Hearing Panel Report

Based on a Public Hearing Held
December 5, 2006

Addressing the Class 1 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 Pricing Formula
Based Upon a Public Hearing Held on December 5, 2006

This Report of the Hearing Panel regarding proposed amendments to the Stabilization and Marketing Plans for Northern California and Southern California (Plans) is based on evidence received into the Department of Food and Agriculture's hearing folder. The folder includes the Departmental exhibits, written statements and comments received from interested parties, written and oral testimony received at a public hearing held Tuesday, December 5, 2006, and written post-hearing briefs.

Table of Contents

INTRODUCTION/WITNESSES

California Food and Agricultural Code Section 61801, *et sec*., provides the authority, procedures, and standards for establishing minimum farm 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 Milk Stabilization and Marketing Plans for Market Milk (Plans).

Petitions were submitted by:
1. Alliance of Western Milk Producers (Alliance)
2. Western United Dairymen (WUD)

One alternative proposal was submitted:
1. Dairy Institute (Institute)

A total of 10 additional witnesses testified including the Department's witness:

Marie Caron-Lyles, Department of Food and Agriculture (Department)
United Western Grocers (UWC), John Bedrosian
Super Stores Industries (Super Stores), Dennis Brimhall
Dean Foods Company (DFC), Evan Kinser
Crystal Cream and Butter Company (Crystal), Sharon Hale
Land O'Lakes, Inc. (LOL), Jim Gruebele
Driftwood Dairy (Driftwood), Jim Dolan
Albert Nunes, Partner with the CPA firm of Genske & Mulder
Milk Producers Council (MPC), Bill Van Dam
California Dairy Campaign (CDC), Kevin Abernathy

Background: California's Dairy Landscape

The following economic data and statistics represent the current situation of California's dairy industry and were considered when examining and evaluating the proposals and testimony submitted at the hearing.

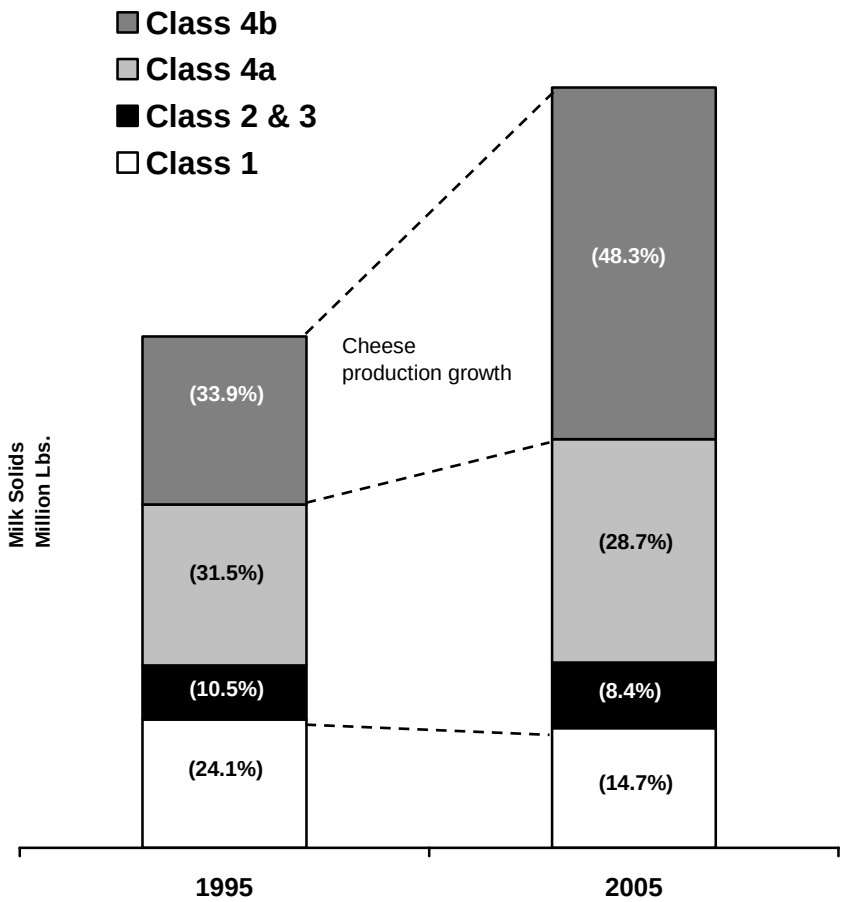
Cost of Producing Milk

- For 2005, the cost of producing milk increased in all four areas of the state when compared to the same period in 2004, with statewide average costs at $13.43 per cwt. (up $0.68/cwt. from 2004).

Mailbox Milk Prices

- For the twelve months ending September 2006, mailbox milk prices for all federal milk orders averaged $13.15/cwt., $2.07 lower than the average for 2005. For California, mailbox milk prices averaged $11.68/cwt. during 2006, $2.43/cwt. lower than 2005.

Use of Total Pool Milk Solids in California by Class, 1995 vs. 2005



Class 1 Usage

- Class 1 in California accounted for 14.7% of total pool fat and solids-not-fat usage in 2005.
- Class 1 usage in California represented 15.7% of the total pool fat and solids-not-fat usage in 2004.

California Milk Production

- Annual milk production has increased at an average rate of 4.5% over the last 20 years; 4.0% over the last 10 years.
- For 2005, milk production reached an all-time high of 37.5 billion pounds, with 11 of the 12 months in 2005 exceeding 3 billion pounds in milk production.
- Trend of increasing milk production over the last 20 years:
  - Above 9% - 3 years
  - 5 to 8.9% - 4 years
  - 3 to 4.9% - 7 years
  - 1 to 2.9% - 5 years
  - Less than 1% - 2 years
  - No years recording decrease in milk production

Milk Cows

- Annual California cow numbers have *increased* at an average rate of 3% over the last 20 years; 3.4% over the last 10 years – while U.S. cow numbers have *decreased* over the last 10 years.
- California has more dairy cows and produces more milk than any other state, yet ranks 8th in milk production per cow, and 8th in total licensed dairies.

Cheese Production (Class 4b)

- In 2005, 48% of California's total milk production was used to produce cheese.
- California cheese production set a record in 2005, at 2.1 billion pounds.
- The California and other western states share of U.S. cheese production increased to 42%.
- California cheese production has more than doubled in the last 10 years.

Butter and Nonfat Dry Milk Production (Class 4a)

- In 2005, 29% of California's total milk production was used to produce butter and nonfat dry milk.
- California is ranked first in the U.S. for butter and nonfat dry milk production, and when combined with the other western states, the U.S. market shares are 45% and 68%, respectively.
- Butter has shown a 19% growth in production over the last 5 years to 407.8 million pounds in 2005.

Cottage Cheese, Yogurt, Ice Cream, as well as other soft and frozen dairy products (Class 2 and 3)

- Frozen dairy product growth has been flat over the last 10 years, but has showed an increase of 7.1% when comparing 2005 to 2004.
- Dry curd cottage cheese production has increased 8.8% over the last 5 years.
- Yogurt production increased 12.8% from 2004 to 2005.

USDA's U.S. National Dairy Outlook

Economic Research Service, USDA, recently provided its outlook forecast of the national dairy market in its November 17, 2006, monthly Livestock, Dairy, and Poultry Outlook publication. In the report USDA forecasts/estimates that:

- The 2006 total U.S, national milk production at 181.9 billion pounds, a 2.8 percent increase above 2005.
- The 2007 total U.S. national milk production will be 183 billion pounds, less than a 1 percent increase over 2006.
- Rising feed prices, especially for corn due to increasing ethanol production, are squeezing milk-price ratios and are likely to continue to do so well into 2007.
- The cheese market is roughly in balance. Demand for cheese remains strong. Some reallocation of production to dry products could occur in the balance of 2006. Although cheese demand is strong, supplies are such that any further large increase in prices in the balance of 2006 and the first half of 2007 are unlikely.
- The season average price for cheese is projected at $1.230 to $1.240 a pound for 2006. In 2007, the price is forecast at $1.305 to $1.395 a pound.
- Whey supplies could tighten further as milk is directed toward Nonfat Dry Milk (NDM) and Skim Milk Powder (SMP) production. Whey prices are projected to average 32.0 to 33.0 cents a pound in the current year and 30.0 to 33.0 a pound in 2007.
- The market for NDM, SMP and whey remain very tight. Cumulative exports of SMP were tailing year earlier levels through May; however, the gap had nearly disappeared by September. Tight domestic supplies have also contributed to high prices. A reallocation of milk to butter/powder usage would boost cheese and whey prices firm.
- An increase in Class IV use to augment NDM/SMP supplies could soften butter prices in the balance of 2006 and into 2007. However, demand for butter remains seasonally strong and lower prices are encouraging additional retail activity. The butter price is expected to average $1.205 to 41.235 a pound in 2006 and $1.250 to $1.370 a pound in 2007.
- The expected modest increase in milk production in 2007 in the face of strong product demand should boost milk prices in 2007. The expected average all milk price is estimated to be $12.80 to $12.90 in 2006 and $13.40 to $14.30 in 2007.

The California Class 1 Pricing Formula Diagram

The Commodities: Obtain the prices for Grade AA butter and 40 lb. block Cheddar cheese as traded on the Chicago Mercantile Exchange for the 26th of the previous month to the 10th of the current month; take the simple average and round to four decimal places. Obtain the two most recent weekly reports for Grade A and extra grade nonfat power f.o.b. California manufacturing plants available as of the 10th of the current month, rounding the weighted average of the two weeks to four decimal places. the commodity prices are obtained, they can be placed in the following equations to calculate the Class 1 price.

First Step: Calculate the Class 1 fat price using CME butter commodity price.

Butter Adjuster

Price of Class 1 Fat = (CME Butter – $0.10) x 1.2)

Second Step: Choose a Commodity Reference Price (CRP). The CRP is the ***"higher of"*** the following two calculations (this "higher of" result can change from month-to-month based on the commodity prices that make up the Cheddar/Whey Butter calculation and the Butter/Powder calculation):

***CRP** = the "higher of":*

Cheddar: (CME Cheddar) x 9.8 + (CME Butter – $0.10) x 0.27 *(do not round the result)*

OR

Butter/Powder: (CME Butter x 1.2) x 3.5 + (CA NFDM x 0.99) x 8.7 *(do not round the result)*

Third Step: Once you have the CRP figure, you can calculate the SNF and Fluid Carrier:

Class 1 SNF = (((CRP + $0.464) – (Class 1 Fat Price x 3.5)) x 0.76) / 8.7 *(round to four decimals)*

CRP Differential**

Class 1 Fluid = (((CRP + $0.464) – (Class 1 Fat Price x 3.5)) x 0.24) / 87.8 *(round to four decimals)*

Final Step:
Once the component prices have been assigned to fat, SNF, and fluid carrier portions of milk, these component prices are converted to a standardized milk price. Take all the figures from the above calculations and place in the following formula to calculate the Class 1 Price based on a hundredweight of milk:

(3.5 x Class 1 Fat Price) + (8.7 x Class 1 SNF Price) + (87.8 x Class 1 Fluid Carrier)

**The CRP differentials are policy instruments that allow the Department to adjust Class 1 prices giving consideration to all relevant economic factors, including but not limited to:

- prices in contiguous states
- farms costs relative to price
- the supply of milk relative to demand
- changes in state and federal economic, environmental and sanitary regulations for dairy
- the balance among producers, handlers, and consumers

California Class 1 formula and the Federal Order Class I formula (Differences/Similarities):

- California formula uses the CME commodity prices, federal formula uses NASS commodity prices
- Federal formula includes a "dry whey factor" in the equivalent California Cheddar CRP formula
- California formula uses 40 lb. block Cheddar, federal formula uses 40 lb. block and barrel Cheddar; and California formula directly uses whey butter prices in the cheese CRP formula
- Both the California and federal formulas use the "higher of" concept in determining the CRP differential

SUMMARY OF PROPOSALS

The following proposals were submitted (all proposed changes are in **BOLD** print):

The Alliance:

***Class 1 Fat = ((CME Butter – $0.10) x 1.2) – **$0.0216**

Commodity Reference Price (CRP) = *the higher of the two calculations*

(CME Cheddar) x 9.8 + (CME Butter – $0.10) x 0.27 or
(CME Butter x 1.2) x 3.5 + (CA NFDM x 0.99) x 8.7

Class 1 SNF = (((CRP + **$0.850**) – (Class 1 Fat Price x 3.5)) x 0.76) / 8.7

Class 1 Fluid = (((CRP + **$0.850**) – (Class 1 Fat Price x 3.5)) x 0.24 / 87.8

Western United Dairymen:

Class 1 Fat = ((CME Butter – $0.10) x 1.2) – **$0.0200**

Commodity Reference Price *(the higher of)*

(CME Cheddar) x 9.8 + (CME Butter – $0.10) x 0.27 or
(CME Butter x 1.2) x 3.5 + (CA NFDM x 0.99) x 8.7

Class 1 SNF = (((CRP + **$0.900**) – (Class 1 Fat Price x 3.5)) x 0.76) / 8.7

Class 1 Fluid = (((CRP + **$0.900**) – (Class 1 Fat Price x 3.5)) x 0.24 / 87.8

Dairy Institute

***Class 1 Fat = ((CME Butter – **$0.118**) x 1.2)

Commodity Reference Price *(the higher of)*

(CME Cheddar) x 9.8 + (CME Butter – $0.10) x 0.27
+ (Dry Whey Price x 5.8) – $0.850 or

(CME Butter x 1.2) x 3.5 + (CA NFDM x 0.99) x 8.7

Class 1 SNF = (((CRP **– $0.17**) – (Class 1 Fat Price x 3.5)) x 0.76) / 8.7

Class 1 Fluid = (((CRP **– $0.17**) – (Class 1 Fat Price x 3.5)) x 0.24 / 87.8

***Mathematically, these two formulas are equivalent.**

Table 1: Estimated Impact of the Difference from Class 1 and Pool Prices*
January 2002 - December 2006; Annual and Five-Year Averages

(In Dollars Per Hundredweight)

	Alliance	WUD	Institute
Class 1 Prices			
2002	$0.39	$0.44	-$0.56
2003	$0.39	$0.44	-$0.56
2004	$0.39	$0.44	-$0.29
2005	$0.39	$0.44	$0.03
2006	$0.39	$0.44	$0.12
5-Year Average	$0.39	$0.44	-$0.25
Pool Prices			
2002	$0.08	$0.09	-$0.11
2003	$0.08	$0.09	-$0.10
2004	$0.07	$0.08	-$0.05
2005	$0.07	$0.08	$0.01
2006	$0.07	$0.08	$0.03
5-Year Average	$0.08	$0.08	-$0.04

*Based on current formulas if proposals had been in effect during the five-year period

THE HEARING ISSUES

In granting the authority to establish minimum prices to the California Department of Food and Agriculture (Department), the California Legislature established a number of statutory criteria for establishing and amending California minimum milk prices (see Hearing Exhibit 7a). It is the responsibility of the Department to carefully evaluate and consider those legislative criteria in making appropriate adjustments to the minimum pricing formulas.

A public hearing was held on December 5, 2006 with the purpose of determining whether or not (1) the existing Class 1 pricing formula satisfies the statutory criteria and (2) if not, what adjustments to the pricing formula are necessary and appropriate. The Alliance and WUD, citing evidence that California's Class 1 prices were not in reasonable relationship with the prices in contiguous states, requested a public hearing. To achieve the needed price alignment with contiguous states, both the Alliance and WUD proposed amendments that would raise the Class 1 price by $.039/cwt. and $.044/cwt., respectively.

The Institute cited evidence that the current disparity between California's Class 1 price and the Class I prices of contiguous states is caused by two unique conditions. First, the federal order Class I pricing formulas incorporate the value of dry whey in the calculation of its Class I price, while California's Class1 pricing formula does not. Secondly, current national dry whey prices are historically high. To improve a better price relationship between California and the contiguous states, the Institute proposed the adoption of a dry whey factor into California's Class 1 pricing formula.

In addition, all three organizations (Alliance, WUD, and the Institute) proposed to shift some value from the fat component of the Class 1 formula to the solids-not-fat (SNF) and fluid carrier components of the formula. Given the relatively small proportion of fat in all types of fluid milk combined (2.2%) compared to solids-not-fat (9.8%) and fluid carrier (88%), a deduction in the component price value of fat and re-distributing that value among the SNF and fluid carrier components results in a slightly higher Pool price, but without any effect on announced Class 1 hundredweight prices.

Those supporting the adoption of the dry whey factor were not in unanimous agreement regarding specific aspects of its incorporation into the pricing formula. Both MPC and the Institute testified in support of slightly different whey adjusters. More importantly, both MPC and the Institute had significantly different positions on the appropriate level of the CRP adjuster, whether it should remain at the current level or be modified. The Institute testified in support of reducing the current CRP adjuster value both as a means to accommodate the addition of the dry whey factor to the CPR calculation and to establish a lower Class 1 price level. MPC testified in opposition to any reduction in the current CRP adjuster that would result in a specific reduction in the Class 1 price level.

In order to address the key issues, the Hearing Panel Report has been organized in accordance to the following issues:
Issue 1: Reasonable relationship of California's Class 1 prices/fixed increase
Issue 2: Adjustments to the fat price in the Class 1 pricing formula
Issue 3: Dry whey factor and CRP adjuster

REASONABLE RELATIONSHIP OF CALIFORNIA'S CLASS 1 PRICES/FIXED INCREASE

Issue

Whether or not California's Class 1 prices are "reasonably" related to the Class I price in contiguous states has been a central question for almost every Class 1 pricing hearing since 1990. During this time, fluid milk processors have consistently maintained that California's Class 1 price levels create a competitive disadvantage for California fluid products and should be reduced. Dairy producer representatives have consistently maintained that California Class 1 prices should be increased so that they will be brought into a "reasonable relationship" with the minimum Class I price in neighboring states.

At the December 5, 2006 hearing, testimony addressed the interpretation of the Food and Agricultural Code Section 62062.1 and its importance relative to other code sections. The same points and arguments made at the prior May 3 and 6, 2005 Class 1 hearing relating to the "appropriate" interpretation of the governing code sections were again made at the December 5, 2006 hearing.

After carefully reviewing all the evidence and testimony, it remains the Panel's opinion that "there is nothing in the statutes which implies that Section 62062.1 or any other section is the overriding criteria for establishing California Class 1 prices. There is every reason to interpret Section 62062.1 as simply another criteria for consideration by the Department in establishing appropriate Class 1 prices in California." The chapters of the Food and Agricultural Code dealing with milk marketing "shall constitute a single comprehensive scheme for the regulation of the production and handling of milk." (Sections 61345, 61810 and 62504)

Both WUD and Alliance proposed to increase the Class 1 pricing levels because of the annual difference between California's weighted average price and those in contiguous states for 2006. This fixed increase has no real relationship to the dynamic factors that drive the minimum fluid milk prices in federal milk marketing orders. Since the factors driving the pricing formula may be quite different in the following year, the fixed increase may actually create "alignment" relationship issues the following year. The Alliance testimony stated that if the adjustments recommended by the Alliance were made effective and caused California's Class 1 prices in 2007 not to be in reasonable relationship with those in contiguous states, another hearing should be held.

MPC, supported by CDC, did not support a fixed increase, citing their concern that 25 percent of the fluid milk currently sold in Southern California comes from out-of-state production in locations that are greater distances away than available California milk supplies. They expressed concern about how a fixed price increase might adversely impact California fluid sales and therefore could not support a fixed increase in the Class 1 price.

The Panel concurs with the concern that an increase in the Class 1 pricing formula may address the "reasonable relationship" that existed in the prior year, but it does little to address potential reasonable relationship issues that may happen in the future. The Panel believes it is more important to incorporate changes in the Class 1 pricing formula that will be more reflective of the market factors driving prices in contiguous states now and in the near future. It is a far more proactive approach to ensure that California Class 1 prices maintain a

reasonable relationship with contiguous states than the approach of simply correcting prices after the fact.

In order to assess the actual impact that the increasing value for dry whey might have on the Class I Price in neighboring states over the next few months, the Panel analyzed the impact of the most recent dry whey values on the Class I prices in Oregon. The Panel's analysis shows that the higher values for dry whey will result in sharply increased Class I prices in Oregon. Even with the adoption of a fixed increase of $0.44/cwt. as proposed by WUD, the spread between the Class 1 prices in California and Oregon will increase significantly, possibly approaching $1.50 to $2.00/cwt.

The Panel's preliminary analysis indicated the inclusion of the dry whey factor in the Commodity Reference Price (CRP) calculations provided the potential of keeping the difference between California Class 1 prices and prices in Oregon and other federal orders more constant. It would also provide substantial increases in the Class 1 price levels during a time when dairy farmers are experiencing higher costs.

After carefully examining all the testimony and evidence, the Panel has concluded that:

- Making a fixed increase in the Class 1 pricing formula may address the "reasonable relationship" that existed in the prior year. It does little to address the dynamic factors that may be driving the differences.
- A fixed increase may make the relationship between California and its neighboring states worse the following year.
- Adoption of the dry whey factor into the Class 1 pricing formula does provide the potential for improving the alignment of California Class 1 price with contiguous states.

The Panel does not believe that "reasonable relationship" means "the same as," nor was that the legislators' intention. Given the sustained period of record high dry whey prices (throughout 2005 and 2006), there exists, however, risk of future divergence of prices which the Panel feels would lead to or currently may be unreasonable, all other factors being equal. The Alliance and WUD proposals are not able to sufficiently address this concern with a fixed increase.

Panel Recommendation

The Panel recommends that a fixed increase as recommended by WUD and the Alliance be denied.

ADJUSTMENTS TO THE FAT PRICE IN THE CLASS 1 PRICING FORMULA

Issue

Assigning a value to the fat component of milk is the first step in calculating the Class 1 price. The fat price equals the average Chicago Mercantile Exchange (CME) butter price less a butter adjuster and then all times a yield factor. The solids-not-fat (SNF) and fluid prices are calculated as residuals. By definition then, any deduction from the fat value would be transferred to the SNF/fluid value.

The Institute stated that, "At previous hearings, we had argued for a higher fat price and a lower skim price relative to federal orders as a means of helping 'California-standard' milks face less of a competitive disadvantage when they were marketed in surrounding states. It is our understanding that the majority of California-processed milk that is sold outside California today is processed to federal standards, so there is less of a reason for the current skim/fat value 'tilt' to be maintained."

Review of Proposals

All of the proposals would decrease the Class 1 fat price. All of the testimony received on this issue supported the concept of shifting a portion of the Class 1 value from fat to SNF to bring California fat prices into better alignment with contiguous states. (See Table 2).

Table 2: The Difference Between Northern California Class 1 Fat Prices and Oregon Class I Fat Prices

(In Dollars Per Pound)

Year	Current	WUD	Alliance & Institute
2002	$0.021	$0.001	-$0.001
2003	$0.022	$0.002	$0.001
***2004**	-$0.005	-$0.025	-$0.027
2005	$0.022	$0.002	$0.000
2006	$0.027	$0.007	$0.006
5-Year Average	**$0.017**	**-$0.003**	**-$0.004**

* 2004 differs from all other years probably because of a price spike for butter in November 2004 when there was a record 11¢ difference between the CME and the NASS prices.

The Alliance and Institute recommendations result in the same dollar amount using different equations. Alliance recommended an overall adjustment of -$0.0216 to the Class 1 fat price and the Institute proposed the same result using a different formula -$0.118 x 1.2. WUD agreed with the concept but proposed an overall adjustment of -$0.0200 to the Class 1 fat

price. All three proponents felt comfortable with either of the proposed adjustments. All testimony on this issue supported the concept of a change to the Class 1 fat price. There was no testimony in opposition.

Impact of Proposals

All three proposals would have virtually the same impact on Class 1 prices and Pool prices. For the five years 2002 to 2006, the proposed changes to the butter adjuster would have resulted in average price increases of 0.4¢ to 0.7¢ per gallon for all types of milk, excluding whole milk that would remain the same. (See Table 3).

Table 3: Current Formula Butter Adjuster and Proposed Butter Adjuster
The Difference Between Northern California Class 1 Prices and
Oregon Class I Prices - Various Fluid Milk Products
Annual and 5-year Averages, January 2002 to December 2006

	California Standards			
	Whole Milk	**Reduced Fat**	**Lowfat**	**Skim**
	3.5% 8.7%	2% 10%	1% 11%	0.1% 9%
	(¢/gallon)	*(¢/gallon)*	*(¢/gallon)*	*(¢/gallon)*
Current Formula Butter Adjuster				
2002	-0.4¢	-4.8¢	-7.9¢	-1.1¢
2003	1.4¢ [1/]	-1.7¢	-3.7¢	0.7¢
2004	-4.3¢	-7.5¢	-9.7¢	-4.4¢
2005	-5.3¢	-10.0¢	-13.3¢	-6.2¢
2006	-6.8¢	-11.7¢	-15.1¢	-8.0¢
5-year average	**-3.1¢**	**-7.1¢**	**-10.0¢**	**-3.8¢**
WUD Proposed Butter Adjuster [2/]				
2002	-0.4¢	-4.5¢	-7.4¢	-0.5¢
2003	1.4¢	-1.3¢	-3.1¢	1.3¢
2004	-4.3¢	-7.2¢	-9.1¢	-3.8¢
2005	-5.3¢	-9.7¢	-12.8¢	-5.6¢
2006	-6.8¢	-11.3¢	-14.5¢	-7.3¢
5-year average	**-3.1¢**	**-6.8¢**	**-9.4¢**	**-3.2¢**
Alliance & Institute Proposed Butter Adjuster [3/]				
2002	-0.4¢	-4.5¢	-7.3¢	-0.4¢
2003	1.4¢	-1.3¢	-3.1¢	1.4¢
2004	-4.3¢	-7.2¢	-9.1¢	-3.7¢
2005	-5.3¢	-9.7¢	-12.7¢	-5.5¢
2006	-6.8¢	-11.3¢	-14.5¢	-7.3¢
5-year average	**-3.1¢**	**-6.8¢**	**-9.4¢**	**-3.1¢**

[1/] Shading indicates years in which Northern California prices averaged higher than Oregon prices

[2/] The price changes when using WUD proposed butter adjuster are constant over all years:

0.00¢ 0.35¢ 0.60¢ 0.66¢

[3/] The price changes when using Alliance & Institute proposed butter adjuster are constant over all years:

0.00¢ 0.38¢ 0.65¢ 0.71¢

Discussion

The Panel felt that the adjustments proposed to the Class 1 fat component had a very small impact on the overall Class 1 price and Pool price level (see Table 4), and provided better alignment with prices in contiguous states. As previously stated, no testimony at this hearing opposed the adjustments to the Class 1 fat component.

Table 4: Estimated Impact of Proposed Butter Adjusters to Pool Prices [1/]

(In Dollars Per Hundredweight)

Year	WUD	Alliance & Institute
2002	$0.0059	$0.0064
2003	$0.0055	$0.0060
2004	$0.0053	$0.0057
2005	$0.0052	$0.0056
2006	$0.0051	$0.0055
5-Year Average	**$0.0054**	**$0.0058**

[1/] There would be no increase in Class 1 prices at a 3.5% 8.7% test.

The Panel supports the adjustment to the Class 1 fat component and prefers the simplified algebraic calculation proposed by the Institute.

Panel Recommendation

The Panel recommends the adoption of a butter adjuster of -$0.118/lb.

THE DRY WHEY FACTOR AND CRP ADJUSTER

Issue

In the previous discussion, the Panel mentioned that the dry whey factor has the potential of tracking better than a fixed increase. This section specifically examines the concept of adding a dry whey factor and the sub-issues associated with its implementation.

Specifically the Panel will address:

- Relevance of the dry whey factor,
- Appropriate dry whey adjuster,
- Appropriate CRP adjuster,
  - Impact of modifying the current CRP adjuster when the butter/powder represents the higher commodity value,
  - Class 1 Price relationship to the milk production cost, and
  - Competitiveness of California fluid milk with milk from contiguous states.

In addressing these issues, there are two relevant concepts to determining a "reasonable relationship," these are "relative price level" and "tracking." Tracking refers to moving together from one time period to the next. "Relative price level" is the difference in prices over a given time period. For example, the federal Class I price in central Wisconsin "tracks" very well with the price in southern Florida, because both are set as differentials above the same base Class I price. There is however, a $2.60/cwt. difference in the "relative price level." Similarly, for the 12 months ending August 2001, the "relative prices" between central Oregon and northern California were the same: $15.20/cwt. However, the two price series did not "track" well. In December 2000, the northern California price was $0.55/cwt. higher than the central Oregon price, but seven months later, in July 2001, the price was $0.23/cwt. lower.

Review of proposals

Witnesses at the December 5, 2006 hearing tended to focus on either "tracking" or "relative price level," but not both. The Alliance and WUD both requested fixed price increases to address what they viewed as low "relative price levels" in 2006. Their proposals however, would not have improved tracking.

The Institute and MPC both requested the addition of a dry whey factor in the Class 1 pricing formulas to address what they viewed as poor "tracking" with prices in contiguous states. The Institute proposal also addressed relative price level. Testimony provided by Institute, MPC, and CDC proposed the inclusion of a dry whey factor into the commodity reference price (CRP) formula for various reasons and in different variations on the concept. WUD and Alliance did not support the inclusion of a dry whey factor. The proposals relative to the inclusion of a dry whey factor were as follows:

Table 5: Estimated Impact of Proposed Changes on Current Prices
Difference from Northern California Class 1 and Oregon Class I Prices
January 2002 - December 2006, Annual and 5-Year Averages

Formulas Using the following criteria:

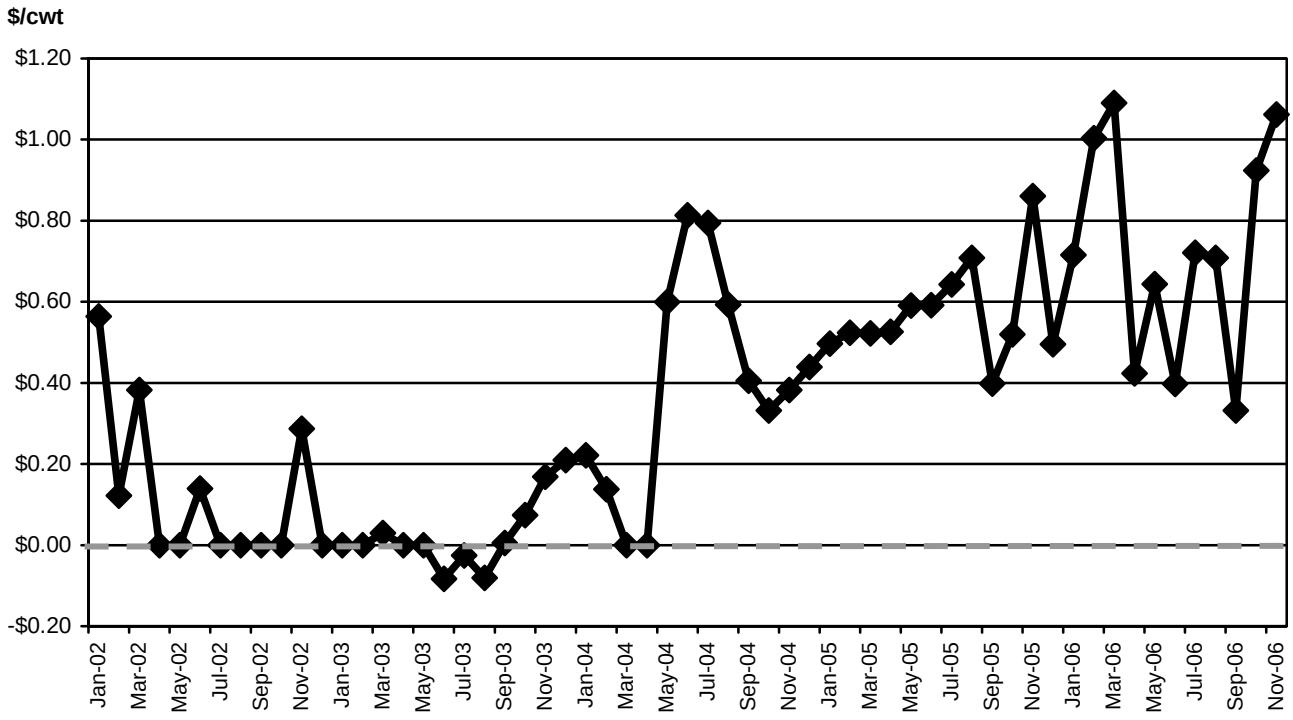
	Current	MPC	Institute
Whey	N/A	Yes	Yes
Whey Adjuster	N/A	-$0.98	-$0.85
CRP Adjuster	+$0.464	+$0.464	-$0.17

Year	Current	MPC	Institute
	In Dollars per Hundredweight		
Change to Current California Class 1 Price			
2002	N/A	$0.04	-$0.56
2003	N/A	$0.00	-$0.56
2004	N/A	$0.23	-$0.29
2005	N/A	$0.54	$0.03
2006	N/A	$0.62	$0.12
5-Year Average	N/A	**$0.29**	**-$0.25**
Northern California Prices: Difference from Oregon Federal Class I Price			
2002	-$0.05	-$0.01	-$0.61
2003	$0.16	$0.16	-$0.40
2004	-$0.50	-$0.27	-$0.80
2005	-$0.61	-$0.07	-$0.58
2006	-$0.79	-$0.17	-$0.67
5-Year Average	**-$0.36**	**-$0.07**	**-$0.61**
Southern California Prices: Difference from Arizona Federal Class I Price			
2002	-$0.23	-$0.19	-$0.79
2003	-$0.02	-$0.02	-$0.58
2004	-$0.68	-$0.45	-$0.97
2005	-$0.79	-$0.25	-$0.76
2006	-$0.97	-$0.34	-$0.85
5-Year Average	**-$0.54**	**-$0.25**	**-$0.79**

The Relevance of the Dry Whey Factor

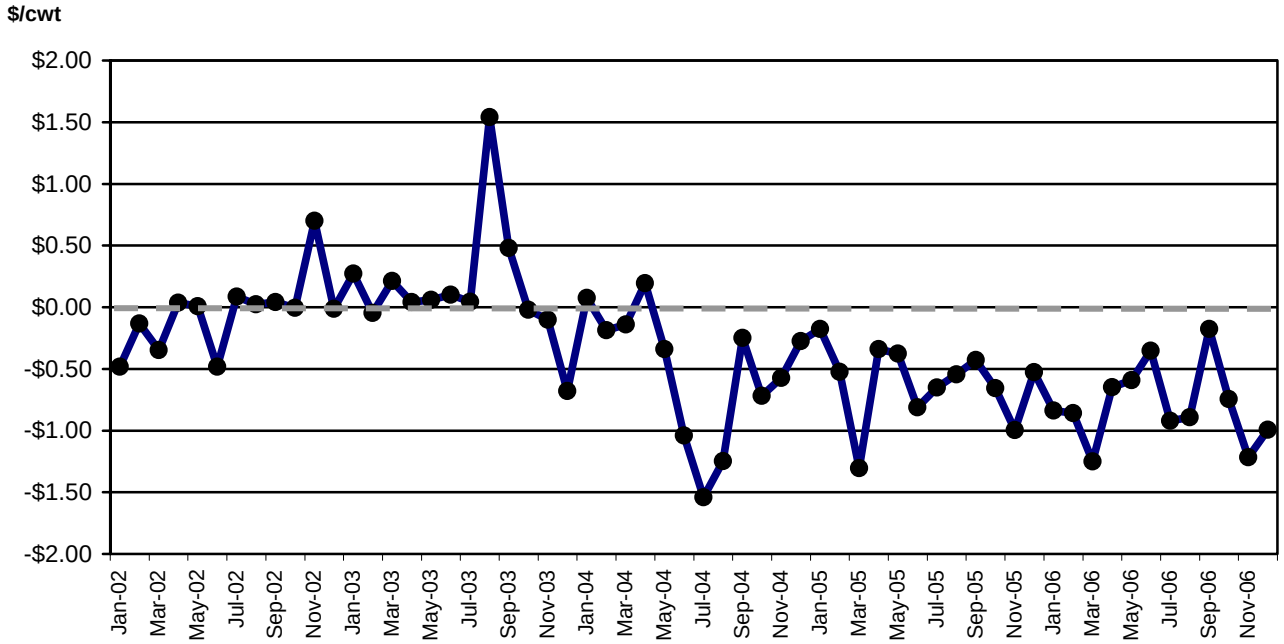
Given that a dry whey factor is currently included in the federal order Class I pricing formula, and in light of recent high, even record, dry whey prices, dry whey has continued to contribute substantially to federal order Class I prices. Figure 1 displays the total amount added to the federal Class I prices over the last five years, solely from the inclusion of dry whey in the formula.

Figure 1: The Dry Whey Factor: Its Impact on Federal Class I Prices
January 2002 – December 2006



In comparison, California Class 1 prices, which are not determined using a dry whey component, have sustained decreases in the level of Class 1 prices as compared to those of the federal order over the same time period (see Figure 2).

Figure 2: Current Northern California Class 1 Prices: Difference from Oregon
January 2002 – December 2006



The facts and evidence at the December 5, 2006 hearing demonstrate that high dry whey prices are driving the federal order fluid milk prices higher and creating a larger disparity with California's fluid milk prices. Before dry whey prices reached record high levels, the divergence of California prices from the federal order prices was less apparent and was less significant. In recent months the inclusion of dry whey in the federal pricing formula has increased the federal order prices by more than $1.30/cwt. At that level, a fixed adjustment of $0.44/cwt. or $0.39/cwt. would be insufficient in addressing the issue.

Panel Recommendation:
Include a dry whey factor in the CRP portion of the Class 1 pricing formula.

Dry Whey Adjuster

The most effective means of improving "tracking" with federal prices is to adopt the federal order formula outright. At the May 2005 hearings, the CDC proposal offered the potential to simplify the complexity of simultaneously addressing price alignment and price level between California and the contiguous states. The proposal called for amending California's Class 1 pricing formula to mirror the structure of the federal order Class I pricing formula. While there were significant concerns from industry participants in regards to this proposal, there is simply no question that having the California Class 1 pricing formula mirror the structure of the federal order Class I pricing formula would address most existing alignment issues between Class 1 prices in California versus those in contiguous states operating under a federal order. It would have been far easier for policy makers to distinguish proposals that improve price movement (tracking) versus those that primarily address the price level between California and its contiguous neighbors.

Testimony was received that suggested that the inclusion of the whey improved tracking with federal order Class 1 prices. Notably, while the inclusion of a dry whey factor would lead to slightly better tracking, it is not the only source of difference in the two pricing systems. The use of NASS commodity prices rather than those of the CME can be a greater cause for the lack of tracking from month-to-month, thus not all tracking issues will be resolved.

One measure of tracking refers to the synchronism with which both the federal order and California pricing system are using the same commodity when choosing between the "higher of" CRP. Improving the number of occasions when California and the federal orders are using the same "higher of" commodities is an objective measure of improved tracking.

Commodity Reference Price (CRP) Formula "Higher of"

Cheese/Dry whey: Cheddar Factor + Whey Butter Factor + **Dry Whey Factor**
or
Butter/Powder: Butter Factor + Powder Factor

For a more thorough description of the "higher of" concept as it relates to Class 1 prices, see the Class 1 Pricing Formula Diagram on page 7.

An analysis of this measure of tracking is presented in Table 6 below.

Table 6: Frequency With Which the Same "Higher Of" Component Is Used in California and Federal Order States January 2002 - December 2006

	Potential Adjuster		
	Current	**Institute**	**MPC**
	n.a.	**-$0.85**	**-$0.98**
CDFA Cheese/ Federal Butter	1	2	1
CDFA Butter/ Federal Cheese	15	2	5
Total Different "Higher Of" Components	**16**	**4**	**6**
Both Butter/Powder	13	12	13
Both Cheese	31	44	41
Total Same "Higher Of" Components	**44**	**56**	**54**

Over the last 5 years, there have been 16 instances when the two pricing systems used different CRPs. Fifteen of these times, the California pricing system used the butter/powder and the federal order used cheese/dry whey. Of the 16, 11 occurred between 2005 and 2006, all of which were instances in which the California system was using butter/powder and the federal system was using cheese/dry whey.

Adding a dry whey factor with an appropriate adjuster to the formula will improve the number of times both the federal order and the California order use the same “higher of” commodities to determine prices. Of the testimony provided, the Institute recommended the use of a dry whey factor, multiplied by the yield of 5.8, and an adjuster of -$0.85. MPC proposed a different adjuster of -$0.98 based on federal formula numbers. In analyzing the two adjusters, Table 6 shows the 16 instances in which the two systems did not match can be reduced to 6 using the -$0.98 adjuster and can be reduced even further to 4 using the -$0.85 adjuster. (To see the individual months when these differences occurred see Appendix B).

Panel Recommendation:
Include a dry whey adjuster of -$0.85 in the CRP formula.

Commodity Reference Price (CRP) Adjuster

Although it can be expected that improved tracking ought to lead to better price alignment, given the optimum dry whey adjuster to achieve the best tracking is -$0.85, any additional price alignment accounting for the value of whey is addressed through adjustments to the CRP adjuster. MPC testimony advocated that no change to the CRP adjuster was needed to account for dry whey. On the other end of the spectrum, the Institute proposal recommended a decrease of $0.634, from $0.464 to -$0.17, both as a means of accounting for dry whey and as a price level adjustment.

During the 5-year period 2002 to 2006, the MPC proposal would have resulted in either no change in the average annual price compared to the current pricing formula or only an increase. Incorporating the MPC proposal would ensure that the dairy producers captured the entire value of the dry whey factor. On the other hand, the Institute's proposal would raise the Class 1 price slightly in recent years, in light of record high dry whey prices, but would result in a decrease all other years and under circumstances of a dry whey price of about $0.26/lb. In other words incorporating the Institute's proposal would generally reduce the Class 1 price level in exchange for slight price increases when dry whey prices were high.

In the Panel view, the positions offered by MPC and Institute represent the high and low range for an appropriate CRP adjuster. In order to carefully evaluate the appropriate level of the CRP adjuster, it was critical that the Panel carefully consider:

- Class 1 price in relationship to the cost of milk production
- Alignment with federal order dry whey value
- Impact when butter/powder is the "higher of"
- Competitiveness with surrounding states

Each of these considerations are examined in more detail in the following sections.

Class 1 Price in Relationship to the Cost of Milk Production

The relatively high milk production costs and the inability of many dairy producers to cover their production costs is a key consideration for this hearing. At the Class 1 hearings in May 2005, plentiful national milk supplies and weakening commercial demand resulted in relatively low milk prices. Over the past 18 months, increasing milk production costs and continuing low milk prices have placed added financial pressures on California dairy producers. Feed costs in the form of higher prices for corn, soybean, and alfalfa hay as well as most milk production inputs have continued to increase since May 2005. Meanwhile dairy farms are facing increasing pressures to satisfy an increasing number of environmental regulations and mandates. Given the economic conditions facing dairy producers, the Panel is of the opinion that this is not the appropriate time to implement changes that would result in a general decrease in the Class 1 price level.

The Panel recognizes that based on the most recent dry whey prices, the addition of a dry whey factor could result in substantially higher prices for producers than a number of the hearing proposals would have provided for what appears to be the next few months.

Alignment with Federal Order Dry Whey Value

Those opposed to the inclusion of dry whey into the Class 1 pricing formula voiced concern that this method created the potential to decrease the Class 1 price whenever dry whey prices drop below a threshold/break-even level. Under the MPC proposal, this break-even dry-whey price would be $0.17/lb. The Institute testified that their proposal results in a break-even dry-whey price of $0.14/lb., however this is understated. Given the proposed change to the CRP adjuster, the actual break-even dry-whey price would be $0.256/lb., meaning that when dry whey prices go below $0.256/lb. the Class 1 price will be lower than it would have been under the current formula. *(Admittedly, Institute's proposal suggested some of the decrease in the CRP adjuster was to account for the dry whey factor and some for price alignment. However, since there were no specifics given on how much of the CRP adjustment was to account for dry whey, the entire change was used for the dry whey price break-even analysis.)*

The equivalent dry whey break-even in the federal Class I formula is $0.1956/lb. (the current federal Class III make allowance for dry whey). In the federal formula, when dry whey prices are below $0.1956/lb, there is a reduction to the Class I pricing formula, assuming that cheese/dry whey is the "higher of."

After much thoughtful deliberation, it was the consensus of the Panel that the goal of this adjustment should, as much as possible, ensure that when a dry whey price triggers a decrease/increase in the California Class 1 price, the federal Class I formula price will also decrease/increase, thus keeping California's Class 1 price in better alignment. The Panel determined that an adjuster of $0.147 would result in a break-even point of $0.2012/lb. which is very close to the $0.1956/lb. used in the federal Class I formula. While the absolute difference between federal and California fluid milk prices will continue to vary, largely as a result from the federal use of NASS commodity prices versus California's use of CME prices, the direct contribution from dry whey in both formulas will remain nearly equivalent, within $0.05/cwt. (see Appendix C)

In addition, given a direct comparison of the effect of a change in hundredweight commodity prices, with the inclusion of dry whey and all other factors being equal, the impact of commodity price changes affects the federal and California formulas similarly (see Table 7).

Table 7: Impact of a 1¢ Change in Commodity Prices on California Class 1 Prices (Current and Proposed), and Federal Order Class I Prices

(In Dollars per Hundredweight)

		Results in a hundredweight Class 1 price change of . . .		
A 1¢ per pound Change in the Price of . . .	**When the "higher of" is . . .**	**Current Formula**	**Panel Proposals**	**Federal Formula**
Butter	Cheese/Whey	$0.003	$0.003	$0.004
	Butter/Powder	$0.042	$0.042	$0.042
Nonfat Dry Milk	Butter/Powder	$0.086	$0.086	$0.086
Cheddar Cheese	Cheese/Whey	$0.098	$0.098	$0.097
Dry Whey	Cheese/Whey	N/A	$0.058	$0.059

Based on the calculations the Panel has made on the current dry whey values, adoption of a dry whey factor into the Class 1 pricing formula with a whey adjuster of -$0.85 and a CRP adjuster of $.0147 will provide an increase in Class 1 prices and some income relief to California dairy producers now and in the foreseeable future. Inclusion of the dry whey factor will also reduce the increasing disparity between California fluid milk prices and those in contiguous states.

The impact of the change in the CRP adjuster to $0.147 combined with a dry whey adjuster of -$0.85 is depicted in the following three tables:

Table 8: Change to Current Price and Difference between California and Federal Order Based on Panel Recommendation, January 2005-December 2006, Annual Averages

Year	Current California Class 1 Formula	Panel Proposed Formula
	Dollars per Hundredweight	
Change to Current Class 1 Prices		
2005	N/A	$0.35
2006	N/A	$0.44
Northern California Prices: Difference from Oregon Federal Class I Price		
2005	-$0.61	-$0.26
2006	-$0.79	-$0.35
Southern California Prices: Difference from Arizona Federal Class I Price		
2005	-$0.79	-$0.44
2006	-$0.97	-$0.53

Figure 3 – The Dry Whey Factor: Panel Recommendation Impact on California Class 1 Prices, January 2005 – December 2006

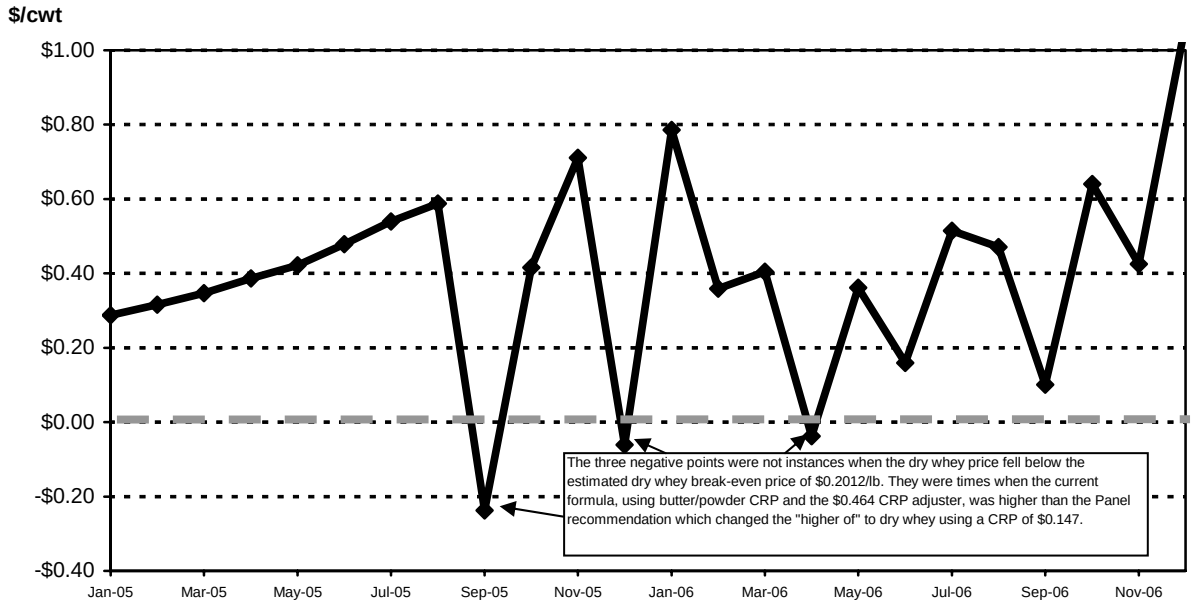
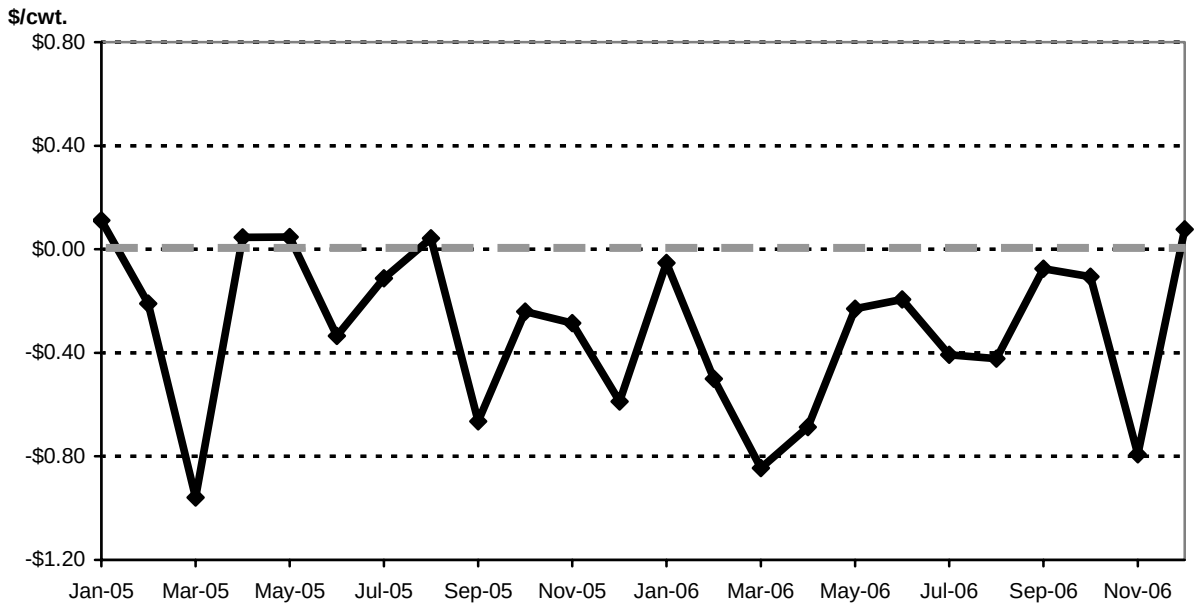


Figure 4: Panel Recommendations
Northern California Class 1 Prices: Difference from Oregon Class I Price
January 2005 – December 2006

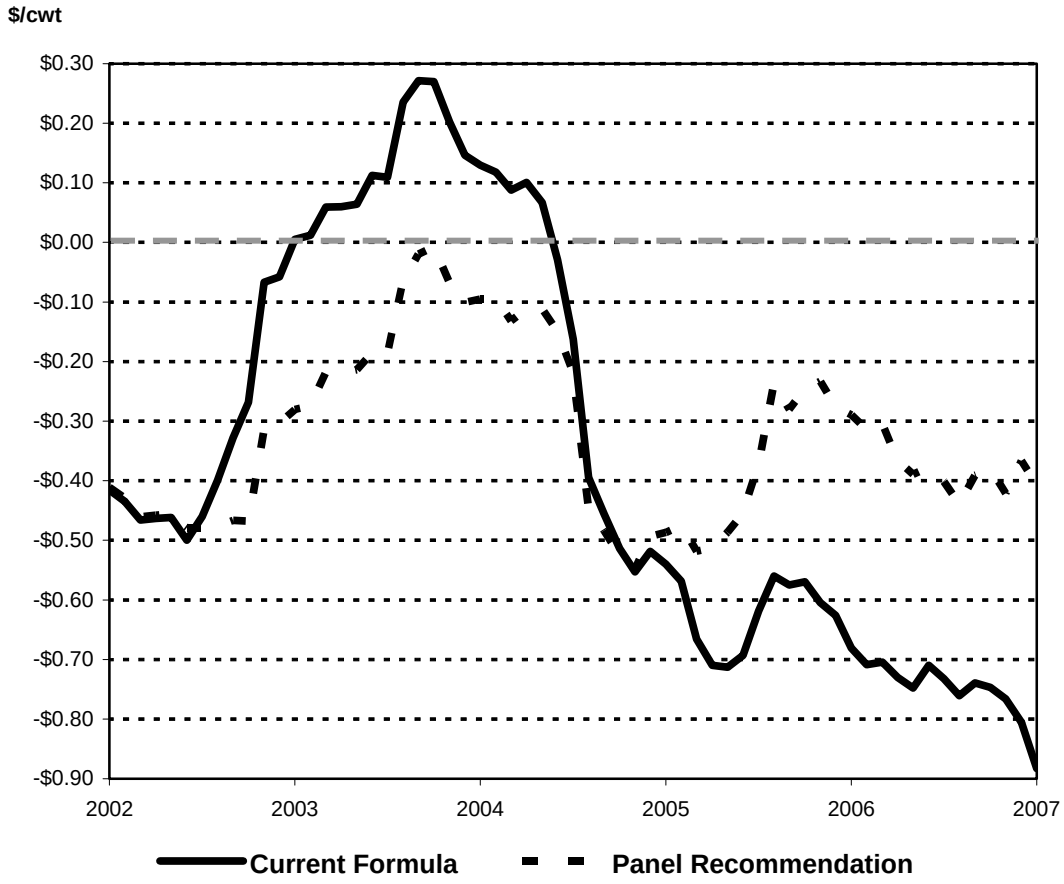


In January 2007, had the Panel recommendations been in effect, Class 1 prices would have increased by $1.23/cwt. This increase still would have left northern California Class 1 prices $0.53/cwt. below Oregon Class I prices for January 2007. Looking ahead at February 2007, Class 1 prices are expected to increase by an even higher amount.

Impact When Butter/Powder Is the "Higher Of"

The Panel is mindful that decreasing the CRP adjuster in an effort to equalize or compensate for some of the increase resulting from the inclusion of dry whey, has a consequence of lowering the price when the CRP is based on the butter/powder "higher of." This is apparent in the following figure as much of the time in 2002, the "higher of" is based on the "butter/powder" components.

Figure 5: Northern California Class 1 Price: Difference from Oregon Class I Current Formula and Panel Recommendations 12-month Rolling Average, January 2002 – January 2007



Ideally, in order to preserve the current pricing structure when butter/powder is the "higher of," the CRP adjuster for butter/powder would not change when the "higher of" is not based on cheese/dry whey. The Panel found the only way to achieve this objective and maintain tracking gains through the -$0.85 whey adjuster would be to assign a unique CRP adjuster to each of the CRP formulas. In months when the "higher of" CRP is determined from the cheese/dry whey formula, a CRP adjuster of $0.147 would be used. In months when the CRP is determined from the butter/powder "higher of," the current CRP adjuster of $0.464 would be used. This would be consistent with testimony provided by Alliance that changing the CRP formula to lessen the positive impact of adding dry whey would result in a "reduction of California Class 1 prices in relation to surrounding Class I prices when the butter/powder CRP is the "higher of."

However, given the complexity of this solution, the favorable outlook that dry whey prices will remain high at least in the foreseeable future, and the lack of industry input, the added complexity is not advisable at this time. Although the use of two CRP adjusters would avoid decreasing the price when the "higher of" CRP is chosen from butter/powder, this would have occurred only once between August 2003 and January 2007, given the Panel recommendation of a -$0.85 adjuster. (See Appendix B)

The Panel is of the opinion that if economic conditions change which cause the CRP to be consistently chosen from the butter/powder commodity, then this issue should be re-examined with full input from industry participants. The next 12 months will provide an opportunity to evaluate how well the proposed adjustments to the California Class 1 pricing formula track with the federal order Class I prices as well as any changes that may come as a result of the pending federal Class I hearing. Given the speed with which the California system can convene a hearing, should longer-term issues develop, they can be addressed quickly.

Competitiveness with Surrounding States

One issue affecting the competitiveness is the ability of out-of-state producers to bypass federal and state minimum pricing laws, not easily fixed through a pricing solution. Addressing this issue could mean that the California Class 1 price would have to be set close to the federal blend price in contiguous states.

The Panel remains concerned about the issue of the competitiveness of California fluid milk products as stated in prior Panel reports, but at this point it is not clear what level the Class 1 price needs to be below contiguous states to allow processors to compete. The review of proposals shows that even under the Panel's recommendations, the average price of fluid milk in California in 2006 would remain below both Oregon and Arizona by $0.35/cwt. and $0.53/cwt. respectively. (See Table 8) The available data on total California fluid milk sales is inconclusive, (there is no reliable information on the amount of packaged products entering the state). There is however, no evidence or testimony in the hearing record that the quantity of fluid milk products imported has increased since the last hearing.

Based on the May 2005 hearing record, the Panel recommended, in large part due to the then competitive situation facing California fluid milk products, a major reduction in the Class 1 price level. Yet there was no evidence or testimony in the December 5, 2006 hearing record that the quantity of fluid milk products imported into the state has increased appreciably since the last hearing.

The December 5, 2006 hearing record reflects concern by processor organizations and at least two producer organizations that unreasonable increases in California's Class 1 prices can provide additional margins to out-of-state milk supplies for serving California's fluid market; this could decrease the proportion of California's production in California's fluid market. Given California's significant milk supplies that are in closer proximity to its major markets, it is not in the long term interests of California (i.e., consumers, retailers, dairy farmers, dairy processors, and general public) that a significant proportion of California's fluid market is supplied by more distant regions outside California.

In order to thoroughly assess the issue of competition, more complete data on packaged products coming into California is needed as well as a more complete hearing record from industry participants on the issue. Within the next year the Department plans to explore options about getting the data necessary to address this concern. Without this data and additional process, the Panel believes it cannot make any recommendation based on competition with any degree of precision.

As is stands now, what is clear is that producers have been experiencing low prices and higher costs of production, and much of the current difference in price is a result of the value of dry whey included in the federal formula and not currently included in the California formula.

Panel Recommendation:
The Panel recommends a CRP adjuster of +$0.147.

This Hearing Panel Report has been prepared and submitted by:

_____	_____
David Ikari, Branch Chief	Candace Gates, Research Manager
_____	_____
Thomas W. Gossard, Ag. Economist	Hayley Boriss, Assoc. Ag. Economist

Appendix A

Summary of Panel Recommendations With Pros and Cons

Panel Recommendations:

- The fixed increases as recommended by petitioners be denied.
- Adopt a butter adjuster of -$0.118/lb.
- Include a dry whey factor with an adjuster of -$0.85 in the CRP portion of the Class 1 pricing formula.
- Adopt a CRP adjuster of +$0.147/cwt.

Price Effects of Panel Recommendations

Had the Panel recommendations been in effect from January 2002 to December 2006, the five-year average impact would have been:

- A Class 1 price increase of $0.06 per cwt.;
- An increase of $0.01 per cwt. for California pool prices.

Had the Panel recommendations been in effect for the last 12 months, January-December 2006, the average annual impact would have been:

- A Class 1 price increase of $0.44 per cwt.;
- An increase of $0.08 per cwt. for California pool prices.

Panel Recommendation Pros:

- Generally, producer Pool prices will be higher when cheese/whey is the “higher of.”
- Addition of the whey factor will result in better alignment between Class 1 and Class 4b prices
- Will enable California’s Class 1 prices to track significantly better with the Class I prices in contiguous states.
- Change will enable California’s Class 1 Price formula to reflect an economic factor (dry whey) that has been driving substantial price increases over the past year in contiguous states.
- Based on the most recent dry whey value, the resulting increase in the California Class 1 price will provide welcome income relief to California dairy producers.
- Increasing milk production costs, especially feed costs in the form of higher prices for corn, soybean, and alfalfa, and continuing low milk prices have placed added financial pressures on California dairy producers.

Panel Recommendation Cons:

- Consumers may see an increase in retail milk prices.
- May make California fluid milk products less competitive.

- May result in less consumption of California fluid milk products.
- Does not provide income relief to dairy producers that the Alliance or WUD proposal would have if the market conditions change and the “higher of” driver in the Class 1 price becomes the butter/powder commodities.
- Generally, producer Pool prices will be lower when butter/powder is the “higher of.”

Appendix B

Frequency with Which the Federal and California Formulas Use the Same Commodities in Determining "Higher Of" Components

1 = Formula Uses Cheese "Higher Of"			2 = Formula Uses Butter/Powder "Higher Of"			
Year	**Federal Formula With Whey**	**Current California Formula**	**Alliance Proposal**	**Western United Proposal**	**-$0.85 Whey Adjuster**	**-$0.98 Whey Adjuster**
Jan-02	**1**	**2**	**2**	**2**	1	1
Feb-02	**1**	**2**	**2**	**2**	1	**2**
Mar-02	**1**	**2**	**2**	**2**	**2**	**2**
Apr-02	2	2	2	2	2	2
May-02	2	2	2	2	2	2
Jun-02	1	1	1	1	1	1
Jul-02	2	2	2	2	2	2
Aug-02	2	2	2	2	2	2
Sep-02	2	2	2	2	2	2
Oct-02	2	2	2	2	2	2
Nov-02	1	1	1	1	1	1
Dec-02	2	2	2	2	2	2
Jan-03	2	2	2	2	2	2
Feb-03	2	2	2	2	2	2
Mar-03	1	1	1	1	1	1
Apr-03	2	2	2	2	2	2
May-03	2	2	2	2	2	2
Jun-03	**1**	1	1	1	1	**2**
Jul-03	2	2	2	2	2	2
Aug-03	1	1	1	1	1	1
Sep-03	1	1	1	1	1	1
Oct-03	1	1	1	1	1	1
Nov-03	1	1	1	1	1	1
Dec-03	1	1	1	1	1	1
Jan-04	1	1	1	1	1	1
Feb-04	1	1	1	1	1	1
Mar-04	**2**	2	2	2	**1**	2
Apr-04	**2**	**1**	**1**	**1**	**1**	**1**
May-04	1	1	1	1	1	1
Jun-04	1	1	1	1	1	1
Jul-04	1	1	1	1	1	1
Aug-04	**1**	**2**	**2**	**2**	**2**	**2**
Sep-04	1	1	1	1	1	1
Oct-04	1	1	1	1	1	1
Nov-04	1	1	1	1	1	1
Dec-04	1	1	1	1	1	1
Jan-05	1	1	1	1	1	1
Feb-05	1	1	1	1	1	1
Mar-05	1	1	1	1	1	1
Apr-05	1	1	1	1	1	1
May-05	1	1	1	1	1	1
Jun-05	1	1	1	1	1	1
Jul-05	1	1	1	1	1	1
Aug-05	1	1	1	1	1	1
Sep-05	**1**	**2**	**2**	**2**	1	**2**
Oct-05	**1**	**2**	**2**	**2**	1	1
Nov-05	1	1	1	1	1	1
Dec-05	**1**	**2**	**2**	**2**	1	1
Jan-06	1	1	1	1	1	1
Feb-06	**1**	**2**	**2**	**2**	1	1
Mar-06	**1**	**2**	**2**	**2**	1	1
Apr-06	**1**	**2**	**2**	**2**	1	1
May-06	**1**	**2**	**2**	**2**	1	1
Jun-06	**1**	**2**	**2**	**2**	1	1
Jul-06	1	1	1	1	1	1
Aug-06	**1**	**2**	**2**	**2**	1	1
Sep-06	**1**	**2**	**2**	**2**	1	1
Oct-06	1	1	1	1	1	1
Nov-06	**1**	**2**	**2**	**2**	1	1
Dec-06	1	1	1	1	1	1
Times Using Different "Higher Of"	-------	16	16	16	4	6

Boxes with shading or dot pattern indicates when the federal formula and other formula are using different "higher of" components

Appendix C

Analysis of the Value of Dry Whey in the Federal Formula and Panel Recommended Formula Change

	Added Value from Inclusion of Whey Alone	
	CALIFORNIA	**FEDERAL CONTIGUOUS STATES**
	Panel Recommendation	**Federal Formula**
	Yield=5.8; Dry Whey Adjuster = -.085; CRP Adjuster Change from .464 to .147 = -.317	**(((Whey Price-0.1956)*1.03)*5.9)*0.965**
Hypothetical Whey Price	**Cwt. Change to Class 1 Price**	**Cwt. Change to Class I Price**
0.50	$1.73	$1.79
0.48	$1.62	$1.67
0.46	$1.50	$1.55
0.44	$1.39	$1.43
0.42	$1.27	$1.32
0.40	$1.15	$1.20
0.38	$1.04	$1.08
0.36	$0.92	$0.96
0.34	$0.81	$0.85
0.32	$0.69	$0.73
0.30	$0.57	$0.61
0.28	$0.46	$0.49
0.26	$0.34	$0.38
0.24	$0.23	$0.26
0.22	$0.11	$0.14
0.2012	**$0.00**	$0.03
0.20	-$0.01	$0.03
0.1956	-$0.03	**$0.00**
0.18	-$0.12	-$0.09
0.16	-$0.24	-$0.21
0.14	-$0.36	-$0.33
0.12	-$0.47	-$0.44

= Break-Even Dry Whey Price

Equivalent Linear Regression	Equivalent Linear Regression
y = 5.8x - 1.167	y = 5.8643x - 1.1471
(-1.167 = -0.85 + -0.317)	

Appendix D

SUMMARY OF TESTIMONY

ALLIANCE OF WESTERN MILK PRODUCERS – Jim Tillison

Alliance interprets Section 62062.1 of the Food and Agricultural Code as meaning California's statewide weighted average minimum Class 1 price level must be reasonably near the price level of the minimum prices paid in contiguous states.

- A reasonable relationship between Class 1 prices has not existed for the last two years.

- Since a simple comparison of California's weighted average price reflected that:
  - The 2005 annual weighted average was $15.87 per cwt.
    - ✓ It was 7¢ per cwt. higher than Southern Nevada
    - ✓ It was 43¢ per cwt. lower than Western Oregon
    - ✓ It was 99¢ per cwt. lower than Arizona
  - The 2006 annual weighted average was $13.17.
    - ✓ It was 11¢ per cwt lower than Southern Nevada
    - ✓ It was 61¢ per cwt. lower than Western Oregon
    - ✓ It was 81¢ per cwt. lower than Southwestern Arizona
- Therefore it is reasonable to
  - Adjust the Class 1 butter fat value downward and increase the value in the solids-not-fat and fluid carrier price components
  - Increase the Commodity Reference Price Adjustment factor in both the SNF and fluid carrier portions of the formula from 46.4¢ to 85¢.

- The Alliance presented three tables comparing the relative differences of the current pricing formula, the three proposals using
  - the California weighted average Class 1 price against the Medford, Oregon;
  - the Northern California Class 1 price less Medford, Oregon
  - the Southern California Class 1 price less Yuma, Arizona
  - All the tables reflected that the current pricing formula had the largest difference, with the Dairy Institute proposal's the second largest, the Alliance the third largest, and the Western United proposal the narrowest difference.

- The Alliance would not be opposed to the adoption of the WUD proposal.

- The Alliance proposes to adjust the Class 1 butterfat value by subtracting an additional 2.16¢ to bring the fat values into a more reasonable relationship and increase the solids-not-fat and fluid carrier price components.

- An adjustment of the CRP adjustment factor from 46.4¢ to 85¢ should be made to allow a more reasonable relationship between California Class 1 prices and those prices in contiguous states.

- The 2006 year data is the only relevant data on which any decision should be based. Five-year averages don't really tell the story.

- Year-to-year differences are due to CME cash prices used in California compared to federal orders use of NASS prices and the lag between those prices, CME price volatility exacerbated by the lag effect, and the higher of CRP versus the higher of Class III or Class IV skim milk values.

- Because each year the Department is required to look at the Class 1 price relationships, if the adjustments recommended by the Alliance result in 2007 prices not being in a reasonable relationship, another hearing should be held.

- According to Mark French (Executive Director of the Nevada Dairy Commission) no packaged milk from Las Vegas is moving into Southern California, making Southern Nevada bulk and packaged milk a non-issue for California producers and processors - should not be a major factor in determining what adjustments should be made to the California Class 1 producer milk price.

- The Western United proposal is very similar to the Alliance proposal and the Alliance would not be opposed to it being adopted.

- The Alliance testified it is opposed to adding a whey factor to the cheese CRP.

- The Alliance is opposed to adding a whey factor to the cheese CRP as no other commodity value in the CRP formulas includes an adjustment to reduce the commodity value as the 85¢ does for whey. And at the federal level, producer organizations are struggling with how to get away from changes in manufacturing allowances in cheese and butter/powder formulas reducing Class I milk values.

- The analysis comparing how often California and federal order class I prices use the same commodity to determine the "higher of" basis for calculating Class I prices is not an effective measure of how milk prices track.

- Comparing California Class 1 prices under any of the proposals to the federal order Class I base prices show that none of the proposals, including Dairy Institute's, provide significantly better price tracking than the current formula.

WESTERN UNITED DAIRYMEN – Tiffany LaMendola

- Adjusting the Class 1 fat price by $.02/pound and increasing the Commodity Reference Price adjuster from $.464 to $.90 will increase the hundredweight price by $0.44 and bring California's Class 1 price into better alignment with surrounding areas.

- The dynamics surrounding the fluid bottler in Arizona that used to be able to always undercut the competition are much different today than they were at the last Class 1 hearing and under Western United's proposal, Southern California processors will still enjoy a $.24 per hundredweight or $.021 per gallon raw product cost advantage over the bottler in Yuma, AZ.

- The threat of out-of-state bulk milk shipments has to do with the incentive to purchase milk from more "competitive sources," which is not a direct effect of California's Class 1

prices being too high, but rather the way this more “competitive” milk was, and currently is, handled in the California pool.

- Since April 2004 and as a result of the Hillside-Ponderosa lawsuit, out of state sourced milk used for Class 1 purposes is credited at the Class 1 price and therefore is essentially exempt from pool obligations. The advantage made available by the inability to regulate interstate commerce will exist regardless of the level of the Class 1 price.

- Based on conversations with the Nevada Dairy Commission, there is not a growing milk shed available in Nevada from which to supply California. The portion of Northern Nevada bulk milked shipped into Northern California is based on a long standing relationship that is unlikely to change from current levels.

- We do not foresee nor expect any sizeable increases in bulk shipments into California from Nevada, but were surprised to see increases in imports in 2006. Since we are not aware of any new dairies or major expansions it is easy to assume that some of this milk has been “round-tripped”

- A recent downward trend is noticeable both in terms of the bulk imports from Arizona and the difference in prices. The inclusion of two large fluid processing plants in the Arizona pool has likely enhanced the Arizona uniform price, making it less attractive to export to California. Rough estimates show their addition may have increased the hundredweight price by $1.28. Also, transportation costs are also high and milk production growth has not been as large as in other Western states like New Mexico, Idaho and California.

- The findings from the 2005 Class 1 hearing clearly outline that a reduction to the regulated Class 1 price is not the appropriate mechanism to deal with a round-tripping problem.

- The proported benefit to the consumer should not be used as justification from maintaining or lowering the current Class 1 price. The legislature recognized the complexities in retail pricing of milk, which is “affected by a large number of economic and other factors apart form minimum producer prices for market milk, many of which factors are not within the power of the director to regulate or control.”

- Other factors, besides price, may have played a role in expansion of production by producers. These include the lag that exists between planting/breeding decisions and realization of output, opportunity costs determining supply relationships (which are difficult to determine empirically), short-run changes in output as a result of weather, pests, and long run changes in supply attributable to improved technology, and higher prices resulting in more rapid adoption of new techniques. Therefore, milk production alone should not be viewed as sole indication that producers are making adequate incomes.

- Other concerns include a building debt base not easily removable, fluid plants located in areas of declining production/relocation leading to increased costs on the transportation system, and cheese manufacturers encouraging a switch to Grade B production to receive the 4b price.

- Statewide cost of production figures/mailbox prices reveal the average CA producer has operated on a close to zero or negative margin in four of the last six years and spikes in feed costs will make this worse.

- If the Department wishes to promote lower retail prices, it needs to look at other levels of the marketing chain and determine why such a large farm-to-retail spreads are maintained in California over other states.

- Kenneth Bailey notes justifications for higher Class 1 prices include: increased costs to maintain Grade A producers, higher transportation costs, and ability to price discriminate.

- When producers made the commitment to ensure adequate supplies to the Class 1 market it was thought the Class 1 market would continue to expand which has not occurred. Support for justified increases to transportation allowances is dwindling.

- Since March 1993, the Class 1 price has been increased only once, in 1993, and reduced four times, in 1993, 1997, 1999, and 2000.

- A precise representation of California Class 1 sales has not been achieved. The data must also include packaged Class 1 products sent directly to wholesale and retail customers in California from out of state plants and California packaged product sold outside California. Therefore the data is incomplete and should not be used in setting the price.

- Use of Class 1 should be represented as actual pounds rather than percentage, which can be misleading.

- The Producer-Handler advantage is limited given that the level of their exemption is static and they are required to compete at the same price level with the remainder of their production. The affect of the Western United proposal on the PD advantage would be miniscule in comparison to total exemption and the only way to establish a uniform price with PDs would be to eliminate their exemption entirely.

- “Reasonable” should be viewed as a price that allows California processors to be competitive, but at the same time provides a fair return to producers.

- California processors have been competitive in nearby out-of-state markets with their share of Class 1 packaged sales in Nevada increasing and now comprise 20 percent of Nevada’s Class 1 sales.

- The northern Nevada Class 1 price is set equal to the northern California Class 1 price, thus any change to California’s price should have no impact on the current dynamics in this market.

- In southern Nevada, 30 percent of milk used by Meadow Gold fluid plant (one of the two fluid processors in the area) is supplied by California sources. The Las Vegas market is growing and California is the closer source of milk, with the Las Vegas plant built with the intention to serve the Las Vegas market it is unlikely it will compete for a share of the

California market. The passage of MREA has also given California processors a competitive advantage.

- The Western United proposal will still keep northern California fluid processors competitive with Oregon as they will still enjoy a $0.31 per hundredweight advantage.

- Because the Institute's proposal of a negative differential to the CRP, and that a drop in dry whey prices could lead to a significant reduction in the Class 1 price, which is contrary to the outcome we are proposing, we do not support their proposal

DAIRY INSTITUTE – Bill Schiek

- In establishing the pricing formulas, the Secretary must weigh the factors found within the statute. Since section 61801 declares that milk production and marketing is a business that affects the public interest, the dairy program must be operated so that the public interest is served. The Institute cited the additional statutes:

  - That prices promote, foster, and encourage intelligent production and orderly marketing of milk and to eliminate economic waste (Sec. 61802(e))
  - That Prices are fair and reasonable to consumers (Sec. 61802(h) & Sec. 62062(b))
  - Secretary must consider how pricing formulas provide for uniform milk prices to handlers operating within the marketing areas (Sec. 61805(b))
  - Combined producer revenues from all classes of milk must be sufficient to result in an adequate supply of milk for all purposes which is vital to the public health and welfare (Sec. 61802 (1-d) and Sec. 62062(b))
  - That in setting such milk prices Secretary shall consider the milk production costs (Sec. 62062(a)).
  - That Class 1 prices are in reasonable relationship to Class 1 prices in surrounding states (Sec. 62062.1)
  - That prices for market milk bear a reasonable and sound relationship to each other (Sec. 62062©)
  - Conform the pricing standards governing minimum producer prices to current economic conditions (Sec. 61802(g))
  - Consider any other relevant economic factors in setting milk prices that are not explicitly set for the in the Code (Sec. 62062)).

- The department must look beyond the confines of a single Section of the Code. The Secretary must consider how to set pricing formulas that ensure all the declared intentions of the legislature are met as closely as possible.

- The current Stabilization Plans fail to conform to the Statutory Directives because the Class 1 prices are too high relative to the manufacturing classes of milk and relative to the Class 1 prices in surrounding states.
  - Specific argument contain in Institute's May 3 & 6, 2005 testimony (hearing brief #43).

- Increasing the overall Class price level would only worsen the failure of the existing Stab Plan to meet the statutes.

- The existing Class 1 pricing formula does not track the movement of Class 1 prices in contiguous states as well as it could.

- Institute's proposal would reduce the overall Class 1 price level in both Northern and Southern California, and in doing so would bring the current plans more in line with statutory requirements.

- Under certain market conditions, Institute testified that its proposal to include the dry whey factor in the commodity reference price calculation would result in higher Class 1 prices than does the current formula.

- Institute testified that the addition of dry whey factor would improve the tracking of California prices with those in surrounding states which are driven by Federal order pricing formulas.
  - The Federal Order Formulas currently include a dry whey factor and California Class 1 prices do not.
  - In recent years, the dry whey prices have increased significantly, and the disparity between the California and federal formulas has created a disconnection between the Class 1 Price movements in California compared to surrounding states.
  - Institute's proposal will result in better alignment of prices thr4ough time, over a broader range of dairy commodity markets.

- Institute testified that it is proposing a change to the Commodity Reference Price adjuster- a decrease in the adjuster value from its current +$0.464 to a new value of -$0.17 both as a means to establish an appropriate level for California's Class 1 price differential given the state's status of being the regulated dairy market with the nation's lowest Class 1 utilization percentage.

- Institute testified that it is also proposing shifting some of the Class 1 value from the fat component to the Skim to bring the fat price in better alignment with surrounding states.
  - Majority of California processed milk that is sold outside California market is processed to federal standards.

- Institute emphasized in its testimony that its proposal would:
  - Do a better job than the current formula in tracking federal order Class 1 price movements.
  - Would reflect an overall price level that is appropriate given
    1. California's low Class 1 utilization
    2. And California's competitive position with regard to out-of-state-milk supplies.

- Institute testified that the net impact of their proposed adjustments would lower the California Class 1 price by about 35 cent per cwt. under the average prices generated by the current formula.

- Institute testified that the lower California Class 1 price level would make the average Class 1 price more consistent with the economic basis (policy) used to establish Class I price levels by the Federal order system throughout the rest of the nation.
  - Federal Order Class I price levels are highest in the milk production regions of the nation where the milk production relative to the Class I usage in that region are insufficient.
  - Federal Order Class I price levels are the lowest in the milk production regions of the nation where milk production relative to the Class I utilization is surplus quantities.

- A mathematical relationship between the Class I utilization and the Federal Class 1 differentials was used to by the Institute to determine that a reduction of 35 cent per cwt. level is appropriate for California (which would result in a $1.80 differential).

- Institute testified that dairy producer organizations had attempted to insert language into Section 62062.1 that would have set California prices at specific levels relative to those in surrounding states. The proposal was rejected by the Legislature and the terms "reasonable relationship was adopted instead. Therefore, the Legislature clearly did not mean that the term "reasonable relationship" should be interpreted in all cases and at all time to mean "equal prices."

- Institute testified that is not sound economic policy to establish minimum price levels that discourage the use of the closest milk in serving the State's Class 1 market.
  - Packaged milk from out of state sources is moving into Southern California.
  - Economic incentives exist that would allow processors the opportunity to procure raw milk supplies by alternative means from inside and outside the state at a net cost that is below the regulated Class 1 price.
  - Lowering the Class 1 price level would encourage the use of closer California milk production to supply the local Class 1 markets, thereby promoting an economically efficient policy and encourage more orderly & intelligent use of available milk supplies.

- Institute questioned the logic of trying to increase producer revenues by raising the Class 1 price from a practical standpoint.
  - With Class 1 usage at about 14.3%, a $1.00 per cwt. increase in Class 1 price would increase the pool revenues by about 14.3 cents
    - ✓ The $1 increase would likely raise the retail fluid milk price
    - ✓ The $1 increase would add to the economic incentive for companies outside of California to ship their milk into California to obtain fluid sales.
      - Out –of-state producers would receive most of the $1.00 increase. While California producers would receive about 14.3 cents via the pool blend.

- Any increase in the Class 1 price relative to the manufacturing class prices, increases the advantage that the exempt producer distributor have over those processors that are mandated to pay the regulated minimum price.
  - The advantage that exempt P/D has averaged $1.21 per cwt. (10.4 cents per gallon in southern California - $0.93 per cwt. 8.0 cents per gallon) in Northern California.
  - Currently P/D account for 20% of all California Class 1 sales.
  - P/D amounts to 2.08 cents pr gallon on the entire sales of Class 1 in Southern California; and 1.6 cents on the total sales in Northern California.
  - In a business where accounts are won and lost on price difference of a few hundredths of a cent per gallon the advantage is enormous.

- Oppose the proposal of WUD and Alliance since both would increase overall Class 1 price levels.
  - If either the Alliance or WUD proposals are adopted and whey prices decline from their current levels, California processors will be at a further competitive disadvantage with out-of-state products.
  - Both WUD and Alliance proposals do nothing to improve the tracking of California prices with those in neighboring states.

- Adjusting milk prices to address transitory events (low milk prices caused by surplus production) can create permanent damage to the state's competitive position.
- The Institute's proposal is better suited to provide short-term price relief for producers while maintaining the overall competitiveness of California's class 1 products.
- The Institute's proposal actually results in higher Class 1 price and pool revenues than the proposal offered by WUD and the Alliance.

UNITED WESTERN GROCERS – John Bedrosian

- Support Dairy Institute proposal because it provides equitable pricing alignment, better tracking of federal Class I.
- In 2005, lost 17.9 million pounds milk annually to Arizona processor – strictly because they could offer a better price.
- Potential situation of losing several large accounts that operate dry and refrigerated warehouses and distribution systems – they will go elsewhere if they can get a better price, have milk shipped directly to them and then self distribute (90 million pounds annually).

SUPER STORE INDUSTRIES – Dennis Brimhall

- Support Dairy Institute proposal, including the dry whey factor to improve tracking of prices with regulated Class I prices.
- Competitive pressure at retail level in Northern California is from Western Nevada (Reno) – competing stores in this area receive milk from various sources, including Utah which is not regulated.
- If the Northern California Class 1 price increases, then will be higher than retail prices in the out of state area (Nevada) in which we face stiff competition.
- Class 1 price increase will open door to encourage importation of lower cost out of state processed milk – creating a competitive disadvantage.
- Submitted graphs of California lowest lawful and Nevada lowest retail prices.

DEAN FOODS COMPANY, INC. – Evan Kinser

- Supports Institute proposal.
- Continues to support testimony by Ernest Yates at the May 3, 2005 Class 1 hearing (Exhibit 43).
- Mis-alignment of Class 1 formula creates opportunity for flow of unregulated milk into California.
- Current Class 1 differential is too high relative to similar utilization markets. Growth of California's milk production continues to outpace demand for Class 1 milk.
- Still opportunities and economic incentives for existing regulation to be short-circuited, because CDFA can't stop out of state milk from entering.
- Competition with out of state milk in the southern area of California is still ongoing.
- Feel that the WUD and Alliance proposals will increase the price advantage of out of state milk.
- Affirm the Institute proposal to help the Class 1 formula track with federal formula – even though it will ultimately raise the current Class 1 price, it is a modest increase and dairy producers are also having hard economical times. Would not want a drastic reduction in Class 1 price right now.

- Over last 5 years, the Pool has lost about $148 million to out of state milk in lost Class 1 sales.
- Presented a Table 4 outlining cost advantages of out of state bulk milk in northern California.

CRYSTAL CREAM & BUTTER – Sharon Hale

- Support Institute proposal.
- In support of realigning the butterfat and solids-not-fat component prices.
- In support of adding the dry whey factor to the Class 1 formula.
- Oregon, Washington and Nevada continue to send packaged milk into California – the majority of which is from Darigold.
- Urge the Department to be vigilant in enforcing California standards on fluid milk sold in California.
- Out of state plants have an advantage over California plants as their cost of doing business is less.
- Disagree with WUD and Alliance differential proposal – believe it would enhance competitive position of out of state processors.
- PD exemption is a disadvantage to other California plants. Over past five years, raw product cost advantage for PD's on exempt milk is $.824 per cwt. – 7¢ per gallon.
- The Alliance and WUD proposals would increase the PD advantage.

LAND O'LAKES, INC. – James Gruebele

- In support of Alliance proposal to increase Class 1 price by about 39¢ per cwt.
- Need to lessen the price difference spread between California Class 1 and federal order markets.
- Agree with the adjustment to the fat formula as it will bring the low fat, reduced fat, and skim milks more in alignment with federal order markets.
- Alliance proposal brings Class 1 price up to be just a little lower than Phoenix market, but in better relationship.
- LOL is concerned about out of state milk coming in – about 1.3 to 1.4 million pounds of milk per day.
- Out of state milk coming in is taking money directly out of the Pool.
- Even though increasing the Class 1 price would encourage additional milk to come in from out of state, LOL believes overall pool revenue for producers in California will be enhanced by the Alliance proposal.
- WUD proposal would slightly increase risk from out of state milk.
- Producers prices have been low and feed costs have increased significantly in recent months.

DRIFTWOOD DAIRY – James Dolan

- Support Institute proposal.
- Need to stabilize differential between California and neighboring states.
- Federal orders have announced a Class 1 hearing to address formula issues – California need to take into consideration any changes made to their formulas.

MILK PRODUCERS COUNCIL – William Van Dam

- 25 percent of fluid milk sold in Southern California is coming in from out of state.
- The So. California Class 1 price could be modestly increased without creating meaningful additional incentives to import more milk.
- Federal Class I price includes a dry whey factor that pushes its price higher compared to California (which does not include whey factor).
- Value of whey has increased which has caused significant increase in price spread between So. California and Arizona.
- Having this high whey value has lessened incentive to move milk from Arizona to California.
- Arizona blend price has increased since addition of Sarah Farms and G&H Dairy into the Arizona Pool – an increase of 40 percent in the volume of Class I milk pooled.
- Producers are facing increased costs and need price relief, yet are worried that raising the Class 1 price by the methods suggested by WUD and Alliance will only increase the incentive to move milk in from out of state.
- Agree with the amount of increase in Class 1 price as a result of Alliance and WUD proposals, but not the method.
- Supports adding a whey factor to the commodity reference price – but not at the price level proposed by Institute.
- Must make our formulas move with the same factors as those in the federal orders.
- Addition of whey factor will result in better tracking of formulas and stabilize incentives that exist between markets and pass the whey driven price increases to producers.
- Agree with Institute for the need of the whey factor and the adjustment factor to reduce value of cheese CRP.
- We support the Institute 85¢ adjustment to the whey factor. However, we would rather have 98¢ be the adjustment which is the difference in the federal order formulas between the total make allowances per cwt. applied to Class III and Class IV milk.
- Do not agree with reducing the “plus” differential. Do not support addition of whey factor if differential is left at current 46.6¢, or if reduced further.

GENSKE and MULDER – Albert Nunes

- Testimony was presented verbally with no written narrative.

CALIFORNIA DAIRY CAMPAIGN – Kevin Abernathy

- Support MPC position calling for addition of whey factor to the commodity reference price.
- Adding whey factor will limit fluctuation between the California Class 1 price and federal order prices.
- Oppose the part of the Institute proposal calling for pricing adjustments that would substantially reduce Class 1 price.
- Decreasing Class 1 price would widen gap between federal order and California prices.
- Support efforts of WUD and Alliance to increase Class 1 prices, but consider it important to eliminate variation between federal and state prices.

SUMMARY OF THE POST-HEARING BRIEFS

ALLIANCE OF WESTERN MILK PRODUCERS – Jim Tillison

- Opposes Institute's proposal to lower producer prices.
- Milk available in Riverside and San Bernardino has fallen nearly 50% and 25% respectively in last 5 years.
- Implied differential for southern California is too low.
- Do not believe that adding a whey factor will result in federal formula and California formula tracking better.
- Adding a whey factor with a make allowance (adjustment factor) can result in reduction in cheese CRP not related to the cheese commodity value – will occur when the whey price falls below 17¢.
- Retail milk prices in contiguous states are lower than California even though farm prices in California are lower.
- Demographic differences in California vs. U. S. account for much of the differences in consumption in California and the U.S. Half of the population (Hispanic and Asian) in California are not considered regular milk drinkers.

MILK PRODUCERS COUNCIL – William Van Dam

- Do not agree with Institute's proposal to change the differential – MPC proposes to leave $0.464 as the differential.
- Adding a whey factor will bring CA formula and federal order formula closer in alignment.
- Supports WUD asking CDFA to look into increase in milk flow into Southern California from Nevada.
- A lower Class 1 price when formula using butter/powder as higher of will help in preventing increases in the incentives to import milk into California from Arizona and Oregon.

WESTERN UNITED DAIRYMEN – Mike Marsh

- Clarifying testimony regarding the Milk Regulatory Equity Act (MREA).
- MREA was designed to level the playing field ensuring all plants located within a federally-regulated milk market area, and all market milk in a state which has regulated minimum milk prices under a state government's authority, will be regulated by that federal order.
- A plant located in a federal order in Colorado changed its sales and distribution patterns in order to avoid being regulated by federal order under MREA – this scenario illustrates that the MREA legislation's intent was broader than the regulation of a single plant.

DEAN FOODS – Evan Kinser

- Responded to question from Panel member on source of data presented in their testimony – answered that it was data from the Workshop Analysis.
- Favor or would support proposal by MPC (though not at the enhanced price level they suggest) over the other alternatives.
- Non-California regulated milk coming into the state continues to drive market pricing.

- Losing Class 1 dollars and more pool dollars flowing out of state could cost plant capacity in California as processors lose business and are forced to consolidate to remain efficient.
- Support Institute proposal to lower Class 1 price in northern and southern California marketing areas.
- Believe CA Class 1 price is out of alignment with alternative supplies and other class prices.

DAIRY INSTITUTE OF CALIFORNIA – William Schiek

- Increase in Class 1 price will hurt ability of California processors to supply Class 1 market in Las Vegas. Some of the sales from California plants to Las Vegas stores occur when the processor supplying the milk and the retailer buying the milk are under common ownership.
- Original calculation of the Northern California P-D advantage was understated – should have used the quota price that would be available to the PD ranch operation, net of any quota adjusters. The Northern California P-D advantage averaged $120/cwt. ($.104/gallon) – about same as Southern California P-D advantage.
- Do not support MPC proposal that would increase the long-run average Class 1 price level so substantially, because it would negatively impact the competitiveness of California processors.