I am going to ask the witness about some questions. He is not introducing the exhibit.

JUDGE PALMER: That is what had me confused.

MR. YALE: I am sorry, no. I just wanted to have it available in a hard copy. Okay?

CROSS-EXAMINATION

BY MR. YALE:

Q. Mr. Wolfe, first of all, there is one question I wanted to ask you about, because it has become a big issue, and that is the issue of energy and cost of energy on the farm.

Can you explain to us how the high cost of energy has impacted you in your operation in the last two years?

A. I have a 550 gallon off-road diesel tank. I have a 175 gallon tank and I have an on-road tank of 150 gallons. Three years ago. filling those three tanks up would have cost me in the neighborhood of $900. Today it costs about $2150. And on a yearly average, that is probably, on my farm, depending on the weather. probably $5,000 extra a year.

The other costs are milk hauling has gone up 10 cents. so there is, you know. another $75 a month. Feed grinding and delivery has gone up, mixing, hauling, that has gone up.

Of course, you know, the route drivers.

everybody is getting their cost out of the energy, everything has gone up. Any parts you have delivered, UPS or FedEx or whatever. So I think, in a rough guess, I would think that energy on my farm has probably gotten pretty close to a dollar a hundredweight increase in the last three years.

Q. More?

A. Right.

Q. Okay. If you would look at Exhibit 19, and if you would turn through from the beginning and go in through a few pages, you will come to, in the upper left-hand corner, you will see the words "Ohio, monthly dairy cost of production per hundredweight of milk sold," and I would like you to keep turning until you really get to the one that shows for the year 2006.

Do you have that in front of you?

A. Yes.

Q. Now, keep in mind, you know, I don't know how these numbers are generated. These are averages or numbers that the Economic Research Service comes up with. So I want to kind of get a relationship in terms of how that fits the size of farm you have and your operation and the

like to look at the cost.

You know, if you could go down through here, and let's just look at December for the moment. We won't go through the whole thing. So by starting at the end, maybe we will be done with that page to help keep moving.

But if you could go down through there and look at those costs, particularly under the word "Operating costs," to see whether those are somewhat, on a per hundredweight basis, somewhat approximate what your operations are, and if you see any that you think are off, kind of indicate those.

A. Well, I know just the price of corn and soybean meal from July and August of last year. my feed bill has risen from about $17. $1800 every two weeks, up to, I think the last one was 2247. so that is every two weeks.

Somebody had mentioned about contracting corn and contracting milk. I had contracted feed 2003, 2004 and 2005. When August of 2006 came around and I wanted to do my contracts again, the feed mill refused to do contracts with any of us in Northwest or Northeast Ohio.

Q. Did they explain why?

A. They just weren't doing it. I can guess why now.
Q. So the fact that this shows from January on the total feed cost line of 9.61, January, to December of 12.27, that somewhat parallels the fact that it has grown for you as well; is that right?
A. Right. Probably $2 a hundredweight.
Q. And the total operating costs of 16.16. is that per hundredweight? Does that --
A. I would say it is probably somewhat close. Some of my figures would be a little different. I think our farm interest would be higher, but our veterinarian bills are lower.
Q. We may need to move back for comparison purposes back to October. It has changed a little bit, but it would have shown 14.53, indicating a little bit cheaper feed, it appears, at least for that month. Again, were feed prices climbing through the fall?
A. Yes, and they are still climbing this year. I have probably climbed from 6.60 up to 7.30 so far in 2007.
Q. Now, if you would, turn to the, it would be about the last page, I think, of this

attachment, of Exhibit 19, there is a page that is styled "Mailbox Milk Prices for Selected Reporting Areas." Do you see that?

A. Yes.

Q. And if you go down to Ohio and go across. and let's look at October, for example, for 2006, it shows 13.81. Okay?

A. Yes.

Q. I am not asking you to do the obvious. It is clear, at least on here, that the operating costs for October appear to exceed the operating costs -- or the mailbox. Is that something that you experienced?

A. Oh, yes.

Q. That there was less money than what -- you were paying out other money?

A. Right.

Q. And you say you have off-farm income from your wife?

A. Right.

Q. And right now, that is how you are getting through, and other reserves?

A. We have paid off, I was just fortunate to have $1800 in loans paid off at the first of the year. So the corn prices and soybean meal

sucked that up, just grain prices in general. We have cut way back on our veterinarian service. We try to do as much as we can ourselves.

Q. So I want to come down here. Those are some operating expenses. But I want to look down here. Do you have hired labor on your farm?

A. A little bit.

Q. Okay. Have you had to make any changes with that?

A. We have cut way back on that.

Q. How could you describe it, you went from two to one employee or part-time or how would you describe it?

A. Usually I have a high school person help me with the evening chores and then we had somebody all day on Sundays. And, of course, during the summer, we have -- probably hire up to five high school kids. We have gone from trying to put up dry hay to doing round wrap wet balage with a neighbor, which has cut us some costs.

But, yeah, we just cut way back. I get up at 6:00 in the morning, I am lucky if I get in the house at 4:30 in the afternoon to grab

something to eat and put some dry socks on, and I am out in the barn usually until 9:30, 10:00. From 10:00 until 11, I am cooking supper and doing laundry and helping my wife with the house, because she gets home at quarter after 11.

Q. So coming down to the other, this "Opportunity cost of unpaid labor." I'm not asking -- it's probably impossible to do, but it has got down $4 per hundredweight for -- that is unpaid labor is you from --

A. I wish I made a dollar an hour.

Q. Okay. I really wanted to get down based on the comment you made earlier with Mr. Smith about the capital recovery on machinery. You say you are not purchasing any machinery, so you don't have that expense right now.

But is that really something that you are really saving by doing that?

A. No, it is going to catch up with me. I am going to wake up some day and I am going to have six pieces of equipment that is totally drunk. We are burning up assets, everybody is burning up assets.

I think in New York, a study was done that

the average age of a tractor up there is 32 years. I would like to see consumers drive 32-year-old cars back and forth to work.

We used to buy one or two pieces of equipment every year. Just, you know, so we didn't have junk, and it is just not happening.

Q. What are some of the key pieces of equipment you have on your farm?

A. We have four tractors, complete line of haying equipment, silage chopping equipment, a small line of tillaging equipment.

Q. What is the typical cost of one of those tractors today?

A. Probably a hundred horse tractor is going to cost you in the neighborhood of 40 to $50.000. We haven't bought a tractor since '93.

Q. Now, do you have repairs on those?

A. Oh, yes.

Q. So you have that expense?

A. I have rebuilt every tractor motor in probably the last six years. By the way, my newest tractor is an '82, my two big tractors are '78s. We have an '82, two '78s and a '72 model year tractors.

Q. What about milking equipment?

A. We remodeled our barn in '94, we milk in 16 tie stalls on a pipeline, and we have a small free stall barn.

Q. And what about the bulk tank and that equipment, was that remodeled then too?

A. I think everything was put in in '94.

Q. What is the normal life of such an installation?

A. It is going to be my life. I don't know what the average -- I think, you know, you can replace those components pretty easy without replacing the whole system as they wear out.

Q. Now, is there a market for a farm such as yours as an operating dairy farm, are there people that would be willing to buy a farm of your size and with your equipment today?

A. Probably not for dairy, unless it is an Amish family.

MR. YALE: I don't have any other questions.

JUDGE PALMER: Yes, Mr. Galarneau.

CROSS-EXAMINATION

BY MR. GALARNEAU:

Q. Clayton Galarneau, Michigan Milk Producers. Good afternoon. Mr. Wolfe. You said you are a

member of the National Family Farm Coalition?
A. Right.
Q. Is that a milk marketing co-op?
A. That is a coalition of about 35 national and regional farm organizations with about 90.000 members.
Q. Who markets your milk?
A. My milk is marketed through Pennsylvania Farmers Union Milk Co-Op.
Q. Oh. Do you know about how much milk they market a year, including yours and others?
A. I think we are down to about 60 members. I don't know pounds-wise how much they market.
Q. Do they have any manufacturing plants?
A. No.
Q. Does your co-op understand your cost of production and that you are struggling?
A. Oh, yes. We have -- when I started five years ago. we had 104 members, and we are down. I am sure the last figure I seen was 64. That is last fall. We have to be well under 60. So we are losing members. They are not moving elsewhere, they are just quitting.
Q. Do you have any idea why they don't try to charge more and get more for your milk pricing?

A. They don't want to rock the boat, because they are afraid of upsetting, honestly. DFA. Dean Foods through the qualification of milk. They are not going to do anything that is going to upset anybody, because they need the milk qualified. There is no competition in Northeast Ohio or Northwest Pennsylvania. One way or the other, you are at the mercy of DFA. DMS and Dean.

Q. How far are you from Michigan?

(Laughter.)

MR. GALARNEAU: No other questions.

JUDGE PALMER: Any other questions? Thank you very much --

MR. STEVENS: I have a question.

CROSS-EXAMINATION

BY MR. STEVENS:

Q. I want to thank you for coming, sir, coming here to participate in the hearing. I know the Secretary wants to hear your views, I know that. So that is what this hearing is for, for the farmers to tell the Secretary what their desires are and what their needs are. So I am glad you came and I am glad you participated.

A. One of the reasons -- I would just as soon

be at home and stay in the barn and never leave the farm

Q I understand that

A One of the reasons I got into farm organizations and being active is the tremendous amount of suicides I see in the farm community And this upsets me greatly

And I had, about 18 years ago my best friend decided a 357 was his best answer We have had numerous young people, 28, 32 years old, taking their lives, because they felt they had absolutely no direction to go

I had two kids I went to school with where their mothers literally laid down in a creek and drowned their self in 18 inches of water, so I guess I want you folks to understand when these people are talking about costs of production and we should be happy with what we get, what they are putting us through

And the mental depression out there, you know, my Congressman always asks, "How come I don't hear from the farmers?" Well. they believe that nobody cares, they believe the Federal Government wants them gone They believe all that Government wants is corporate

agricultural. And so that is why I am here today.

Q. Well, and I am here to say today that, at least for our part here, the purpose of the hearing is for you to tell your Secretary of Agriculture and tell your Government what your desires are and what you --

A. I do it every chance I get.

Q. I know you do and I know you are very active in doing that.

You know, the Secretary wants to hear from small businesses and wants to hear what your concerns are about the proposals. You described a little bit about your operation.

The cutoff point for small businesses is $750.000 gross profit. I guess. The regs say what it is. And if you fit that definition or if you are close to it, would you care to inform the record of that, and then beyond that, would you like to express your concerns, which -- most of which you already have, certainly, and very articulately, of what your concerns as a small businessperson are with respect to the proposals that the Secretary is hearing in this hearing?

A. Well. I am definitely a small business. I

don't come anywhere close to that three-quarters of a million dollars.

Q. All right.

A. And I just wish some of the farmer's proposals were being considered on cost of production. I understand the processors have to make money too. But also, the farmer has to make money too.

And the retooling that is going to need to take -- that has to take place out there is a very serious matter. So when you are talking about just cost of production at $16, it is that machinery cost and land cost at $6 and on up is what is going to kick most of these guys out of business. There are guys literally running out there with junk. And, you know, that is just what is going on out there.

Q. And so I hear you. I guess I don't want to testify for you, certainly, but I know you are certainly capable of testifying for yourself and your members and the people you know. These proposals, do they offer you any relief? Are they detrimental to you? Maybe if you could expand on that in what way they are detrimental?

A. I don't think any of the proposals out

there right now are going to benefit farmers. you know, until something is done on our cost of production. I haven't really had time to study all these.

My sense on these make allowances is this is supposed to be a capitalistic system, and cost should be passed on to the buyer and not passed down on to the farmer. I was always under the assumption that make allowances were only necessary when there was high CC purchases, for incentive for the processors to keep manufacturing finished products.

So I don't know where this is -- the norm has got to be, you know, operating your plant off the backs of the farmers. And, you know. I think -- I think everybody would agree that this whole dairy system is screwed up from top to bottom, and trying to put band-aids on this mess isn't getting the job done.

What we need is a few people with some integrity and honesty to straighten this thing up so it works for the farmers and the processors and the consumers.

I think last year, the CME on cheddar cheese probably averaged $1.20, but the retail

end of it was $4.33. You are telling me we can't recoup some of that money? There is something wrong here.

Q. Well, I want to thank you for coming, sir. If there is not anything else you want to add. again, thanks for coming to participate.

A. Thanks for the opportunity to express my views.

JUDGE PALMER: I am going to receive his statement, Exhibit 18.

MR. YALE: I want to move that 19 be admitted.

JUDGE PALMER: Nineteen will be admitted also.

MR. BESHORE: May I comment, on 19. I don't have any objection to it, but it is a document that doesn't show the source. I understand it is from a USDA Web page somewhere. There are no URLs or anything on these or document publication cover. I think we at least need that for the record.

JUDGE PALMER: I assumed it was authentic.

MR. YALE: Right. Tomorrow we will give you the URLs and we will ask for

official notice of not just Vermont and Ohio, but all the states.

JUDGE PALMER: I am going to receive it, but subject to that.

MR. YALE: It is a valid point, we did it in a hurry.

MR. BESHORE: I don't have any objection. We need to know where it comes from for the record.

JUDGE PALMER: Absolutely.

MR. STEVENS: So we received the statement of Bryan Wolfe, and I guess we received --

JUDGE PALMER: Yes. But we are going to have some supplemental data to show where the agricultural market reports that would be found on the Web sites.

(Thereupon, Exhibits 18 and 19 were received into evidence.)

JUDGE PALMER: Do we have anything more today? I presume not.

MR. YALE: I don't have anything. We have a witness available tomorrow first thing, Gary Genske.

JUDGE PALMER: Let's go off the

record.

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

JUDGE PALMER: All right. I will see everybody later, 9:00 again.

(Thereupon, the proceedings were adjourned at 4:50 o'clock p.m.)

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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 8th day of March, 2007.

Binnie Purser Martino, RDR. CRR

My commission expires June 26, 2009.

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