November 9, 2012

Karen Ross, Secretary
California Department of Food and Agriculture
1220 N Street
Sacramento, CA 95814

Dear Secretary Ross:

On behalf of Hilmar Cheese Company, Inc., I am writing to request that you deny the November 2, 2012 petition submitted by California Dairies, Land O' Lakes and Dairy Farmers of America.

While we recognize the struggles producers are facing as a result of high feed costs, the regulatory solutions proposed by the petitioners will not solve their problems. Real relief must come from the marketplace, or it will not be lasting. Market prices are currently rising in response to growing supply concerns. Producer pay prices are up over 40-50% since May and premiums across the state are on the rise. The industry can and will make market based price adjustments and can do so more quickly and efficiently than state formulas. We should let markets work.

Furthermore, comparing Federal Order Class III to the California 4b formula is simply not valid. As it has been repeatedly noted in previous hearing records, California's primary out of state cheese competitors operate in unregulated areas (i.e. Idaho), or have the opportunity to opt out of Federal Milk Marketing Orders. These plants are not obligated to pay minimum prices. California processors do not have this option and thus regulated minimum prices need to remain at market clearing levels.

The repeated comparisons between Class III and 4b also neglect the fact that minimum prices do not necessarily reflect the price producers actually receive for milk in the marketplace. Regulated minimum prices do not stop processors from paying more than minimum prices when market conditions merit. If allowed to function, market supply and demand conditions will drive premiums and establish a value for milk above the regulated price, which often occurs today.

To attract, incentivize, and grow the supply of high quality, high component 'cheese' milk, Hilmar Cheese Company, Inc. has consistently paid premiums to its producers above and beyond the minimum regulated 4b since its inception. Hilmar Cheese Company, Inc. is not alone and there are other examples of this in the marketplace. These premiums flow directly to producers who have invested in facilities and genetics to supply the local market with the products it demands. If we increase the regulated minimum prices, our producers lose as their premiums fall. Market signals will be further distorted as the value created by Hilmar Cheese Company, Inc. and these producers will be redistributed through the pool to others who have not invested in producing the milk the market wants.

Once again, we find the petitioners recent request to be misplaced and misdirected. These large dairy farmer owned marketing cooperatives, which represent 80-85% of the milk in California, regularly negotiate supply agreements with buyers of 4b milk. This is the proper place for these discussions to take place.

Instead of going to the marketplace and asking their customers for a higher price or investing in plants that create this value, the large producer-owned entities have chosen to delegate their responsibility to the California Department of Food and Agriculture. Creating value and getting the most out of milk is not the job of the Secretary of Agriculture–it is the job of those who market milk.

One of the fundamental problems with our pricing system is that it rewards those who have not invested and penalizes those who make successful investments. The petitioners all own cheese plants, yet none of them have chosen to invest in whey processing technology in California. Additionally, some of the petitioners have elected to sell or close large cheese plants in recent years.

Now these same entities are going to Sacramento demanding that they participate in the whey returns that have been created by others who have been successful in these areas. Entities that divest plant assets, make poor investments, or just operate poorly should not be rewarded or helped via the pool.

If we continue to reward these non-investors, we will continue to drive down the milk price in California as these entities are not forced to compete and grow the value of milk. Those who do make successful investments will continue to make new investments outside of California.

The constantly changing regulatory climate has done little to encourage investment in California at a time when capacity is growing in other regions. In the past twelve years, we have had twenty-six milk price hearings in California. The whey component of the 4b formula was not immune from this changing pricing environment. The whey factor was first introduced to the 4b formula in April of 2003. Since that time the whey factor was changed in 2007, 2011, and 2012. As individual companies consider long-term investments that require massive amounts of capital, this frequently changing regulatory environment paralyzes investment in this state by creating uncertainty. This uncertainty adds tremendous risk to investment decisions.

In this environment is it any surprise that new investment in California has been scarce and cheese plants continue to exit? Even if the appropriate market signals existed today, any potential investor would have put their plans on hold while they await the outcome of this petition request and potential hearing. This uncertain regulatory environment does not benefit a state that desperately needs additional plant capacity to create more competition for milk.

We respectfully request that the petition submitted by California Dairies, Land O'Lakes and Dairy Farmers of America be denied.

Sincerely,

David Ahlem
VP of Dairy Procurement & Policy