Hearing Panel Report

Based on a Public Hearing Held On
May 20, 2013

Addressing the Class 1, 2, 3, 4a, and 4b Pricing Formulas
Contained in the
Stabilization and Marketing Plans
for Market Milk for the
Northern and Southern California Marketing Areas

Hearing Panel Report

Addressing the Class 1, 2, 3, 4a, and 4b Pricing Formulas Based Upon a Public Hearing Held on May 20, 2013

This Report of the Hearing Panel regarding proposed amendments to the Stabilization and Marketing Plans for Market Milk for Northern California and Southern California (Plans) is based on evidence received and entered into the Department of Food and Agriculture's hearing record. The evidence includes the Departmental exhibits, written statements and comments received from interested parties, and written and oral testimony received at a public hearing held on May 20, 2013.

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INTRODUCTION/WITNESSES

California Food and Agricultural Code (Code) Section 61801, *et sec*., provides the authority, procedures, and standards for establishing minimum prices by the California Department of Food and Agriculture (Department) for the various classes of milk that handlers must pay for milk purchased from producers. These statutes provide for the formulation and adoption of Stabilization and Marketing Plans for Market Milk.

A total of 17 witnesses testified including the Department's witness:
Department Witness, Erica Sanko
Joseph Gallo Farms (Gallo), Joe E. Paris
Western United Dairymen (WUD), Michael Marsh
Dairy Farmers of America, Inc. (DFA), Gary Stueve
Saputo Cheese USA Inc. (Saputo), Greg Dryer
California Dairies Inc. (CDI), Eric Erba
Dairy Institute of California (DI), William Schiek
Kraft Foods (Kraft), Renee Peets
Farmdale Creamery, Inc. (Farmdale), Scott Hofferber
Land O'Lakes, Inc. (LOL), Thomas Wegner
California Dairy Campaign (CDC), Lynne McBride
Milk Producers Council (MPC), Rob Vandenheuvel
Hilmar Cheese Company, Inc. (Hilmar), David Ahlem
Agricultural Council of California (Ag Council), Emily Rooney
T-Bar Dairy, Tom Barcellos
Los Altos Food Products, Inc. (Los Altos), John Clement
Leprino Foods (Leprino), Sue Taylor

Correspondence Received Prior to the Close of the Hearing:
Dairy Goddess Farmstead Cheese (Dairy Goddess), Tony and Barbara Martin

SUMMARY OF THE PROPOSALS

The proposals submitted at the hearing centered on two basic methods of implementing a temporary price increase to the pricing formulas:

Proposal A: Extend the February 1 through May 31, 2013 temporary price increases on Class 1, 2, 3, 4a and 4b pricing formulas, as implemented from the December 21, 2012 hearing.

Proposal B: Increase the solids not fat (SNF) price of the Class 4b pricing formula by $0.1380/lb.; no increase to the Class 4b Fat; no increases to the Class 1, 2, 3,and 4a pricing formulas.

Time Periods: Proposed time periods for temporary price increases ranged from: six months; no specific ending date; an ending date to be determined by an unspecified event; or an ending date that coincides with permanent changes to the pricing system should legislation and/or the Dairy Future Task Force recommendations be implemented.

Table 1 - **Specific Temporary Changes Proposed for the Class 1, 2, 3, 4a, 4b Pricing Formulas Including Proposed Time Period for Temporary Pricing Changes of the Class Pricing Formulas (In Dollars Per Pound)**

The Department received 17 specific proposals in the format prescribed by the Hearing Announcement and all proposals resulted in increases to the per pound component prices

Proposal	Class 1			Class 2		Class 3		Class 4a		Class 4b		Time
	Fat	SNF	Fluid	Fat	SNF	Fat	SNF	Fat	SNF	Fat	SNF	Period
PROPOSAL A SUPPORTERS:												
Joseph Gallo Farms												
	+$0.0006	+$0.0045	+$0.0001	+$0.0082	+$0.0082	+$0.0082	+$0.0082	+$0.0246	+$0.0246	+$0.0246	+$0.0246	Undetermined*
Saputo Cheese USA, Inc.												
	+$0.0006	+$0.0045	+$0.0001	+$0.0082	+$0.0082	+$0.0082	+$0.0082	+$0.0246	+$0.0246	+$0.0246	+$0.0246	6 months
Dairy Institute												
	+$0.0006	+$0.0045	+$0.0001	+$0.0082	+$0.0082	+$0.0082	+$0.0082	+$0.0246	+$0.0246	+$0.0246	+$0.0246	6 months
Kraft Foods												
	+$0.0006	+$0.0045	+$0.0001	+$0.0082	+$0.0082	+$0.0082	+$0.0082	+$0.0246	+$0.0246	+$0.0246	+$0.0246	6 months
Farmdale Creamery, Inc.												
	+$0.0006	+$0.0045	+$0.0001	+$0.0082	+$0.0082	+$0.0082	+$0.0082	+$0.0246	+$0.0246	+$0.0246	+$0.0246	6 months
Hilmar Cheese Company, Inc.												
	+$0.0006	+$0.0045	+$0.0001	+$0.0082	+$0.0082	+$0.0082	+$0.0082	+$0.0246	+$0.0246	+$0.0246	+$0.0246	6 months
Los Altos Foods												
	+$0.0006	+$0.0045	+$0.0001	+$0.0082	+$0.0082	+$0.0082	+$0.0082	+$0.0246	+$0.0246	+$0.0246	+$0.0246	6 months
Leprino Foods Company												
	+$0.0006	+$0.0045	+$0.0001	+$0.0082	+$0.0082	+$0.0082	+$0.0082	+$0.0246	+$0.0246	+$0.0246	+$0.0246	6 months
Dairy Goddess Farmstead Cheese												
	+$0.0006	+$0.0045	+$0.0001	+$0.0082	+$0.0082	+$0.0082	+$0.0082	+$0.0246	+$0.0246	+$0.0246	+$0.0246	Undetermined*
PROPOSAL B SUPPORTERS:												
Western United Dairymen												
	-	-	-	-	-	-	-	-	-	-	+$0.1380	Undetermined*
Dairy Farmers of America, Inc.												
	-	-	-	-	-	-	-	-	-	-	+$0.1380	Undetermined*
California Dairies, Inc.												
	-	-	-	-	-	-	-	-	-	-	+$0.1380	Undetermined*
Land O'Lakes, Inc.												
	-	-	-	-	-	-	-	-	-	-	+$0.1380	Undetermined*
California Dairy Campaign												
	-	-	-	-	-	-	-	-	-	-	+$0.1380	Undetermined*
Milk Producers Council												
	-	-	-	-	-	-	-	-	-	-	+$0.1380	Undetermined*
Agricultural Council of California												
	-	-	-	-	-	-	-	-	-	-	+$0.1380	Undetermined*
T-Bar Dairy												
	-	-	-	-	-	-	-	-	-	-	+$0.1380	Undetermined*

* Undetermined indicates proposals ranging from no specific ending date, to an ending date to be determined by an unspecified event, to an ending date of when permanent changes to the pricing system resulting from either legislation and/or the Dairy Future Task Force recommendations are implemented.

ESTIMATED IMPACTS OF THE PROPOSALS
ON CALIFORNIA CLASS AND POOL PRICES

- The table below shows the impacts of the proposed amendments on class and pool prices relative to current prices from April 2008 through March 2013.
- The analysis assumes that the proposed amendments and current formulas (without temporary price increases) were in effect throughout the entire period.
- When a change is a "plus," the proposal would have increased the price.
- When a change is a "minus," the proposal would have decreased the price.

Table 2 - **Estimated Impacts[1] on Class 1, 2, 3, 4a, 4b, and Pool Prices if the Hearing Proposals had been in Effect for the Five-Year Period: April 2008 to March 2013**
Five-Year Averages

Proposal	Class 1 ($/cwt.)	Class 2[2] ($/cwt.)	Class 3[2] ($/cwt.)	Class 4a ($/cwt.)	Class 4b ($/cwt.)	Pool[3] ($/cwt.)
Proposal A* (Extends Feb. 1-May 31, 2013 temporary price adjustments on Class 1,2,3,4a, and 4b)						
5-year average	+$0.05	+$0.10	+$0.10	+$0.30	+$0.30	+$0.25
Proposal B (Increase Class 4b SNF $0.1380/lb.; no increase to Fat & SNF in Class 1,2,3,4a, no increase to 4b fat)**						
5-year average	-	-	-	-	+$1.20	+$0.53

[1] Compares proposed amendments with current California formulas.

[2] Estimated Class 2 and 3 price impacts assume no pass through effects from proposed Class 4a price adjustments.

[3] Quota and overbase price.

* Proposal A Supporters	** Proposal B Supporters
Joseph Gallo Farms	Western United Dairymen
Saputo Cheese USA, Inc.	Dairy Farmers of America, Inc.
Dairy Institute	California Dairies, Inc.
Kraft Foods	Land O'Lakes, Inc.
Farmdale Creamery, Inc.	California Dairy Campaign
Hilmar Cheese Company, Inc.	Milk Producers Council
Los Altos Foods	Agricultural Council of California
Leprino Foods Company	T-Bar Dairy
Dairy Goddess Farmstead Cheese	

BACKGROUND: EVENTS LEADING TO THE CALL OF THE HEARING

A public hearing was held on December 21, 2012 that resulted in a four-month (February through May 2013) price increase across all classes of milk. The increase was intended to provide dairy producers with increased income to ease the financial circumstances that impacted dairy producers through much of 2012. Although the temporary price increase was designed to help dairies "weather" the financial conditions facing them, it was not intended to enable dairies to recoup the equity lost during this episode, or any other previous episode of financial difficulties.

Although the December 21, 2012 hearing was held to address a specific issue observed in late 2012, the high cost of feed corn influenced by drought in the corn growing regions of the U.S., other longer-term issues with the current pricing system have been the focus of attention over the last few years.

For dairy producers, feed costs, especially the cost of corn, have increased to historically high levels since the end of 2007. These feed costs appear unlikely to return to pre-2007 levels. Coupled with the loss of equity experienced during the financially challenging 2009-2010 period, feed prices have challenged producer margins and appear to have made many California dairies susceptible to any event that causes the cost of production to spike. Especially hard hit are those dairies that rely on purchasing the majority of their feed.

For processors, markets for finished dairy products are increasingly more competitive and dynamic as these products are sold throughout the world. As a result, global markets are becoming more important and crucial for both the California and the U.S. dairy industries. Competing in both domestic and global markets requires pricing flexibility and strategies not as important in the past when these markets were less integrated. Modern pricing strategies and flexibility are not supported well by the current pricing system.

In order to address these long-term issues, efforts are underway to find solutions to the regulations and laws governing milk pricing in the state. During the fall of 2011 and spring of 2012, the Department held a series of Dairy Advisory Committee (DAC) meetings to address two specific long-term issues facing the California dairy industry. The first issue was exploring potential changes to the state's milk pricing regulations that would ensure the long-term viability of the California dairy industry and address the long-term issues confronting both dairy producers and processors. The second issue was the data confidentiality and consolidation issues associated with the Cheddar cheese and dry whey product manufacturing in California. Because dry whey is only consistently manufactured by one plant in the state and because Cheddar cheese production is dominated by one plant in the state, publicly releasing product sales and manufacturing cost data for these products is prohibited. This makes it impossible to adjust the various factors embodied in the Class 4b pricing formula in a transparent, economically-justified manner.

In August 2012, the Secretary formed the California Dairy Future Task Force (Task Force) comprised of representatives from various stakeholder groups in the state. The Task Force held meetings during the fall of 2012 and the spring of 2013. Presently, work is continuing by sub-groups of the Task Force examining various long-term issues affecting the industry.

In addition, beginning in 2012, dairy producers explored two additional alternatives to address the long-term issues with the current pricing system. One alternative was replacing the state's milk pricing regulations with federal regulations administered by the United States

Department of Agriculture (USDA). The other alternative was potential California State Legislation, introduced for the 2013-2014 legislative year, which would modify the pricing and pooling of Class 4b milk through a significant increase to the dry whey factor. During work on this potential state legislation, the chair of the State Assembly Committee on Agriculture sent a letter to the Secretary requesting a hearing be called to consider the appropriateness of extending the temporary price increases resulting from the December 21, 2012 hearing.

At the time of the May 20, 2013 hearing, the Task Force, the exploration into federal regulations in California, and the potential state legislation were all in progress in an effort to seek solutions to the long-term issues facing the dairy industry. Moreover, the temporary price increases resulting from the December 21, 2012 hearing were set to expire at the end of May 2013. The May 20, 2013 hearing was held in order to examine whether temporary price increases should be extended, as the industry continues to seek long-term solutions to these issues.

THE PROPOSALS

The details of the proposals and their estimated impacts on class and Pool prices can be found in Table 1: *"Summary of Proposals"* and Table 2: *"Estimated Impacts"* of this Panel report on pages 4 and 5. Of the two proposals contained in the hearing record, representatives of nine organizations proposed to extend the temporary price relief granted in the December 21, 2012 hearing to all the pricing formulas. This is designed to raise class prices which would lead to higher Pool prices, therefore providing temporary price relief to dairy producers. Representatives of the eight remaining organizations supported the proposal centered on a temporary change to only the Class 4b pricing formula, which is designed to increase the Class 4b price and Pool price, thus also providing temporary price relief to dairy producers.

Summary of the Estimated Impact of the Proposals

The Department analyzed the 17 proposals, assuming the proposals were in effect from April 2008 through March 2013, to estimate the impact to the current class and Pool prices. The proposals would have resulted in five-year monthly average increases in the class prices from $0.05/cwt. to $1.20/cwt. and an increase to the Pool price of either $0.25/cwt. or $0.53/cwt. The proposals that increased only the Class 4b price resulted in the largest increase in both class price and Pool price, while the proposals extending the February through May 2013 temporary price increases were relatively more modest in comparison.

TEMPORARY PRICE RELIEF

Testimony focused on the continuing financial challenges facing California dairies. Witnesses testified that the impacts of volatile milk prices and the upward trend in feed costs have continued to pressure margins on California dairies. Several witnesses stated that since 2007, negative margins have weakened financial positions and eroded equity for many of the state's dairies. As a result, many dairies remain vulnerable to periods of negative margins, as well as market price and production cost volatility, as was seen in 2012. The hearing record contains testimony that high feed costs, combined with other production costs, have resulted in various periods of negative margins since 2007 that have contributed to some dairies exiting the industry.

In order to determine if continued temporary price increases are appropriate, the Code mandates that any relevant economic factors be considered. These economic factors include, but are not limited to, maintaining an adequate and continuous supply of milk in relation to the demand for milk and considering the combined income from class prices in relation to the cost of producing market milk. These and other relevant economic factors are examined in this section.

Feed Costs

Feed cost increases in the latter part of 2012, specifically for feed corn, were the foundation for the temporary price increases resulting from the December 21, 2012 hearing. As cited during that hearing, the significant drought in the corn growing regions of the U.S., during the summer of 2012, caused feed corn costs to increase to historic levels. Corn is an integral part of the California dairy feed ration and because feed corn costs represented a significant portion of the total feed cost increase during that time, the temporary price increases were, in large part, based on the feed corn cost increases observed.

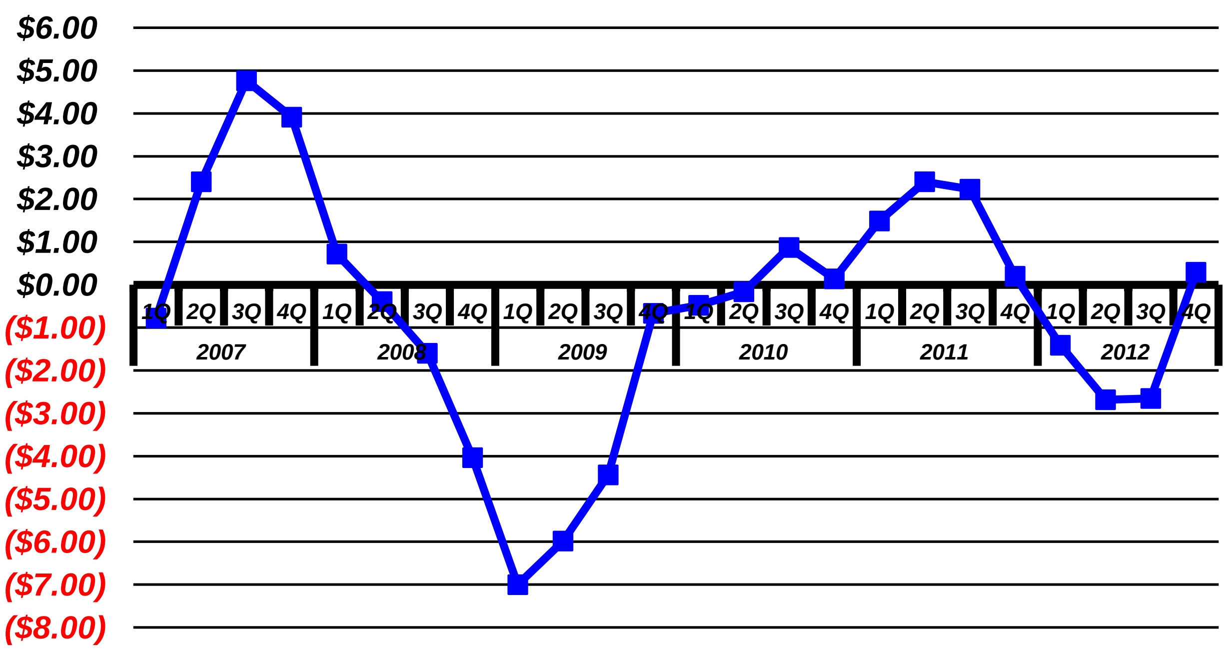
The level of feed corn costs and their contribution to total feed costs remained relatively high through the fourth quarter of 2012, but the hearing record is void of any new feed cost data for 2013 to support a specific level of continued temporary price relief. At the time of the hearing, data from the Department's cost of production survey show that, on average, the total cost of feed increased from $10.91/cwt. in the second quarter of 2012 to $12.09/cwt. in the third quarter of 2012, and then increased an additional $0.15/cwt. from the third quarter of 2012 to the fourth quarter of 2012. Corn feed costs continued to account for approximately 20 to 40 percent of the total feed costs for the majority of California dairies participating in the Department's cost of production survey. These data show that feed corn costs remained at relatively high levels through the end of 2012. However, data for the first part of 2013, with regards to feed corn costs and cost of production, were not available at the time of the hearing.

Witnesses testifying at the hearing stated that they had no data for 2013 for neither feed costs, nor specific cost of production figures. The Department's cost of production survey data for the first part of 2013 was preliminary and did not provide concrete evidence of conditions during the first five months of 2013. Due to the lack of data, continued price relief is unsupportable at this time.

Cost of Production

The Code mandates that the combined income from class prices in relation to the cost of producing market milk must be considered when setting minimum prices. In order to examine this economic factor, *Figure 1* displays the estimated average margin observed on California dairies participating in the Department's cost of production survey from the first quarter of 2007 to the fourth quarter of 2012. The figure compares mailbox milk prices to the total cost of production, considering allowances for return on investment and return for management. *Figure 1* displays the cyclical nature of financial conditions on the dairy and shows that by the end of 2012, the estimated average margins were positive, suggesting improved conditions. This improvement in margins in the fourth quarter can be attributed to increased mailbox milk prices at levels sufficient to cover production costs, including allowances for return on investment and return for management.

Figure 1:
Difference Between California Mailbox Milk Price Less California Cost of Production
Based on the California Production Cost Survey, with Allowances
January 2007 through December 2012
(In Dollars per Hundredweight)



Data Source: CDFA Dairy Marketing Branch

Financial conditions on the dairy or businesses in general, tend to exhibit fluctuations as they cycle through periods of positive and negative margins. Witnesses testified that the financial losses of dairies during previous episodes of negative margins could not be recouped by temporary price relief. The Panel agrees with this testimony and must consider the most current data available in order to determine whether to continue price relief. At the hearing, witnesses testified that they did not have any current data on observed margins on the dairy for 2013. Department data, as shown in Figure 1 above, only extends through the fourth quarter of 2012. Since the hearing record is void of any concrete data indicating the level of estimated margins on dairies for 2013, the most current data available, shown in Figure 1, indicates that estimated margins were positive again and that the income received by dairies in relation to the cost of production of market milk appeared adequate.

Milk Supply

Another important and relevant economic factor to consider when setting minimum prices is the state's milk supply. Specifically, the Code mandates that minimum prices shall insure an adequate and continuous supply of market milk in relation to the demand for that milk. At the time of the hearing, the most current Department data available on monthly California milk production was through March 2013. Although average monthly milk production for January through March 2013 was below 2012 levels for the same period, it was 2.2 percent higher than in 2011 (which the hearing record indicates was a typical milk production year). Representatives of producer cooperatives testified that 2013 milk supplies were generally at manageable levels that did not abnormally stress plant capacity. Testimony also indicates that the spring flush period of 2013, up to the time of the hearing, was usual and did not indicate an imbalance of milk supplies in relation to the state's plant capacity or the demand for farm milk. Upon questioning, witnesses did not foresee that milk supplies would fall short of the current expectations for milk and dairy product demand for the remainder of 2013. It is difficult to predict future outcomes in the marketplace for farm milk and finished dairy products because of the dynamic and volatile nature of these markets. The Panel concurs with testimony that the state's milk supply, in relation to demand, appears to currently be in balance and may not be a concern for the remainder of 2013.

Additional Factors

Economic theory suggests that there are other economic factors that could affect milk prices, costs of production, and dairy product markets. Availability of substitute goods, inventory levels of storable dairy products, consumer income levels, and exchange rates can all impact the demand for dairy products and thus influence milk prices. Global and domestic weather events, water availability, environmental regulations, and prices and availability of other feeds like roughages and pasture can also influence the cost of production. Additionally, the hearing record includes reports by USDA that project higher milk prices and lower corn prices as 2013 progresses, which suggest that financial conditions on the dairy should improve compared to those experienced in the early part of 2012. However, the hearing record does not contain any firm data or discussion related to these economic factors that would indicate how these factors may influence the industry in the future.

Conclusion

As a result of the uncertainty regarding the current condition of the dairy industry because of the lack of concrete data, the Panel is concerned and needs to be cautious in recommending temporary price relief, so that the normal marketing conditions of the state's milk supplies or finished dairy products are not disrupted. If, for example, during a period when temporary price relief was in place, dairy markets were to increase significantly, the competitive balance of marketing dairy products could be disrupted. Because dairy markets are dynamic and volatile, these markets can change significantly in a matter of days or weeks depending on changes in such market factors as domestic and global milk supplies, international demand, and production costs such as feed corn. Therefore, the Panel is concerned with the uncertain impact that these relevant economic factors may exert on dairy markets when potential temporary price relief would be in effect.

Ultimately, when reviewing the available information in the hearing record, the Panel recommends not continuing temporary price relief. First, the most current data available indicates that estimated margins on the dairy have improved from the levels observed in early 2012. Although corn feed costs continued to be at historic levels through the end of 2012, improved milk prices were sufficient to push margins positive once again. Second, the state's milk supply appears to be balanced in relation to the demand for milk, as evidenced by Department milk production data and testimony by representatives that market the majority of the state's milk supply. Third, there is not sufficient concrete data associated with the relevant economic factors that will influence future markets that clearly indicate temporary price increases should continue. Although the hearing record contains both positive and negative outlooks regarding the future condition of dairies as 2013 progresses, the Panel is concerned with recommending temporary price increases without firm quantitative justification for such increases.

Panel Recommendation

The Panel recommends no temporary price increases.

This Hearing Panel Report has been prepared and submitted by:

Original Signed by:

Candace Gates, Branch Chief

Original Signed by:

Hyrum Eastman, Dairy Economic Advisor

Original Signed by:

Kevin Masuhara, Division Director

Appendix A

CALIFORNIA'S DAIRY LANDSCAPE

The following background statistics reflect the dairy landscape in California with the most current data available at the time of the hearing.

Cost of Producing Milk

- For 2012, the cost of producing milk increased in all four areas of the state when compared to the same period for the previous year, with statewide average costs at \$17.57 per hundredweight (cwt.) (up \$1.40/cwt. from 2011). When including return on investment and management, the cost of producing milk in 2012 was \$19.03/cwt. (up \$1.25/cwt. compared to 2011).

Mailbox Milk Prices

- California mailbox milk prices for 2012 averaged \$16.23/cwt., a decrease of \$1.90/cwt. compared to the average 2011 mailbox price of \$18.13/cwt.
- For the first two months of 2013, the California mailbox milk prices averaged \$17.66/cwt., an increase of \$2.41/cwt. compared to the average mailbox milk price for the same time period in 2012 of \$15.25/cwt.

California Milk Production

- California's annual milk production has increased at an average annual rate of 1.8 percent over the last 10 years, compared to the 10-year U.S. average annual rate of 1.7 percent.
- For the twelve months ending March 2013, California milk production has shown a 2.4 percent decrease over the same time period ending March 2012.

Milk Cows

- Annual California cow numbers have increased at an average rate of 0.8 percent over the last 10 years – while U.S. cow numbers have increased 0.1 percent over the last 10 years.

Class 1 Sales

- For 2012, 13.1 percent of California's total pooled milk production was used to produce packaged fluid milk.
- For April 2012-March 2013, total Class 1 sales showed a decrease of 2.1 percent when compared to April 2011-March 2012.
- For January-March 2013, total Class 1 sales have shown a decline of 2.8 percent compared to the same time period in 2012.

Class 4b Products:

- For 2012, California cheese production closely resembled 2011 totals, at 2.25 billion pounds.
- In 2012, 43.5 percent of California's total milk production was used to produce Class 4b products.
- For January-March 2013, total cheese production was down 3.2 percent when compared to January-March 2012.

Class 4a Products:

- In 2012, 35.2 percent of California's total milk production was used to produce Class 4a products.
- For 2012 compared to 2011, California NFDM (for human consumption) production showed a 9.3 percent increase to 830.8 million pounds; Other Dry Milk Products (dry whole milk, dry buttermilk, skim milk powder and blends, milk protein concentrate dry, milk protein isolate dry 90% protein, casein dry, caseinates dry, NFDM animal feed, and other dry milk products) showed a decrease of 11.6 percent to 290.8 million pounds; Butter production showed a 5.1 percent increase to 654.2 million pounds; and Condensed and Evaporated Milk showed a 1.3 percent decrease to 1.04 billion pounds.
- For January-March 2013: total NFDM (for human consumption) production was down 33.6 percent; total butter production was down 7.3 percent; total Other Dry Milk Products production was up 135.3 percent; and Condensed and Evaporated Milk production was down 0.9 percent.

Class 2 and 3 Products:

- For 2012, 8.3 percent of California's total milk production was used to produce Class 2 and 3 products.
- For 2012 compared to 2011, frozen dairy product production showed a decrease of 4.2 percent to 167.5 million gallons, total cottage cheese production increased 6.0 percent to 107.1 million pounds, and yogurt production decreased 6.3 percent to 587.3 million pounds.
- For January-March 2013 compared to January-March 2012, total frozen dairy product production was down 4.7 percent, total cottage cheese production was down 11.6 percent, and yogurt production was down 6.5 percent.

<u>Resources:</u> CDFA Dairy Information Bulletin, CDFA Dairy Statistics 2012 Data Annual, CDFA California Cost of Production 2012 Data Annual

Appendix B

SUMMARY OF TESTIMONY

JOSEPH GALLO FARMS, Joe E. Paris

Testimony

- Supports continuing the temporary class price increases that were in effect Feb. 1 – May 31, 2013. Do not support any changes, up or down, to the levels that were enacted in February 2013.
- Recommend temporary increases remain in place until Dairy Future Task Force has concluded report and recommended decisions are in effect.
- Gallo is a third generation dairy milking 10,000 cows and also buy milk from two cooperatives.
- Gallo operates a farmstead cheese operation, making cheddars, Monterey Jack, Mozzarella, Muenster, and Pasta Filata.
- Processes over 45 million pounds of milk monthly.

WESTERN UNITED DAIRYMEN, Michael Marsh

Testimony

- Supports temporary price increase only to Class 4b pricing formula: $0.138/lb. on the Class 4b solids-not-fat. Would want the increase to continue until the Secretary calls another hearing and implements a change.
- The December 2012 hearing's increase in the Class 4a price has made it so that the Class 4a is higher than the Class IV and that restricts the ability of the cooperatives in the state to sell product into that marketplace.
- WUD proposed change would result in $0.50/cwt. increase in overbase price.
- The $0.50/cwt. increase would not resolve the structural inequity that still exists within the Class 4b formula with regard to the value for whey.
- WUD proposed increase not enough to recoup all losses but will help bridge gap between cost of production and milk revenues and provide closer relationship between Class 4b and Class III.
- WUD proposal provides fair Pool value for cheese making revenues.
- In 2013, milk prices continue to remain under the cost of production.
- Current dry whey scale falls short of a fair method to determine the whey value in the Class 4b formula.
- If going to have a sliding scale for whey value, the factor should more closely reflect the whey value generated by Class III formula.
- WUD petitioned the Department with a dry whey credit concept in August 2012.
- Immediate price relief for dairy farmers is needed.
- Will take a prolonged period of improved margins for dairy producers to recover the losses and eroded equity that occurred 2008-2010.
- Frazer LLP reports that for first half of 2012, dairies in Southern California, Kern County and San Joaquin Valley had average net incomes of $-2.24/cwt., $-0.92/cwt. and $-1.75/cwt., respectively.
- Submitted table of dairy production margins, highlighting 2009.
- Submitted a figure/chart of California overbase less California cost of production, 2003-2012.
- Feed costs reached record high for fourth quarter 2012 at $12.24/cwt. and cost of production at $20.08/cwt. (submitted figure/chart displaying feed costs/cwt.)

- Declines in overbase prices combined with steady record high feed prices have struck California dairy families in a way no one saw coming.
- Whey value creates most variance between Class 4b and Class III prices, over 80 percent of the difference.
- Class 4b plants are not sharing into the Pool like other classes.
- Provided a table/chart of Whey Value, Class III vs. Class 4b comparison.

DAIRY FARMERS OF AMERICA, Gary Stueve
Testimony

- Supports temporary price increase only to Class 4b pricing formula: $0.138/lb. on the Class 4b solids-not-fat.
- Impact of DFA proposal: no increases in Class 1, 2, 3, 4a prices, 4b price would be increased by approximately $1.20/cwt. Pool impact of $0.54/cwt.
- The December hearing increase to the Class 4a has had a minimal effect on DFA plant, but we are a very small drying plant.
- We firmly believe that DFA plant would to continue to be viable and profitable, even at our proposed level of increase.
- The $0.54/cwt. increase doesn't represent everything that the producers need or require to be viable going forward, but it's a start.
- DFA markets over 30 percent of U.S. milk, owns and operates 32 plants and the 315 DFA members in California represent 20 percent of California's milk production.
- Results from this hearing need to provide additional margin relief to producers.
- Don't have specific numbers, but it is possible that first quarter 2013 will show some margin improvement.
- Agree with WUD proposal and calculations.
- DFA proposal focuses on misalignment between California Class 4b and Federal Order Class III prices.
- For 2012, Class 4b price was $1.91/cwt. below Class III price.
- Submitted Department Statewide Cost Comparison Summary tables for Third Quarter 2011-Fourth Quarter 2012.
- Last positive margin for California dairies was third quarter 2011 and quarters following showed negative margins.
- Milk production growth has not been fueled by positive economics but by eroding farmer equity.
- We have not implemented any production controls or supply management on our members this spring.
- DFA is at a peak in milk production right now and in the fall, have a situation where they would like to bolster milk production somewhat because of new opportunities at the end of the year, the plant DFA is building in Nevada.
- This hearing should provide price relief until beneficial long-term changes in policies can be initiated; through legislation, hearings, Dairy Future Task Force actions, etc. Would have to continue to evaluate the formula going forward.

SAPUTO CHEESE USA INC., Greg Dryer
Testimony

- Supports continuing the temporary class price increases that were in effect Feb. 1 – May 31, 2013 for a period not to exceed six months.
- As far as how the increases have affected Saputo, the temporary price increase in place today and other increasing costs represent an increase of $0.80/cwt., that's a big number to us.

- Saputo has 27 facilities in U.S., seven of those are in California.
- Six months allows time for Dairy Future Task Force to develop a more permanent solution to outdated milk pricing system.
- California's existing end-product pricing system is no longer sustainable.
- Economic conditions since 2009 have shaken California dairy farmers but they are not the result of California milk pricing system.
- Many states have lost more dairies this year – a result of feed costs reaching record levels.

CALIFORNIA DAIRIES INC., Eric Erba

<u>Testimony</u>

- Supports temporary price increase only to Class 4b pricing formula: $0.138/lb. on the Class 4b solids-not-fat.
- CDI proposed increase should be in place until something else comes along and causes another hearing to remove it.
- The current temporary increase to Class 4a has resulted in millions of dollars a month that we are not going to be able to count towards cooperative profits that we would have had otherwise. It has been a severe impact to the profitability of the cooperative.
- CDI proposal justified based on milk prices in surrounding states and market conditions facing dairy industry.
- Impact of CDI proposal: Class 4b price would be increased by approximately $1.20/cwt. Pool impact of $0.52/cwt.
- The CDI proposed increase is not going to fix all the issues of producers but represents some middle ground and a concession on the part of producers to get back to where they need to be.
- CDI proposal is consistent with AB31 legislation.
- When making class-by-class comparison of California milk prices with other milk marketing orders, Class 4b stands out as not being close.
- CDI members produce 47 percent of California's milk production.
- CDI's California plants produce 400 million pounds of butter and 800 million pounds of powdered milk products in 2013.
- CDI proposal provides California dairy producers relief they need and brings equity to the price of milk used in cheese processing.
- Feed costs remain high and dairy margins hover near historic lows.
- CDI production bases are always in, we did not assess any penalties this year.
- CDI has gone past the peak milk production for 2013 without any significant problems. CDI customers run their plants very efficiently and if this was not the case, we would have had problems.
- CDI anticipates having more milk to deal with this year compared to last year. CDI picked up new producers in January.
- Submitted figure/chart displaying Class 4b prices and Class III prices, with dry whey prices.
- Differences between Class 4b and Class III price have grown since Department stopped end-product pricing approach to valuing whey.
- CDI experienced five percent drop in member milk production compared to last year.
- CDI lost 32 dairies and had lowest daily average since 2005.
- Attempting to achieve a milk price high enough to erase financial losses by producers as a result of inappropriate whey valuation and high feed costs is problematic for both producers and processors in California.

- For milk used to produce butter and milk powders, California price averaged $0.27/cwt. less than federally announced price since 2011.
- For milk used to make cheese, Class 4b price has averaged $1.96/cwt. less than Class III since 2011.
- Almost 80 percent of the Class 4b and Class III difference is explained by the change in the value of dry whey.
- Recent study by Drs. Stephenson and Nicholson identified Class 4b-Class III price spread as problematic and suggested a manufacturing differential on Class III price could resolve the problem of higher milk prices and encourage Pool participation by cheese plants. The study was focused on something entirely different, this point I made was something that came out of the study.
- There is no talk of releasing to the public the study conducted by Drs. Stephenson and Nicholson.
- Increasing Class 4a price only functions to redistribute money from the producers who made investments in butter and milk powder processing facilities to those who have not.
- When price increases hit the Class 4a plants primarily owned by producers, there is a differential impact on the producers as far as the pricing received out of the Pool.

DAIRY INSTITUTE OF CALIFORNIA, William Schiek
<u>Testimony</u>

- Supports continuing the temporary class price increases that were in effect Feb. 1 – May 31, 2013 for a period not to exceed six months, July-December 2013.
- The six-month extension would be in line with the calendar year proposed by the Legislature to get something done and seems to be what our members feel like they can agree to.
- Current temporary price increases come out of the processor margins, a greater hardship for some members than for others.
- California end-product pricing system is no longer viable.
- Globalization impacts are driving a new economic reality that will challenge the industry.
- The drought in 2012 drove feed prices to record levels and squeezed profit margins on dairies.
- Taking advantage of rising global demand means we must have an industry and policy environment that encourages investment and fosters proper business decision making.
- Many of state’s cheese makers do not have margins to support large revenue transfer to producers nor can they get such revenues from competitive environment.
- Proposing extension of price relief to give industry time it needs to address longer-term pricing issues.
- Feed prices have moderated since the latter half of 2012 and even lower prices are expected during second half of 2013.
- Milk production has been increasing strongly on a month-to-month basis.
- Temporary price increase will provide additional revenue on top of price increases from the market.

KRAFT FOODS, Renee Peets
<u>Testimony</u>

- Supports continuing the temporary class price increases that were in effect Feb. 1 – May 31, 2013 for a period not to exceed six months, July-December 2013.
- Six-month extension will allow Dairy Future Task Force to create a pricing system to replace the current pricing system.

- Current temporary price increase has impacted Kraft to the extent of several million dollars that comes directly out of our bottom line. The cheese and cultured products industry have very small margins and had to take it out of the margin.
- Kraft did not pass any of the price increases to consumers. Cheese products have been the most impacted.
- New pricing system must allow producers and processors to maintain and grow their businesses.
- Outlook is for farmer profitability to improve over the course of 2013, should eliminate the need for further temporary relief following the proposed six-month extension.
- Current legislation proposing permanent mandated pricing in California at higher levels will not create a long-term system that is sustainable for all stakeholders.

FARMDALE CREAMERY, INC., Scott Hofferber
<u>Testimony</u>

- Supports continuing the temporary class price increases that were in effect Feb. 1 – May 31, 2013 for six months, July-December 2013.
- Current temporary price increases have come directly off our bottom line. Have not passed any increases to consumers.
- Farmdale processes average 24.2 million pounds of milk and cream per month (100 loads per week) into cheese, sour cream, and buttermilk.
- Regulatory stability is a necessary component to planning and executing a growth strategy in manufacturing industries requiring large capital investment.
- Submitted five articles from industry news outlets Ag Web and Cheese Market News regarding dairy crisis and milk pricing dilemmas.
- Encourage continued participation in the Dairy Future Task Force.
- Outlook for feed costs has improved since the last hearing.
- Milk prices are up and holding since the last hearing.

LAND O'LAKES, INC., Thomas Wegner
<u>Testimony</u>

- Supports temporary price increase only to Class 4b pricing formula: $0.138/lb. on the Class 4b solids-not-fat.
- Proposed increase to Class 4b formula to remain in place until a suitable alternative to the current Class 4b formula is adopted.
- LOL has 240 California member-owners supplying over 16 million pounds of milk per day.
- Dairy market analysts project whey prices will remain at levels of $0.50-$0.60/cwt. for the rest of 2013.
- Adding LOL's proposed $0.50/cwt. to overbase prices would have a significant, positive financial impact to California's dairy farmers.
- For LOL members, over two-thirds of the $0.25/cwt. increase in the overbase price came from LOL Class 4a contribution to the Pool.
- Class 4a has historically tracked closely to the comparable federal order price. The February through May 2013 temporary price increase resulted in the Class 4a price exceeding the Class IV price by an average $0.10/cwt. for February-April 2013.
- For February-April 2013, the Class 4b price has averaged $1.47/cwt. lower than the Class III price.
- Although margins on the dairy improved in the fourth quarter of 2012, they did not come anywhere near to offsetting the losses of the first nine months of 2012.
- California dairies are facing another financially challenging year in 2013 because of the water situation, corn crop and hay supply.

- Alfalfa acreage in California is expected to be down by six percent in 2013.
- LOL has production caps in place but there have been no penalties in 2013.

CALIFORNIA DAIRY CAMPAIGN, Lynne McBride
Testimony
- Supports temporary price increase only to Class 4b pricing formula: $0.138/lb. on the Class 4b solids-not-fat.
- CDC proposed increase to the Class 4b formula should be in effect until substantial changes are made to state dairy pricing system. CDC believes the change should remain in effect until comprehensive changes to the pricing system are made that recognize the cost of production in pricing formula and other critical factors.
- Current prices paid to producers do not cover production costs.
- California mailbox prices are consistently the lowest in the nation.
- Submitted graph of average dairy producer profit and loss dollars, January 2002-2012.
- Periods of net losses on dairies far exceeds periods of profitability.
- Submitted a graph from Bureau of Labor Statistics and Chicago Mercantile Exchange (CME) prices showing margins between CME Cheddar prices and retail prices.
- Need to increase the Class 4b price to be in reasonable relationship with prices paid in federal orders.
- Department cost of production data show feed costs increased 10 percent from fourth quarter 2011 to fourth quarter 2012.
- Alignment with federal orders is only way to end inequity in state pricing system.
- CDC proposed increase to Class 4b formula will not solve all problems in pricing system but would provide additional revenue to producers.

MILK PRODUCERS COUNCIL, Rob Vandenheuvel
Testimony
- Supports temporary price increase only to Class 4b price of $1.20/cwt.
- Price increase to stay in effect until legislation, task force, federal order or other alternative creates a compromise.
- Submitted chart comparing Department's cost of production data and California blend price.
- California dairy families have lost an average $0.63/cwt. over the last three years.
- Comparing Class 4b and Class III prices show significant difference.
- The Class 4b and Class III price difference is the difference between dairy farmer profits and losses in California.
- For 2010-2012, California producers received a statewide blend milk price of $0.63/cwt. below state's estimated cost of production.
- Fundamental tenant of the pooling structure is that each of the five classes must make a fair and equitable contribution to the Pool.
- Class 1, 2, 3, and 4a plants heavily subsidized the cheese plants over the past three years.

HILMAR CHEESE COMPANY, INC., David Ahlem
Testimony
- Supports continuing the temporary class price increases that were in effect Feb. 1 – May 31, 2013 for a period not to exceed six months, July-December 2013.
- In California, Hilmar processes over 13 million pounds of milk per day and purchases milk from over 200 dairies.

- Support continuation of temporary price increases for short-term relief and support active engagement of Dairy Future Task Force to modernize California regulated milk pricing system as long-term solution.
- High feed costs have changed competitive position of producers throughout the western U.S.
- Producers who have ability to grow own feed are in better financial position than those who purchase outside feedstuffs.
- Hilmar continues to enforce contract caps and has a waiting list of producers who wish to increase their caps.
- In the springtime we have not extended as much contract caps as producers would like and over time they sell surpluses to calf ranches or other alternative markets.
- Unless driven by market fundamentals, regulated price increases are artificial and benefits to producers are short-lived.
- Hilmar was founded to pay more for milk and pays market-driven premiums for milk.
- Nothing precludes processors from paying more and nothing prevents milk sellers from asking for more from buyers.
- Participation in the federal orders is optional for cheese manufacturers – but not in California.
- Proposed minimum price increase puts California cheese processors at further disadvantage to competitors in regulated and unregulated markets.
- Regulatory uncertainty paralyzes the industry and increases the risk of new investment.
- Increases to the Class 4b price will take money away from premium-earning producers who supply Hilmar.
- In 2012, more than $6 million of Hilmar premiums were redistributed through the Pool as a result of the past two Class 4b hearings.
- To grow the value of milk in California, must pursue market-based solutions.
- Whey factor debate is a symptom of much larger problem and simple adjustment to whey factor will not solve problem long-term.

AGRICULTURAL COUNCIL OF CALIFORNIA, Emily Rooney
Testimony

- Supports and agrees with California cooperatives to seek elevated Class 4b price.
- Ag Council represents 15,000 farmers across California and 80 percent of the milk produced in California.
- Financial hardship of dairymen and dairywomen in state is widespread.
- Submitted copies of letters from Kristin Olsen and Susan T. Eggman, both of the Assembly Committee on Agriculture.
- Loss of dairies is devastating to the state and communities.
- Need to find a short-term and long-term solution to this crisis.
- Ag Council supports the Secretary's Dairy Future Task Force.
- Short-term solution of improving the Class 4b price would allow dairy families some relief while working for a long-term solution.

T-BAR DAIRY, Tom Barcellos
Testimony

- Supports the adjustments requested by WUD. Request that the adjustment to the Class 4b price be implemented on an emergency basis until the Dairy Future Task Force completes its work.
- Documented in past hearings that the discrepancy is in the whey portion of the Class 4b price.

- Producers have supported reasonable make allowances to enable plants to invest in capacity and efficiency along with technology.
- If plants require additional support they should request a make allowance hearing.
- Plants should manage the supply, not the Department. Plants can institute bases for milk delivery.

LOS ALTOS FOOD PRODUCTS, INC., John Clement
<u>Testimony</u>

- Supports continuing the temporary class price increases that were in effect Feb. 1 – May 31, 2013 for six months, July-December 2013.
- Los Altos is a small, mid-size cheese manufacturer of specialty cheeses.
- Recognize challenges faced by dairy farmers and support an extension of six months to be reviewed at a later date – time necessary for Dairy Future Task Force to provide solution.
- Whey is of no value to Los Altos. It is a byproduct and we have to pay up to $300,000 per year to dispose of the whey.
- Margins at our plant have been lowest seen for many years and our market share would be impacted heavily if we had to raise prices – our competition would take advantage of that.
- We have had to put on hold a project to put solar panels in our building to provide green energy investment.
- This uncertainty of milk price is stopping our investments in the future.
- Health benefit costs have increased and our margins keep going down.
- Los Altos feels that Dairy Future Task Force will provide necessary resolutions equitable to all and are committed to see that process through completion.

LEPRINO FOODS, Sue Taylor
<u>Testimony</u>

- Supports continuing the temporary class price increases that were in effect Feb. 1 – May 31, 2013 for a period not to exceed six months, July-December 2013.
- Leprino is in support of a review of the existing milk pricing system by the Dairy Future Task Force.
- Leprino operates ten Mozzarella plants in the U.S., three in California.
- Leprino's California plants process the whey stream into whey protein concentrate and lactose.
- Feed cost inflation was felt most dramatically by dairies that built their production model around purchased feed.
- National marketplace responded to supply and demand balance shift created by milk supply adjustments last year with increased commodity prices.
- The calendar year-to-date, through April, Cheddar prices averaged 11.6 percent higher, nonfat dry milk averaged 14.1 percent higher, butter averaged 7.3 percent higher, and whey prices averaged 4.4 percent less – than same time last year. Class 4a prices have been 15.4 percent higher than a year ago.
- Strong export markets and declining feed costs are anticipated to result in improved margins during the second half of this year.
- Leprino responded to farm financial stress by significantly increasing its over-order premium structure effective with September 2012 milk.
- Current end-product pricing formula used in California is in jeopardy due to lack of publishable data.

- Focus by producer groups to go with Federal Order whey valuation while not accepting Federal Order pooling rules is emblematic of the need for a deeper understanding of milk price policy.

Received by Correspondence

DAIRY GODDESS FARMSTEAD CHEESE, Barbara Martin
Testimony

- Supports extending the current Feb. 1 – May 31, 2013 class price increases.
- Stressed that California prices paid to producers are not in alignment with the rest of the U.S. (approximately $1.80/cwt. less).
- The $1.80/cwt. would have been the difference for survival of many of the dairy families in California.