— HEARING PANEL REPORT —

ADDRESSING MILK MOVEMENT ISSUES CONTAINED IN THE
MILK POOLING PLAN FOR MARKET MILK AND THE
STABILIZATION AND MARKETING PLANS
FOR NORTHERN AND SOUTHERN CALIFORNIA
BASED UPON A PUBLIC HEARING HELD ON

AUGUST 4, 2004

This Report of the Hearing Panel regarding proposed amendments to the Milk Pooling Plan for Market Milk (Pool Plan) and to the Stabilization and Marketing Plans for Northern California and Southern California (Stab 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 August 4, 2004, and written post hearing briefs.

During the hearing process, testimony and evidence was presented that referenced interstate commerce issues. The Panel has purposely avoided consideration of and basing its decisions on interstate commerce issues. The panel believes that the interstate commerce issues will be best handled by the competitive market place. While some quotes mention this issue, their intention was to give the reader a sense of the discussion and not to indicate that it influenced the Panel's final recommendations.

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Introduction and Witnesses

The Department of Food and Agriculture (Department) held a public hearing on Wednesday, August 4, 2004 in Sacramento. The hearing considered amendments to milk movement incentives, namely, transportation allowances and transportation credits, as provided in the Milk Stabilization and Marketing Plans for Market Milk (Stab Plans) and the Pooling Plan for Market Milk (Pool Plan). The Department called the hearing after receiving a petition from Clover Stornetta Farms, Inc (Clover). After the notice was issued, five alternative proposals were received from California Dairies, Inc (CDI), Dairy Farmers of America (DFA), Dairy Institute of California (Dairy Institute), Land O'Lakes (LOL), and Security Milk Producers Association (Security) prior to the deadline for submission of alternative proposals.

Hearing Witnesses:

A total of thirteen witnesses/organizations testified including the Department's witness.

1. Candace Gates — Dairy Marketing Branch, CDFA
2. Kristina Kreutzer — Milk Pooling Branch, CDFA
3. *Gary Imm — Clover
4. *James Tillison — representing CDI
5. James Tillison — representing DFA
6. *William Schiek — Dairy Institute
7. *James Gruebele — LOL
8. Hank Perkins — Security
9. Richard Shehadey — Producers Dairy and Bar 20 Dairy Farms
10. *Kevin Albernathy — California Dairy Campaign (CDC)
11. Tiffany LaMendola — Western United Dairymen
12. Stephan James — Swiss Dairy
13. *Robert Feenstra — Milk Producers Council (MPC)
14. Sharon Hale — Crystal Cream and Butter

An "*" indicates witness/organization who submitted a post hearing brief. In addition, written submissions were received from two people/organizations who did not give oral testimony:

15. James Dolan — Driftwood Dairy
16. Richard Ghilarducci— Humboldt Creamery (Humboldt)

Attachment A–1 summarizes the panel's recommendations and arguments.
Attachment A–2 summarizes the testimony, written statements and post–hearing briefs.

General Analysis and Discussion of Issues and Proposals for Milk Movement Incentives

Background: Milk Pooling

As in most federal orders, California processors contribute to a central milk revenue pool. In each federal order, revenue from milk is pooled to establish a uniform blend price for all producers who ship milk within the order. The blend price can be modified for each individual by location differentials.

Unlike most federal orders, California does not have a single blend price. Under the California Pooling Plan for Market Milk, the producer is paid based upon his or her allocated quota, base, and overbase at prices that reflect the pool-wide usage of all classes. The monthly quota and base amounts are computed for each producer to the extent these amounts are produced. The maximum monthly quota amount is determined by the current quota allocation, and the maximum monthly base is determined by the difference between production base and quota. Any production that exceeds these two figures constitutes overbase production.

Each handler submits a monthly report to the Department's Milk Pooling Branch. These reports indicate the amount of milk purchased from producers and other handlers and the amounts used in the various classes. The total class value is determined by multiplying the class usage by its appropriate class price for each handler in the pool, and then adding these respective amounts for all pool handlers. This results in the pool-wide usage for each class and its related value.

Revenue from processors is distributed to dairy farmers via quota, base, and overbase prices. Since the Milk Pooling Branch's inception in 1969 until 1993, the quota price was primarily impacted by Class 1, 2, and 3 farm prices, while the overbase price was primarily impacted by the Class 4a and 4b farm prices. This was changed by statute enacted in 1993 and made permanent in 1994. Beginning in January 1994, a fixed differential was established so that the quota price is always $1.70 per hundredweight greater than the base and overbase prices. Historically from 1969 through 1993, the difference between the announced quota and overbase farm prices ranged from $1.06 to $2.26 per hundredweight on an annual average basis. Currently, revenue above that needed to maintain the $1.70 differential is shared equally among quota, base, and overbase production. The announced quota price is adjusted based on farm location by regional quota adjusters (RQA's). Prices paid to an individual producer depend upon his or her farm location and blend of quota, base, and overbase holdings. For computational purposes, the whole $1.70 is assigned to the SNF price. Thus, the announced quota SNF price is set at $0.195 per pound above the base and overbase SNF prices. Because of RQA's, the actual quota SNF price received by individual farmers may be adjusted downward by up to $0.27 per hundredweight based on farm location. The fat prices for quota, base, and overbase are identical.

Handler obligation statements are computed and mailed to each pool handler by the 28th of each month. These statements take into account the handler's class usage and the gross amount the handler is directed to pay producers supplying the handler milk for their producing quota, base, and overbase milk. If the total value of the class usage is greater than the amount the handler owes producers for their milk, the handler pays the difference into the pool equalization fund. Conversely, if the amount owed producers is more than the value of the usage, the handler receives this difference from the equalization fund.

Not all revenue from milk sales is pooled. Grade B milk is not pooled, nor is it regulated by minimum prices. In federal orders, plants not making any Class I products (manufacturing plants) can opt out of the pool. They do this when it is in their self-interest because their plant-blend price exceeds the pool-blend price. In addition, producer-distributors (a.k.a. producer-handlers) in some cases do not account to the pool for their Class I production.

In California, plants not making any Class 1 or 2 products (manufacturing plants) can opt out of the pool. However, they generally will not if they are receiving any milk from producers owning quota. Over 75 percent of producers own some quota; over 40 percent of producers have at least one third of their milk production covered by quota.

In California, exempt producer-handlers (a.k.a. producer-distributors) do not account to the pool for all of their Class 1 production. Option exempt producer-handlers do not account to the pool for their Class 1 production that is covered by the exempt quota they own.

Background: Milk Movement

In August 1999, the Department published a paper entitled "*Options to Facilitate Orderly Movement of Milk to California's Fluid Markets*" (Hearing Exhibit #7d). During 2000 using this paper as a starting point, the Department held a series of four industry workshops that attempted to review fully all aspects of milk movement incentives. A primary objective of the workshops was to try to reach a consensus on potential changes to the structure and scope of the milk movement incentive program. The workshops concluded without industry consensus; rather, the participants urged the Department to consider reviewing the unresolved issues at two public hearings that were held June 28 and July 2, 2001. A subsequent hearing was held June 4, 2003. These hearings resulted in modifications to the existing milk movement system and not its replacement with a new system (Hearing Exhibit #43).

Transportation Allowances: What they are and how they work — When the Milk Pooling Plan was instituted in 1969, location differentials were established to provide producers with economic signals to move milk to designated counties. Location differentials were added to or deducted from quota payments to producers and were determined by the location of the plant that first received the milk. When milk was moved to designated counties, favorable location differentials offset the added cost of transporting milk.

As California milk production began to increase, overbase milk became an increasingly larger share of the total milk production. As a result, location differentials based solely on quota milk were no longer an efficient means of ensuring that adequate milk supplies would be made available to Class 1 plants. Consequently, location differentials were discontinued and a system of "transportation allowances" and "regional quota adjusters" (RQAs) were used as a means of ensuring the Class 1 plants were served.

Transportation allowances partially “incentivize”[1] those producers who are supplying milk to higher valued usage. These allowances apply to all market (grade A) milk moving from dairy farms to plants in qualifying areas that process more than 50 percent of the milk received into Class 1, Class 2, and/or Class 3 products. In addition, cooperative organizations receive transportation allowances on shipments to their plants if the plant is located in a deficit area and if the plant supplies 40 percent of its receipts for Class 1 usage.

Transportation Credits: What they are and how they work — In 1981, transportation credits were introduced to reduce the cost of plant–to–plant shipments. At one time, milk marketing areas in California were more numerous, and differences in hundredweight prices among milk marketing areas were sufficient to cover the cost of moving milk from one processing plant to another. However, with marketing area consolidation, these price differences were no longer capable of covering the cost of interplant shipments.

Transportation credits offset some of the cost of hauling milk assigned to Class 1 usage from plants in designated supply counties to plants in designated deficit counties. Handlers located in designated supply counties may deduct a specified transportation credit from applicable minimum prices for bulk market milk, bulk market skim milk and condensed skim milk shipped to a plant located in a designated deficit county. Shipments of market cream are not currently covered by transportation credits.

Regional Quota Adjusters: What they are and how they work — While Regional Quota adjusters (RQA) do not provide any direct incentive to move milk to Class 1 plants, they relate to a basic principle of location economics. Most Class 1 plants are located in or near the major population centers for economic reasons. Under normal conditions, Class 1 plants attract the nearest milk supply over more distant rural milk production areas. As a consequence, milk produced in close proximity to processing plants has more value.

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[1] “incentivize” - to offer incentives or an incentive to; motivate.

RQAs, which with transportation allowances replaced location differentials, follow this economic principle. RQAs are deducted from the quota payments to producers and are determined by the geographical location of the producer's dairy. RQAs apply to the hundredweight equivalent of quota milk produced. Presently, these rates range from 5¢ per hundredweight for dairy farms located in North Coast counties to 27¢ per hundredweight for dairy farms located in Fresno, Kings, and Tulare counties. There are no RQAs assigned to dairy farms located in the southernmost part of the state.

Call Provisions: What they are and how they work — Milk movement requirements, commonly referred to as "call provisions", were instituted in 1979. They function by bestowing a ranking system for quota milk use when milk supplies are insufficient to meet the demand for fluid milk. Basically, call provisions require that manufacturing plants participating in the pool (i.e., plants receiving milk entitled to the quota price) must make a portion of the milk received available to plants processing Class 1 dairy products upon request. Because call provisions allow fluid plants to request milk from manufacturing plants, the impact of producer shipment decisions are mitigated. In other words, it does not matter to which plant a producer ships milk; call provisions give qualifying Class 1 plants the ability to obtain milk from manufacturing plants when it is needed.

More complete discussions of transportation allowances, transportation credits, regional quota adjusters and call provisions can be found in the Departmental publication, "*Options to Facilitate Orderly Movement of Milk to California's Fluid Markets*" (Hearing Exhibit #7c).

Summary of Proposals

Transportation Allowances for Northern California
Clover Stornetta Farms

- Add Marin and Sonoma counties to Bay Area receiving area.

Dairy Institute

- Add new receiving area, North Bay, to include Marin and Sonoma counties.
- North Bay receiving area to have transportation allowance of $0.20 per CWT
- Producers shipping milk from new North Bay area to Bay area receiving area to receive transportation allowance of $0.15 per CWT.

Dairy Farmers of America

- Rate change for Solano receiving area 0-44 miles at $0.18 per CWT, 44-99 miles at $0.28 per CWT, and over 99 miles at $0.38 cents per CWT.

California Dairies Inc.

- Plants in Alameda County only would have a transportation allowance of 0-99 miles at $0.3475 per CWT, and over 99 miles of $0.3875 per CWT. Other counties currently in Bay Area receiving area would be eliminated from Bay Area receiving area.

Transportation Allowances for Southern California
Land O' Lakes

- Producers shipping milk into the Southern California receiving area from Santa Barbara, San Diego, Imperial, Kern, Kings, and Tulare counties receive a transportation allowance of $0.43 per CWT.
- Producers shipping milk into the Southern California receiving area from Inyo, Los Angeles, Mono, Orange, Riverside, San Bernardino, and Ventura counties receive a transportation allowance of 0-89 miles at $0.09 per CWT, and over 89 miles $0.12 per CWT.

California Dairies Inc.

- Rate change for milk shipped into the Southern California receiving area. 0-89 miles at $0.10 per CWT, 89-139 miles at $0.4775 per CWT, and over 139 miles at $0.6175 per CWT.
- Transportation allowance for milk received in the San Diego receiving area 0-89 miles at $0.10 per CWT.

Security

- Change the transportation Allowance for the Southern California receiving area to 0-89 miles at $0.09 per CWT, 90-139 miles at $0.4775 per CWT, and over 139 miles at $0.7475 per CWT.

Transportation Credits
Land O' Lakes

- Increase from $0.68 per CWT to $0.835 per CWT for milk shipped from Tulare County to Riverside County.
- Increase from $0.60 per CWT to $0.7525 per CWT for milk shipped from Tulare County to Orange, Los Angeles, or Venture counties.
- Transportation Credit on condensed skim of $0.895 per CWT on skim shipped from Tulare County to Riverside or San Diego County.
- Transportation Credit on condensed skim of $0.8125 per CWT on skim shipped from Tulare County to Orange, Los Angeles, or Venture counties.

California Dairies Inc.

- Eliminate Transportation Credits for condensed skim or,
- Have Los Angeles County added to Designated Deficit counties list if proposal to eliminate Transportation Credits for condensed skim is not granted.

Milk Producers Council

- Eliminate condensed skim's eligibility for transportation Credits.

Impact of Proposals

Transportation Allowances

The analysis of the transportation allowances proposals were based on historical milk movement that occurred monthly during August 2003 through May 2004. The data in Table 1 was generated using different filters as proposed in the petition and alternate proposals, including changes in supply counties, changing counties in the receiving areas, and changing the allowance rates.

The petition by Clover to add Marin and Sonoma counties to the Bay Area receiving area would impact the pool $30,598 per month, see Table 1 below. The proposal by Dairy Institute would affect the Bay Area receiving area and create a new receiving area, North Bay. The net change would be a monthly cost to the pool of $19,788, see Table 1 below.

Table 1
Monthly Average Cost of Transportation Allowance
Proposed less Current of $1,273,042

	Clover	Dairy Institute	CDI	LOL	DFA	Security
Northern California	$30,598	$19,788	$92,503		$20,920	
Southern California			$81,957	-$41,909		$188,157
Total	$30,598	$19,788*	$174,460	-$41,909	$20,920	$188,157

* includes cost of North Bay receiving area that does not exist currently

The proposed changes asked for by CDI would affect the Bay Area, Southern California, and San Diego receiving areas. In the Bay Area receiving area the proposed change is in the qualifying counties. In Southern California and San Diego receiving areas the proposal is for rate changes. The impact of all CDI proposals is $174,460, see Table 1 above.

Land O' Lakes proposals would affect the Southern California and San Diego receiving areas. Their proposal is for both a rate change and a change in eligible counties. LOL's changes according to table 1 would save the pool $41,909 per month.

The proposal by DFA is for a rate change for the Solano receiving area. The proposed rate change would cost the pool $20,920 per month, see Table 1 above.

Security proposed a rate change in the Southern California receiving area. This proposal change would cost the pool a monthly average of $188,157.

Transportation Credits

The analysis of the transportation credits proposals were based on historic milk movements. The months of January 2003 through May 2004 were used for changes in volume of milk eligible for transportation credits. June 2003 through May 2004 was used for the cost of transportation credits. The data in Table 2 was generated using different filters as proposed in the alternative proposals. These filters included changing supply and deficit counties, changing transportation credit rates, and having different credits for bulk milk and condensed skim.

CDI's proposal to have Los Angeles County added to the Designated Deficit Counties list will cost the pool an additional $19,175 per month, see Table 2. LOL's proposal changes rates on both bulk milk and condensed skim. Their proposal also asks for changes in both supply and deficit county designation. The total monthly cost of LOL's proposals are $67,500, see Table 2 below

Table 2
Monthly Increase in Transportation Credits Costs
Current System Compared to CDI and LOL Proposals
Proposed less Current of $404,904

	CDI	LOL
Bulk Milk	$4,167	$61,667
Condensed Skim	$15,008	$ 5,833
Total	$19,175	$67,500

Analyses

Why Milk Movement Incentives are Needed — In 2000, at the first of the four Departmental workshops on milk movement incentives, the consensus of the participants was that a regulated system to move milk to the higher usages needs to continue to be in place. The group conceded that milk may move without a regulated system. However, one of the underlying tenets of instituting a pooling program in California was to ensure that Class 1 plants continue to be served in the absence of direct incentives for producers to ship their milk to those plants.

Many producers are paid premiums in addition to regulated minimum prices. These premiums include processing premiums offered by Class 4 plants; competitive premiums offered by Class 1, 2 and 3 plants; and 13th check premiums offered by cooperatives. These premiums are not subject to pooling. The producers who ship milk to plants offering premiums receive both the appropriate pool price (quota, overbase or a blend of the two) plus the associated premium. The availability of these economic incentives may cause some milk production that would have been shipped to fluid milk plants to be diverted to manufacturing plants.

Previous hearing records are replete with definitions of a "deficit market." Not surprisingly, the descriptions of a "deficit market" not only reflected the positions of the witnesses, but supported them as well. The definition for the term "deficit market" is not precise, but for the task at hand, a precise definition is not needed. Most recognize "deficit market" as a general term used to describe the conditions of a market vis-à-vis a "surplus market." Nonetheless, the Panel puts forth its working definition of a deficit market to make a point about the use of transportation credits.

In the strictest sense, a market that has enough locally produced milk to satisfy its Class 1 needs plus a moderate reserve (20 to 25 percent) to account for fluctuations in demand and supply for Class 1 products is not deficit.

Nonetheless for the previous 12 months including May 2004, dairy farmers incurred a cost of nearly $15.5 million dollars in transportation allowances and $4.9 million in transportation credits to bring milk from the South Valley to serve Southern California's Class 1 needs. In 2002, the cost to the pool had been about $8 million for allowances and $4.5 million for credits. Milk produced locally does not necessary move to the fluid milk plants despite the quantity of milk that continues to be produced in the area.

General Discussion and Recommendations

On the day of the hearing, California Dairy Campaign (CDC) and Producers Dairy testified in favor of complete elimination of all transportation allowances and credits. They did not however, submit this concept as a formal proposal as required by the hearing notice. Unlike the five alternative proposals that were submitted in accordance with the provisions of the hearing notice, the Department was unable to notify all interested parties that this issue would be considered at the hearing and thereby ensure comprehensive input on the elimination of transportation allowances and credits. While a complete quantitative analysis was not prepared by the Department, the issues raised by testimony of CDC and Producers Dairy are significant enough that it is appropriate for the Hearing Panel to offer the following qualitative analysis.

CDC suggested that:

- The pooling program needed reform. However, they gave no evidence as to how these other reforms were related to their proposals regarding allowances and credits.
- The current regulatory program of classified pricing and pooling eliminates "market signals." However, allowances and credits are used to reestablish "market signals" through the regulatory process. Additionally, CDFA's production cost studies indicates that most producers receive "market signals" through competitive competition in the form of premiums above minimum prices (Hearing Exhibits #15-17).
- Over time the increases in allowances and credits will reduce the effective Class 1 price to that of Class 4. However, in 2002 the revenue from Classes 1, 2, and 3 above Class 4 prices was ten times the cost of allowances and credits (Hearing Exhibit #43a).
- Allowance and credit increases were not justified because of high retail milk prices. However, most fluid processors are not vertically integrated with a retailer and receive no benefit from retail prices. Additionally, changes in retail prices at club stores match very closely to changes in Class 1 prices (Hearing Exhibit #7b).
- It was unfair for producers to pay for allowances. However, producers always pay for hauling (Hearing Exhibit #20); allowances restore the "market signals" by transferring money from producers serving Class 4 pool plants to producers serving Class 1, 2, and 3 pool plants. Federal Orders have a similar system of transferring money to procedures serving Class I plants (hearing Exhibit #7a).

Producers Dairy suggested that:

- The market should be responsible for the movement of milk. However, allowances and credits are used to reestablish "market signals" through the regulatory process. Additionally, CDFA's production cost studies indicates that most producers receive "market signals" through competitive competition in the form of premiums above minimum prices (Hearing Exhibits #15-17).
- They are at a competitive disadvantage in the market place relative to plants in counties with allowances. However, the 83% of the fluid milk processed in these counties is generally sold locally to the 74% of California's population living in those counties; most of the additional 9% reflects integrated retail chains processing milk

in counties with allowances and distributing the milk to their stores throughout the state. Additionally, processors in those counties with allowances have suggested that as a producer-handler, Producers Dairy has it own competitive advantage (Hearing Exhibit #43: Pages 129-130, January 31, 2000 Hearing Transcript; and Pages 269-270, January 12, 2001 Hearing Transcript).

- Increasing credits and allowances decreases net prices paid to the farmer. However, in 2002 the revenue from Classes 1, 2, and 3 above Class 4 prices was ten times the cost of allowances and credits (Hearing Exhibit #43a).
- Fluid milk processors are relocating from the surplus areas to deficit areas because of the allowances and credits. However, they did not offer any supporting evidence, and the personal experience of the panel and other staff members does not support this suggestion.

Both CDC and Producers Dairy seemed to take a rather simplistic view of the market place. Fluid processing plants come in many sizes. Some represent a single plant firm, while others are part of the largest fluid processor in the nation. Among plants vertically integrated with retailers, the retailers vary from regional supermarkets to national chains. Buyers of fluid products are equally varied. While the majority of fluid milk is sold by retail chains, not all of whom own plants, fluid milk is also distributed though food service companies, club stores, and non-grocery retailers.

Finally, CDC and Producers Dairy did not acknowledge the benefits all producers receive from the stability of the pooling program nor did they address why this milk moment system was originally established. This history is given on pages 8-9 of Hearing Exhibit #7a) California Dairy Industry Review, “Incentives to Supply Class 1 Markets”:

> “Producer price regulation established in the mid-1930's brought stability to the dairy industry, but did not guarantee all producers the same price. . . . There was competition for Class 1 contracts among producers. . . . These factors tended to lead to market instability and price inequity.
>
> Passage of the Gonsalves Milk Pooling Act in 1967 . . . corrected many of these problems. However, it removed the existing incentive that existed under the old contract system for producers to ship their milk to a Class 1 plant. Instead, producers had an incentive to ship to a local plant, which, for most producers is a manufacturing plant.
>
> To address the problem of getting sufficient milk supplies to Class 1 plants, location differentials were established to encourage the movement of only quota milk to Class 1 plants. . . . [Between 1979 and 1982, location differentials were replaced by the current milk movement system:]
>
> **Call provisions** [1979]. Can require that manufacturing plants release milk to Class 1 plants when insufficient milk supplies are available to meet the demand for fluid milk.
>
> **Transportation credits** [1981]. A reduction in the obligation handlers pay for Class 1 milk that partially compensates for the cost of hauling milk assigned to Class 1 usage from plants in designated supply counties to plants in designated deficit counties. If the supply counties and deficit counties are in different marketing areas, the Class 1 area differentials are added to the transportation credit. Transportation credits have historically been designed to include a "shortfall" so that there is an incentive for bottling plants to purchase milk within the local area.
>
> **Transportation allowances** [1982]. These allowances partially compensate for the cost of hauling milk from a producer's ranch to qualified plants in designated receiving areas. They are funded from the producer pool.
>
> . . . federal orders have location-based differentials. . . . The announced farm-blend price for these federal orders is the blend price for producers delivering milk to the main metropolitan areas (high Class I or fluid use areas). The further the plant of delivery is from the main metropolitan area, the more the location differential lowers the producer’s farm-blend prices below the announced blend price for the order.”

Thus, a milk movement system is a necessary component of any pooling system, and neither proponent proposed a replacement for the current system.
There was a second proposal by Producers Dairy:

> "to transition from a transportation allowance program to a market order program, whereas orders are established similar to the federal Class 1 price structure shown on the attached published map that was issued by the Pooling Bureau, I believe. [See hearing Exhibit #7d Background Material specific to this Milk Movement Hearing. In addition to the text, it includes: *Figure 1* -Federal Location Differentials.] And price differentials are defined per area. If you reference 61805(b), it gives you the authority to do this. This would also encourage higher Class 1 milk to move to the deficit marketplace where it belongs." (Hearing Transcript page 130)

The proponent did not supply specific details as to the implementation of this proposal. However, the operation of Federal Location Differentials is described in Hearing Exhibit #7d. Under this system there would still be transportation allowances and credits; they would just have different rates and in some cases would apply to different counties. Producers Dairy suggested that federal order differentials would be an improvement over the current milk movement system. However, the panel's analysis showed that Producers Dairy would be a net gainer from such a system. Most importantly, this proposal was not submitted prior to the deadline for alternative proposals. Thus, no impact analysis of this proposal was available to aid other witnesses in addressing this proposal.

All other testimony at the hearing addressed specific proposed changes to the current milk movement system: (1) allowance and credit rates; (2) county eligibility; and (3) mileage brackets for transportation allowances. There was general agreement on the standards that should be applied in addressing these issues:

Robert Feenstra representing Milk Producers Council:

- "Producers who serve the Class 1 market ought to be rewarded."
- "The closest milk to the market ought to be move first."
- "A regulated system ought to attempt to minimize costs to the pool."
- need for a competitive balance between the TA's and the TC's.

Tiffany LaMendola representing Western United Dairymen:

- cost-justified changes to TA's and TC's.
- "shippers should be made indifferent when choosing to ship the milk locally or to the more distant . . . higher usage plant."
- "a shortfall should continue to exist . . . to encourage the closest milk to move first."

William Schiek representing Dairy Institute of California:

- support cost justified rate increases
- need for a competitive balance between the TA's and the TC's.
- "Historically, the transportation credits and allowances have been set at levels that do not fully compensate handlers for their shipment costs."
- "Inadequate rates also lead to California Class 1 processors being . . . unable to compete favorably with manufacturing plants . . . "

With changing industry conditions however, the Panel must also take into consideration not only the standards of the past, but it "*shall take into consideration any relevant economic factors*" (Code Sections 62062 and 62076). These changing conditions and standards are clearly stated in the Panel reports for the most recent milk movement hearings held June 28 and July 2, 2001, and June 4, 2003 (Hearing Exhibit #43).

There were also several proposals to eliminate or restrict the eligibility for allowances and/or credits for a number of counties. The hearing was called based on a petition regarding the ability of fluid processors in Marin and Sonoma counties to acquire milk.

They stated two problems: (1) a declining local milk supply; (2) competition with fluid processor in other areas. The call of the hearing focused more broadly on changes in milk supplies and competition among all fluid processors. At the hearing, several witnesses testified to the declining milk supply within Southern California. The Panel did not believe it was an appropriate time to put limits on the current system by eliminating county eligibility.

Finally, there is the undisputed fact that fuel prices and hauling rates have increased. At the time of the last hearing in June 2003, diesel fuel prices were in the $1.60 to $1.65 per gallon range; at the time of his hearing, diesel fuel prices were in the $2.05 to $2.10 per gallon range (Hearing Exhibit #7d). Since the time of the last hearing, 25 of the 30 ranch-to-plant hauling rates monitored by the Department have increased; these 25 hauls represent 97 percent of the milk in the studies. The key rate from Kern to Los Angeles increased from $0.70 to $0.74 per hundredweight (Hearing Exhibit #19a).

Transportation Allowances for Southern California and San Diego

There was a great amount of testimony regarding the transportation allowance from milk coming in from Barstow. The testimony was wide ranging, with some arguing that the Barstow issue was a regulatory give away ("[An] *irrational result* [that] *gives a large and costly transportation allowance to producers in the Barstow area*."). Others felt that the issue was an attempt to make a mountain out of a molehill (the Barstow milk only represents six percent of all the non-local milk arriving in Southern California (Hearing Exhibit #19a). The only proposed solution was for lower allowance rates for Barstow milk relative to South Valley milk; a concept the Panel has already rejected. The Panel did try to address the issue by adjusting the mileage brackets. We did examine the effects of the new mileage bracket and based on ten months of data the new mileage bracket should solve the problem. The current over 89 to 139 mileage bracket will be split into two brackets: over 89 to 120 miles and over 120 to 139 miles.

For a long time the Chino Valley milk shed had been one of the most significant sources of local milk for plants in Southern California. However, with the urbanization of western San Bernardino and Riverside counties, this source of milk has significantly decreased. Kern County seems to becoming the most important source of milk for Southern California. As such, it makes an appropriate starting point for considering changes in allowance rates. The current local hauling rate in the Southern San Joaquin Valley is $0.254 per hundredweight. The hauling rate from Kern to Los Angeles is $0.737. The difference is $0.483 per hundredweight; this is identical to the proposed rate proposed by CDI, LOL, and Security. Given the supply situation in Southern California, $0.48 per hundredweight is an appropriate allowance for the new 120-139 mileage bracket.

For the 140 plus mileage bracket, the local haul is again $0.254 per hundredweight and the hauling rate from Tulare to Los Angeles is $0.972. With a $0.05 shortfall, a rate of $0.67 would be appropriate. However, that represents a much larger increase ($0.14) than that proposed above for Kern County ($0.05). There is the danger of making it more economical to move milk from Tulare than from Kern. Thus, it would be more appropriate to increase the rate from Tulare to Southern California by the same $0.05 proposed increase for milk moving from Kern to Southern California. The new proposed rate would be $0.62 per hundredweight, the same as suggested by CDI.

Given the general increase in hauling costs, CDI's one-cent increase to $0.10 per hundredweight for the 0-89 mileage bracket seems appropriate.

For the new over 89 to 120 mileage bracket, the Panel felt that an intermediate rate between the proposed $0.10 and $0.48 would be appropriate. In Northern California, the Panel recommended a $0.29 rate for a comparable distance. Therefore, the Panel recommends $0.29 for the new over 89 to 120 mileage bracket. However, the Panel will monitor the movement of milk in this particular area and modify the allowance if needed.

Similarly the Panel recommends that the San Diego Receiving Area revised in step with the Southern California receiving area for the zero to 89 miles at $.10 and maintain the remaining brackets and rates as currently set for San Diego.

There were several proposals to reestablish different rates depending on the county of origin. However, as one witness put it:

> "If milk moves from Tulare County at a cost of 58 cents per hundredweight versus from Stanislaus County at a cost of 58 cents per hundredweight, there is no difference in the total cost to the pool." (Hearing Transcript page 162)

At the last two hearings on milk movement (Hearing Exhibit #43), the Panel clearly stated that it was not interested in trying to micromanage the milk supply. Distance alone and not county of origin should be the only criteria.

Panel Recommendation: Revise the Transportation Allowance rates for the Southern California Receiving area and split the over 89 to 139 miles bracket into two mileage brackets:

From zero through 89 miles	$.10 per CWT
Over 89 miles through 120 miles	$.29 per CWT
Over 120 miles through 139 miles	$.48 per CWT
Over 139 miles	$.62 per CWT

Panel Recommendation: Revise the Transportation Allowance rates for the San Diego Receiving area:

From zero through 89 miles	$.10 per CWT
Over 89 miles through 139 miles	$.43 per CWT
Over 139 miles	$.58 per CWT

Transportation Allowances for Northern California

The Panel is concerned with the dynamic changes to the milk supply in Northern California. Many traditional supply areas have been or are being reduced significantly. Analysis indicated that the current system of allowances in Northern California may be creating inequities among possessors beyond those mentioned in testimony.

Based on the testimony, the inequitable situation in Marin-Sonoma is one that must be addressed. The testimony showed that Clover is at a competitive disadvantage compared to processors in the surrounding area due to their tight supply and lack of transportation allowances. Therefore, the panel recommends that these two counties be made part of the current Solano receiving area. The brackets would remain unchanged. However, the Panel is proposing changes to the rates, and a new name would be adopted: North Bay receiving area.

For allowance rates going into the Bay Area receiving area, CDI requests a rather modest one-cent increase. However, given the continuing decline in local milk supply, it is unwise to eliminate any mileage brackets. Therefore, the Panel recommends that the allowance rates be increased one-cent in the first two brackets to $0.25 per hundredweight and $0.29 per hundredweight, respectively. The rate for the last bracket would remain at $0.30 per hundredweight.

For allowance rates going into the Solano receiving area (now the new expanded North Bay receiving area), DFA requested increases of two, seven and twelve-cents, respectively, for the three mileage brackets. The latter two increases exceed general hauling cost increase in this area. In addition, it would result in rates higher than those going into the Bay Area receiving area. Therefore, the Panel recommends that the two-cent increase be granted but that the other rates are set equal to the comparable rates from the Bay Area receiving area. Thus, for the three mileage brackets, the new rates would be, respectively, $0.18, $0.25 and $0.29 per hundredweight. This is consistent with the Panel's belief that the time may have come for consolidation of the receiving areas in Northern California.

There was no specific request for a rate increase into the Sacramento receiving area. However, a representative of a Sacramento fluid plant did testify to a four-cent hauling rate increase:

> "Local hauls from Sacramento/San Joaquin were reported as 32 cents per hundredweight in August of 2003 and by April 2004 had moved to 33 cents per hundredweight, a 1 cent per hundredweight increase. Hauling rates for milk from these same two counties that was shipped into the Northern San Joaquin Valley for processing changed from 32.2 cents per hundredweight to 32.8 cents per hundredweight over the same time period, for an increase of .6 cents per hundredweight.
>
> While it appears the incentive to supply the Sacramento deficit market has decreased slightly, Crystal did not feel this change to be significant enough at this time to warrant filing an alternative proposal at this hearing.

> It is unfortunate the Department's hauling rate survey was not available prior to the due date for alternative proposals. In reviewing that information, which was made available just prior to the pre-hearing workshop, we noticed the haul rate for milk moving from the Northern San Joaquin Valley to Sacramento has increased by 4.3 cents per hundredweight. This more sizeable increase appears to have removed what had been a modest incentive to supply milk to the Sacramento deficit market." (Hearing transcript page 187)

There was also testimony of the need to consider that changes in one Northern California receiving area may have an impact on the other receiving areas:

> "We believe DFA's proposed transportation allowance adjustments are undoubtedly designed to fix certain problems that exist within their current supply arrangements. I am confident their representatives will present testimony and evidence which supports their proposal. The Department should then give serious consideration to what is presented. Our concern is over the unintended consequences of any proposal, including DFA's, that adversely impacts Crystal's ability to acquire milk. We feel the Department must use the detailed information at their disposal to make changes in the transportation allowance system that solve as many problems as possible without causing new ones. The industry can and certainly should voice their opinions, but we do not have access to enough information to make the best decisions on matters of transportation allowances. That responsibility rests with the Department." (Hearing transcript pages 192-193)

> "Dairy Institute generally supports DFA's proposal to increase transportation allowances for milk moving into the Solano receiving area to the extent that such changes are cost justified being here. However, the proposed rates could create some competitive inequities with other Class 1 plants, particularly with respect to milk in North Bay and southern Sacramento and San Joaquin counties." (Hearing transcript page 85)

The Panel agrees with Crystal in that increases in transportation allowances and credits in surrounding receiving areas could impact the Sacramento receiving area. Given the increased rates proposed in other receiving areas, and the four cent increase in hauling rates, the Panel believes that the allowance rates for the Sacramento receiving area should be increased by four cents. Thus, for the two mileage brackets, the new rates would be, respectively, $0.13 and $0.16 per hundredweight. This four cent increase is comparable to the increases for the North Bay receiving area for similar distances.

Panel Recommendation: Include the counties of Sonoma and Marin with the Solano Receiving Area and change its name to the North Bay Receiving Area.
Revise the Transportation Allowance rates for the following receiving areas:

For the North Bay Receiving Area:

From zero through 44 miles	$.18 per CWT
Over 44 miles through 99 miles	$.25 per CWT
Over 99 miles	$.29 per CWT

For the Bay Area Receiving Area:

From zero through 99 miles	$.25 per CWT
Over 99 miles through 199 miles	$.29 per CWT

Over 199 miles	$.30 per CWT
For the Sacramento Receiving Area:	
From zero through 59 miles	$.13 per CWT
Over 59 miles	$.16 per CWT

Discussion and Recommendations for Transportation Credits for Bulk Milk and Condensed Skim

Transportation Credits for Southern California

Transportation Credits from Tulare to Los Angeles, Orange, and Ventura counties

Although there have been sufficient production levels in Southern California to satisfy the area's Class 1, 2, and 3 requirements, a significant quantity of the Southern California supply has served other usages. Southern San Joaquin Valley (South Valley) milk production has for over 20 years been used as a major milk supply area to help supplement the needs of the Southern California fluid processors.

Southern California's decreasing milk production and unequal raw product issues relating to a Southern California producer/handler provides added complexities to the milk movement issue in Southern California. Southern California's decreasing production continues to increase in magnitude with the passage of time.

From 1983 through 1996, the Department has adjusted the transportation credit by taking the cost to haul the tailored milk from the South Valley plant to Southern California Class 1 plants, subtracting the differential between the Class 1 prices in Southern California and South Valley, and providing for a modest shortfall (Departmental exhibit 7d, Table 1). The shortfall historically ranged between one to seven cents.

In the Departmental determinations of the June and July 2001 hearings, the Department again reexamined this transportation credit issue by performing new and more extensive analysis focusing on the cost of hauling ranch-to-plant versus plant-to-plant. The more extensive analysis revealed that the cost to the pool of the transportation credits for shipping tailored milk via plant-to-plant shipments was significantly higher than the cost to the pool for comparable transportation allowances for ranch-to-plant shipments. Based on this analysis, the Department denied the proposal to increase the transportation credits. The Department stated in its determinations that the cost to the pool between transportation allowances and credits did not have to be equal, only that the costs between transportation allowances and credits be more comparable.

This issue was reviewed last year in a June 4, 2003 hearing. At the hearing, LOL proposed an increase of 16 cents in the transportation credits for shipments from South Valley to Los Angeles, Orange, and Ventura counties, and 24 cents for shipments from South Valley to Riverside and San Diego counties. In addition, LOL proposed that the transportation credit be established in a manner that no shortfall would exist. In accordance with the policy position, regarding the cost to the pool, taken at the prior hearing, the Department's hearing panel recommended against granting the proposed increases.

However, the hearing panel's recommendations were modified by the Secretary of Food and Agriculture. The Secretary implemented an increase in the transportation credit of 10 cents for all eligible milk shipped to Los Angeles, Orange, and Ventura counties, with an additional 8 cents for shipments into Riverside and San Diego counties.

In making the determinations the Secretary found that the need to ensure that available milk supplies are adequate to serve the needs of the Class 1 plants in the Southern California deficit area was more significant than the goal of minimizing the total cost to the pool or equating equity between transportation allowances and credits. The Secretary also concluded that the Class 1 plants in Riverside County were dependent upon quantities of plant-to-plant shipments from the South Valley, and it could not be assured that sufficient ranch-to-plant shipments would be made available.

At this August 4, 2004 public hearing, LOL proposed an increase of 15.75 cents for milk shipments from Tulare to Los Angeles, Orange, and Ventura counties and 16.75 cents for milk shipments from Tulare to Riverside and San Diego counties (these increases were corrected via the post hearing brief by LOL and are not the same as LOL's hearing testimony). In making the requested increase LOL again proposed that the policy of providing a shortfall be eliminated.

LOL testified that producer milk processed into Class 1 use is paid the highest price. This means that producers have the responsibility to serve that market and to finance milk movement programs. LOL indicated that to maintain equal raw product costs for California fluid milk operations that are dependent upon plant-to-plant transfers it is necessary to update the transportation credit to reflect the increased cost of moving milk and to eliminate the shortfall. LOL also testified that the supplying plant-to-plant milk movement was the most efficient way to service Southern California market. Supplying tailored milk avoids the unnecessary movement of unneeded fat in both directions (tailored milk is discussed in more detail later in this section).

LOL cited the increase in transportation costs from Tulare County to Los Angeles, Orange, and Ventura counties and from Tulare to Riverside and San Diego counties. Citing a pre-hearing workshop exhibit made available by the Department report that listed the daily shipments to Southern California, LOL testified that the daily shipments to Southern California Class 1 plants were broken down according to:

Plant transfers sources from outside So.CA area	1,599,401	6.9%
Out-of-state sources	3,504,288	15.2%
Ranch-to-plant from sources outside So.CA area	6,596,507	28.6%
Ranch-to-plant from So.Ca Sources	11,380,831	49.3%
TOTAL	23,081,027	100.0%

(Source: CDFA Data released at the pre-hearing workshop. Information was complied from April 2004 statistics)

LOL noted that Class 1, 2, and 3 usages supplied by local shipments had dropped from 53 percent to just above 49 percent. It is important to remember that the volumes of milk shipments are based on the statistics from one month.

Available Options

The formal options available to the Department ranged from making no adjustment in the transportation credit to raising the credit up to 15.75 cents for those shipments from the South Valley to Los Angeles, Orange, and Ventura counties. The range of options can be characterized by the following three distinct options:

Raise Transportation Credit by 15.75 cents to 75.75 cents.

> This would change existing policy by establishing a policy of "no shortfall" for the first time. This option would more than compensate South Valley supply plants for the increased hauling costs. Compared to the transportation allowances, this option would cost the pool more money to move an equivalent amount of milk. Yet, this option would help ensure that the plant-to-plant shipments from the

South Valley provide competitive raw product costs to certain Southern California fluid processors.

Raise the Transportation Credit by 5 cents to 65 cents.

With the exception of the 2001 hearing, this would be consistent with the prior hearing decisions. This option would help compensate South Valley supply plants for the increases in hauling costs and continue to maintain a shortfall. Furthermore, it would draw less money out of the pool than the prior option. However, compared to the transportation allowances it would still cost more money to move an equivalent amount of milk. This option would be consistent with the Department's determinations resulting from the 2003 hearings. However, this option would provide less assurance that the plant-to-plant shipments from the South Valley would provide competitive raw products costs to certain Southern California fluid processors.

Make No Adjustment to the Transportation Credit, leaving the credit at 60 cents.

This would be consistent to policy the Department adopted in the 2001 hearing and the hearing panel's recommendations at the 2003 hearing. This option would not compensate South Valley supply plants for the increase hauling costs and would allow the increased shortfall to remain. Moreover, this option would keep the pool cost for funding the transportation credit constant and would make the cost of the credit more equitable with the allowance.

The proponent for increasing the transportation credit to a level that would entail "no shortfall" focuses primarily on two interrelated issues, the hauling rates to transport the tailored milk plant-to-plant and the competitiveness of receiving plant-to-plant shipments of milk.

LOL was the only hearing witness that supported the concept of a "no shortfall" in the establishment of transportation credits. All the producer organizations opposed the concept of a "non-shortfall," including CDI, Swiss Dairy, and Dairy Institute, who represents a majority of the State's fluid milk processors in the state. The only other support for the concept was a letter submitted by Driftwood Dairy which supported the entire LOL proposal.

One point on which there is very little debate and on which the panel members unanimously agree, that upon implementation of the pooling plan, producers accepted responsibility to serve the Class 1, 2, and 3 processors with adequate milk supplies. Probably from the time dairy producers began to sell their milk, it has been the responsibility of dairy farmers to incur the cost of shipping their milk to the plants, that the price is FOB at the plant.

Farm milk typically contains more fat and cream than the fluid processor needs or desires. The typical fluid milk processor that receives their milk supplies directly from dairy farms must incur additional costs to separate the excess cream and handle the surplus by either processing the cream into a manufactured product (butter, ice cream, etc.) or marketing the excess fat and cream to other dairy processors. In addition, since the typical fluid plant only processes fluid milk products four to five days a week, it must bear the additional expense of handling the unneeded daily milk deliveries on those days they do not process fluid products. To cope with these issues, the typical fluid processor must either make significant investments in equipment and facilities or make arrangements for someone else to take their excess milk, often at an economic loss (many processors who purchase their milk supplies from cooperative simply sell back the cream to a cooperative).

Tailoring farm milk supply to remove the surplus fat and cream and to balance the farm milk supply is a service that largely benefits the fluid milk processor and is not typically a function performed by a dairy farmer. Producer cooperatives that own and operate dairy manufacturing facilities can provide this service to their customers, but it is a service that should return some added price for the added value it provides.

Fluid milk processors who receive the tailored milk are being provided competitive advantages over processors who primarily receive their milk supplies from the ranch-to-plant shipments at the expense of the pool.

The Panel members simply do not agree with the concept that it is good policy to place the primary responsibility of funding the transportation costs for plant-to-plant shipments solely on dairy farmers. Since most of these shipments involve tailored milk, the benefits accrue to both the shipping cooperative producer and the receiving milk processor.

As in the last hearing report, there is little equality between transportation allowances and credits. Hearing Exhibit #7d illustrates the inequality as transportation credits cost twice as much a transportation allowance. This inequity between transportation credits and allowances does not seem to be consistent with good public policy as it does not take into account the cost minimization to the pool. Moreover, as evident in the Hearing Exhibit #7d, Table 5, LOL's proposal would increase the inequity.

This inequity did not go unnoticed by several producer organizations. As a witness for Western United Dairymen testified (Hearing Transcript page 166):

> "The LOL proposal disregards the Department's attempt to develop a level playing field. At the last hearing, against recommendations of the Panel, transportation credits were increased. This alone threw off the level playing field, providing a greater net draw from the pool for milk moving plant to plant than for the same amount of milk moving ranch to plant. We urge the Department to reestablish the level playing field by not allowing a greater draw from the pool for milk moving plant to plant."

While the witness representing Milk Producers Council testified (Hearing Transcript page 181):

> "The Land O' Lakes proposal regarding transportation credits, in our opinion, is totally unjustified,. . . The Department analysis, which compares the efficiency of ranch-to-plant with plant-to-plant movement shows that the benefits of the efficiency of plant-to-plant movement accrue to the processing plants. The producers are charged significantly more dollars to facilitate this movement. The Land O' Lakes proposal would only exacerbate this inequity and must be rejected by the Department. "

The Hearing Panel does recognize that the concerns that motivated the Department's prior administration to modify the Hearing Panel's recommendations in the June 2003 hearing remains an important consideration for this hearing as well. The annual data for the last three years suggest that the Southern California fluid processors are increasingly reliant upon milk supplies outside the Southern California market.

While improved equity between the transportation allowance and credit could also be achieved by increasing the amount of the transportation allowances relative to the level of transportation credits, there were no proposals or hearing testimony in support of such a large increase in transportation allowances. More importantly our data did not support an increase in transportation allowances.

It costs the pool significantly more to move milk for comparable quantities of fortified products using credits compared to allowances. Rather than proposing adjustments to the transportation credits that would reimburse LOL for the increased cost in the haul, LOL's proposal would increase the credits to a "no shortfall" level. This is a larger increase than the proposed increase in the comparable allowance. This further aggravates the equity between the credits and allowances.

Panel Recommendation: Make no changes in the transportation credit from Tulare to Los Angeles, Orange, and Ventura counties.

Other Transportation Credit Issues
In Southern California

LOL proposed that transportation credit for milk shipments from Tulare to San Diego and Riverside counties to be one-cent higher than the credits for milk going into Los Angeles, Orange, and Ventura counties. The same reasons and points discussed in the prior section were offered as justification for the increased credits into San Diego and Riverside counties. LOL testified that one cent reflected the higher hauling costs associated with the further distance.
For the same reasons that were stated in the review of the credits for plant-to-plant shipments from Tulare to Los Angeles, Orange, and Ventura counties also apply to the plant-to-plant shipments from Tulare to San Diego and Riverside counties.

Panel Recommendation: Make no change in the credit from Tulare to San Diego or Riverside counties.

CDI proposed adding plant-to-plant shipments within Los Angeles County and increasing the credit by four cents for shipments from Los Angeles County to either Orange or Los Angeles counties over the current rate. CDI also proposed that plant-to-plant shipments between Los Angeles County and Riverside, San Diego, or Ventura counties should receive a transportation credit of 48 cents. This proposal was identical to the proposal made at last year's hearing.

CDI testified that it opposed the inclusion of condensed skim as qualifying to receive transportation credits. CDI further testified that the Department's decision to include condensed skim sales places CDI's condensed skim sales at a competitive disadvantage. If the hearing results in a decision to remove the transportation credit for condensed skim, CDI would withdraw their request for an increase for the Los Angeles to Los Angeles movement because they would have a competitive position on those sales.

CDI testified that it was vital that a new higher rate be allowed for shipments between Los Angeles to Riverside, San Diego, and Ventura counties. This would allow CDI to recover their freight costs for those plant-to-plant sales.

The Panel's review of existing confidential hauling rates that are used to form the summary public hearing exhibits reflects that the CDI is shipping milk within Los Angeles and Orange counties well within the existing transportation credit rates.

Contrary to CDI's testimony, an analysis of CDI's competitive position relative to LOL, for plant-to-plant shipments to Riverside, San Diego, and Ventura indicate very comparable and competitive shortfalls. After accounting for the hauling costs, the price differentials, and the transportation credit for the current plant-to-plant shipments to Riverside, San Diego, and Ventura counties, neither CDI nor LOL have a competitive advantage over each other.

In reviewing the confidential hauling data, it appears that hauling cost for plant-to-plant shipments from Los Angeles to Orange County was within the current 34 cent transportation credit rate. Additionally, it appears that plant-to-plant shipments within the Los Angeles County were well below the 34 cent per cwt rate.

In proposing the new rate for Riverside, San Diego, and Ventura, CDI submitted a quotation from one trucking firm as substantiation of the cost to ship from Los Angeles to Riverside and San Bernardino counties. There is no other information available to the panel which substantiates the cost. The panel does not believe it is good policy to base such an important policy decision on one rate.

Panel Recommendation: Deny CDI's proposal to establish two designated deficit counties for shipments via plants in Los Angeles County: (a) Los Angeles or Orange counties, and (b) Riverside, San Diego, or Ventura counties. Deny CDI's proposal to increase the established transportation credits to 36 cents for Orange/Los Angeles counties and to 48 cents for Riverside, San Diego, or Ventura counties.

Credits for Condensed Skim: Statewide

The Department established credits for condensed skim shipped plant-to-plant on a statewide basis after the hearing last year. The establishment of the credit for condensed skim gives the Class 1 processors additional options for securing their milk supplies. The Department also recognized the importance of effective movement of condensed skim used for Class 1 fortification from all designated supply counties to all designated deficit counties. The changes also assist California's fluid processors in meeting California's fluid milk standards.

CDI proposed eliminating the credits on condensed skim. Western United Dairymen and Milk Producers Council also supported elimination of the credits on the condensed skim.

The following is a table which compares the condensed skim eligible for the credit before and after the August 1, 2003 implementation on a month to month basis.

Condensed Skim Eligible for Transportation Credits
For period July 2002 –May 2004

Prior to the August 2003 Amendment			After the August 2003 Amendment		
2002			2003		
	July	202,115			
	Aug	239,021		Aug	213,200
	Sept	229,828		Sept	195,613
	Oct	204,342		Oct	167,207
	Nov	214,034		Nov	147,019
	Dec	202,122		Dec	129,775
2003			2004		
	Jan	212,404		Jan	139,099
	Feb	187,937		Feb	153,740
	Mar	164,675		Mar	193,276
	Apr	160,190		Apr	188,074
	May	159,930		May	177,572
	Jun	180,550			
	July	210,903			

Very little time has elapsed since the credit for condensed skim was first made effective. The available data reflects the fact that the change has not resulted in a significant increase in the sales of condensed skim. In fact, for the first seven of the ten months after the August implementation the amount of eligible condensed skim was actually lower than the prior year. More time is needed to objectively evaluate whether or not changes to this credit are appropriate.

Panel Recommendation: Deny the proposal to eliminate the condensed skim credit, thereby continuing the credit in the Stabilization Plans.

Submitted August 31, 2007

ATTACHMENT A–1

Summary of Panel Recommendation

Transportation Allowances for Southern California

Revise the Transportation Allowance rates and split the over 89 to 139 miles bracket into two mileage brackets for the Southern California Receiving areas:

From zero through 89 miles	$.10 per CWT
Over 89 miles through 120 miles	$.29 per CWT
Over 120 miles through 139 miles	$.48 per CWT
Over 139 miles	$.62 per CWT

Transportation Allowances for San Diego

Revise the Transportation Allowance rates for the San Diego Receiving area:

From zero through 89 miles	$.10 per CWT
Over 89 miles through 139 miles	$.43 per CWT
Over 139 miles	$.58 per CWT

Transportation Allowances for Northern California

Include the counties of Sonoma and Marin with the Solano Receiving area and change its name to the North Bay Receiving area.

Revise the Transportation Allowance rates for the following receiving areas:

For the North Bay Receiving Area:

From zero through 44 miles	$.18 per CWT
Over 44 miles through 99 miles	$.25 per CWT
Over 99 miles	$.29 per CWT

For the Bay Area Receiving Area:

From zero through 99 miles	$.25 per CWT
Over 99 miles through 199 miles	$.29 per CWT
Over 199 miles	$.30 per CWT

For the Sacramento Receiving Area:

From zero through 59 miles	$.13 per CWT
Over 59 miles	$.16 per CWT

Transportation Credits for Southern California

Make no changes in the transportation credit from Tulare to Los Angeles, Orange, and Ventura counties.

Make no change in the credit from Tulare to San Diego or Riverside counties.

Transportation Credits for Condensed Skim: Statewide

Deny CDI's proposal to establish two designated deficit counties for shipments via plants in Los Angeles County: (a) the Los Angeles or Orange counties, and (b) Riverside, San Diego, or Ventura counties. Deny CDI's proposal to increase the established transportation credits to 36 cents for Orange/Los Angeles counties and to 48 cents for Riverside, San Diego, or Ventura counties.

Transportation Credit for Condensed Skim for Southern California

Deny the proposal to eliminate the condensed skim credit, thereby continuing the credit in the Stabilization Plans.

ATTACHMENT A-2

Summary of Testimony, Submitted Briefs and Letters, and Post Hearing Briefs

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Summary of Testimony

Gary Imm representing Clover Stornetta Farms, Inc (Clover)

Transportation Allowances

- Clover requested that Marin and Sonoma county be added to the Bay Area Receiving Area.
  - o Redress the current inequity created by our exclusion from transportation allowances.
  - o Milk production in Marin and Sonoma counties is now deficit to Class 1 needs.

James Tillison representing California Dairies, Inc. (CDI)

Transportation Allowances

- For the Bay Area Receiving Area, CDI asked both for rates increases and for the elimination of the highest mileage bracket.
- CDI also asked that milk from Marin and Sonoma get a higher TA into the Bay Area than milk from other sources.
- CDI opposed Clover's request that Marin and Sonoma county be added to the Bay Area Receiving Area.
  - o Clover's recommendation excludes a local haul cost
- CDI supported DFA's request for higher rates for the Solano Receiving Area.
  - o Believe changes based on the concept of distant less local haul rates.
- For the Southern California Receiving Area, CDI proposed rate increases for six counties, including three in the South Valley. All other counties would see rate decreases
  - o Changes based on the concept of distant less local haul rates.
  - o Encourages closer in milk from Kern County over more distant Tulare County.
  - o No true local rate from Barstow area.
- For the San Diego Receiving Area CDI proposed one rate for all distances. The rate proposed is slightly higher than the rate currently used for the lowest mileage bracket.
  - o All milk into San Diego is local milk

Transportation Credits

- CDI asked for a rate increase for the Designated Supply County of Los Angeles
- For the Designated Supply County of Los Angeles, CDI proposed assigning Los Angeles County to the list of Designated Deficit Counties. However, they are also proposing the elimination of TC's for condensed skim; if this proposal is

granted, they then withdraw their proposal to add Los Angeles County to this list of Designated Deficit Counties.

  - Need "to be competitive with the plant-to-plant movement from outlying areas"

James Tillison representing Dairy Farmers of America (DFA)

<u>Transportation Allowances</u>

- DFA supports CDI's proposals for rate increases in both Northern and Southern California.
  - "Reflect both the actual cost increases and net costs incurred by DFA and a comparison and adjustment to actual local delivery costs."
  - "Due to the relative lack of milk production in Solano County and the need to attract milk to the county, DFA is advocating no shortfall."
- DFA opposed the addition of Marin and Sonoma counties to the Bay Area Receiving Area.
  - "A highly specialized milk supply as part of their marketing plan."
  - "Sonoma and Marin counties offer an ample milk supply for local deliveries."

Dr. William Schiek representing Dairy Institute of California (Dairy Institute)

The Institute can support any rate increases for both TA's and TC's that are cost justified. However, there needs to be a competitive balance between the TA's and the TC's for milk moving from the South Valley to Southern California.

In general, the Institute supports cost-justified changes to TA's and TC's. They were originally opposed (?) to granting TC's for condensed skim because it would be disruptive to current supply relationships. However, they now feel that this has become institutionalized and its termination would be equally disruptive.

- "Historically, the transportation credits and allowances have been set at levels that do not fully compensate handlers for their shipment costs."
- "Inadequate rates also lead to California Class 1 processors being . . . unable to compete favorably with manufacturing plants . . . "

<u>Transportation Allowances</u>

- To deal with the situation in Marin and Sonoma counties, the Institute proposed making these two counties a new receiving area. They also proposed that there be two sets of rates for milk going into the Bay Area Receiving Area: (1) lower rates for Marin and Sonoma counties to discourage milk moving to the Bay Area; and (2) higher rates for all other counties, either at current levels as may be modified at this hearing.
  - "The North Bay, consisting of Sonoma and Marin counties, the Solano receiving area, and the Bay Area receiving area are each a part of a greater San Francisco Bay Area market, which constitutes the largest deficit fluid milk market in Northern California."

  - "In order that milk moves in the most efficient manner, it would not be inappropriate for the milk to have a small incentive to move. . . to the closest fluid milk plant."
- The Institute felt that Clover proposals of adding the two counties to the Bay Area receiving area would be a workable alternative but not at the rates proposed. The Institute prepared a series of rates to address the concerns of both supporters and opponents of Clover proposals.
  - the proposed allowance rate . . . would appear to overcompensate producers . . . "
- The Institute would be willing to support DFA's rate increases for Solano County if rates in other receiving areas in Northern California are adjusted to maintain the current competitive balance among processors in all three areas.
  - "Competitive inequities with other Class 1 plants, particularly with respect to milk in North Bay and southern Sacramento and San Joaquin counties."

Transportation Credits
- The Institute supports the CDI proposed TC's between Los Angeles plants.

James Gruebele representing Land O' Lakes (LOL)

Transportation Allowances
For both the Southern California and San Diego Receiving areas, LOL request TA rate increases from six counties including three South Valley counties. They also proposed lower rates from Southern California and the elimination of TA's for milk coming from Northern California.
- "It is essential to adjust the transportation allowance in California when the hauling rates warrant such changes."
  - "Change the current transportation allowance to account for the increased hauling costs"
  - "Current transportation allowance. . . is simply too large for producers located in high desert region. Those producers are overcompensated"
  - "Elimination of Fresno County and all other counties not listed below as supply counties. . . there are more than adequate amounts of milk available from Kern and Tulare counties."
- LOL supports the CDI proposal for changes to the TA rates going into the Bay Area, but only for the high mileage brackets

Transportation Credits
For TC from the South Valley to Southern California, LOL asked for rate increases for bulk milk and separate, higher rates for condensed skim.
- "It is essential to adjust the transportation [credit] in California when the hauling rates warrant such changes."
- "In light of the increased need for out-of-area milk in southern California. . . we are advocating no shortfall in the transportation credit program."
- "Plant-to-plant milk movement was a very efficient way to service the southern California market."

Hank Perkins representing Security Milk Producers Association (Security)

<u>Transportation Allowances</u>

- Security proposed increases in the TA rates going into Southern California for the high mileage brackets.
  - o "Serious situation facing California producers regarding high fuel and energy costs and equitable transportation allowances."
  - o Limiting allowances to below 139 miles is unrealistic, especially in today's environment with areas such as Kern County that imposes restrictions that will impede growth and drive costs higher."

Other Witnesses

Richard Shehadey representing Producers Dairy Foods, Inc. (Producers Dairy)

- Producers proposed three possible options for consideration by the Department:
  - o Add or deduct TA's and TC's from or to out of area package sales;
  - o Use federal Class I location differentials; or
  - o Eliminate all TA's and TC's
- Producers felt that any of the three options would be an improvement over the current system
  - o "Increasing transportation credit and transportation allowance burden on the pool, which equates to decreased net prices paid to the farmer. . . . excessive cost to the farmer that should be borne by the marketplace. The reference section there is [Food and Ag Code Section] 61802(h)."
  - o "The current transportation allowance structure is the cause of destructive trade practices, not encouraging the intelligent production and orderly marketing of commodities, and creating economic waste. Section 61802(e) and 62701."

Kevin Abernathy representing California Dairy Campaign (CD)

- CDC proposed eliminating all TA's and TC's.
  - o "Fundamentally unfair that the dairy producer is required to pay additional transportation costs when milk is marketed."
  - o "The current transportation allowances and credits prevent the efficiency of marketing milk and, instead, foster a milk movement system that is not market oriented."

Tiffany LaMendola representing Western United Dairymen (WUD)

- In general, WUD supported cost-justified changes to TA's and TC's.
  - o "Shippers should be made indifferent when choosing to ship the milk locally or to the more distant. . . higher usage plant. . . . [However] a

shortfall should continue to exist. . . to encourage the closest milk to move first."

- WUD felt there should be a balance between TA and TC from South Valley to Southern California.
    - o "We urge the Department to reestablish the level playing field by not allowing a greater draw from the pool for milk moving plant to plant."

Transportation Allowances

- "Diesel rates spiked in May"
- WUD supported the concept of making Marin and Sonoma eligible for TA's, but not the specific proposals of either Clover or the Institute
    - o Clover proposal would be result in rates to high into Marin and Sonoma
    - o The Institute proposal would result in rates too low for Marin and Sonoma producers shipping to the Bay Area
- To the extent they are cost justified, WUD supported CDI and DFA proposed TA rate increases.
- WUD would support CDI proposal for one rate for San Diego TA's if it were justifiable.
    - o "Nearly all the milk moved with transportation allowances is less than 75 miles from the qualifying plant."
- WUD opposed LOL proposals for changes to TA's to Southern California
    - o "If milk moves from Tulare County at $0.58/cwt. versus from Stanislaus County at $0.58/cwt, there is no difference in the total cost to the pool."
    - o "designating eligible and ineligible counties may actually decrease the supply of milk available to Class 1 plants"
- WUD opposed Security proposal for rate increases
    - o "Furthest out bracket goes against the basic principle of encouraging the closest milk to move first."

Transportation Credits

- "Diesel rates spiked in May"
- WUD proposed eliminating condensed skim's eligibility for TC's.
    - o Hauling costs for "manufactured product such as condensed skim" should be covered by the market, not producers.
    - o "Already pay a fortification allowance on condensed skim"

- WUD opposed CDI proposal for making Los Angeles county a receiving area.
    - o "We do not support any transportation credits on condensed skim. "
- WUD opposed LOL proposal for separate rates and rate increases for TC from South Valley to Southern California
    - o "LOL's proposal would eliminate any shortfall"
    - o "Disregards the Department's attempt to develop a level playing field"

Stephen James representing Swiss Dairy Corporation (Swiss Dairy)

- Swiss Dairy clearly stated that they supported the CDI proposals. However, they did not state if this applied to all CDI proposal or just the ones that would affect their plant in Riverside.
  - o "Should be a level playing field [regarding condensed skim sourced from Tulare and Los Angeles]

Robert Feenstra representing Milk Producers Council (MPC)

In general:

- "Producers who serve the Class 1 market ought to be rewarded."
- "The closest milk to the market ought to be move first."
- "A regulated system ought to attempt to minimize costs to the pool."

Need a balance between TA and TC from South Valley to Southern California.

- "Producers are charged significantly more dollars to facilitate [movement plant-to-plant than ranch-to-plant]"

<u>Transportation Allowances</u>

- Support a solution to Marin-Sonoma issue.
  - o "Way to address the equity issue among the North Bay producers is not [Clover proposal], but to support the Dairy Institute's proposal of reducing an obvious generous transportation allowance for milk moving from North Bay to the Bay Area."
- Oppose DFA Rate increases for Solano DFA:
  - o "There is plenty of milk available for the Solano County plant."
- Support CDI TA changes for Southern California, except that would use four counties and not six.
  - o "Clear need to attract milk from [southern San Joaquin Valley] to southern California."
  - o "[An] irrational result [that] gives a large and costly transportation allowance to producers in the Barstow area."
- Oppose Security Rate Increases
  - o "There is a large and growing supply of milk located within the 139-mile bracket"

<u>Transportation Credits</u>

- MPC proposed eliminating condensed skim's eligibility for TC's.
  - o "Provoked a request by CDI for the establishment of a transportation credit for condensed skim within southern California."
  - o "[CDI] have been put in an unfair position."
  - o "Condensed skim is a value-added product."
- MPC proposed the elimination of TC's for Condensed Skim (CS)
  - o Addresses CDI problem without need for LA to LA TC
- Oppose LOL's rate increases for TCs from South Valley to LA and oppose higher rates for CS.

Sharon Hale representing Crystal Cream and Butter Company (Crystal)

Transportation Allowances

- The milk supply situation for Sacramento county needs to be kept in mind
  - The Marin-Sonoma issue is valid, but all the proposed solutions would impact the rest of Northern California
  - Rate increases proposed for Solano would impact Sacramento
  - "Haul rate for milk moving from the Northern San Joaquin Valley to Sacramento has increased by $0.043/cwt."
    - Had this been known this prior to deadline for alternative proposal, a proposal for Sacramento county might have been submitted

Letters Submitted as Hearing Exhibits

Driftwood Dairy
Signed by James Dolan

Transportation Credits

- Support LOL TC Rate increases to their plant
  - Declining milk supply in Southern California
  - Need for a competitive alternative source
  - Current shortfall too large

Humboldt Creamery Association
Signed by Rich Ghilarducci

Transportation Allowances

- All rate adjustments should "reflect the current economic cost to transport milk."
- Humboldt supports the general concepts of Clover, CDI and DFA to address inequities in the North Bay. However, they leave the details up the Department.
  - "proposals address regional inequities."

Summary of Post Hearing Briefs

Clover Stornetta Farms, Inc
Signed by Gary Imm, August 9, 2004

- Confirm panel question that Clover Stornetta is receiving shipments from 17 producers, and only one of the 17 is over 40 miles away from the plant.
- Clover Stornetta also receives 3 loads of condensed and 5 loads of milk each week from Humboldt Creamery.

- The hauling costs from Humboldt Creamery are not included in their cost calculation of their local haul. The calculation also excludes the extra costs for organic. The $0.3890 per hundredweight only related to the 17 local producers.

California Dairies Inc.
Signed by Gary Korsmeier, August 11, 2004

- CDI has over 10 independent third party haulers in Southern California hauling milk in excess of 50 miles over more congested highways at a rate of 33-34 cents per cwt. It appears that Clover's 42 cents per cwt to haul seems excessive based on their experience.
- Obtained a local rate from Five J's Trucking of between 32 to 34 cents per cwt without knowing the location of the individual dairies.
- Five J's Trucking started in 1996 and currently hauls in excess of 50 loads of milk per day for various companies and cooperatives.

Land O'Lakes
Signed by James Gruebele, August 11, 2004

- Relative to the adjustments in the transportation credit to Riverside, San Diego, Los Angeles, Orange, and Ventura counties:
  - Driftwood Dairy completely supported LOL's proposal.
  - Dairy Institute also supported LOL's proposal for adjustments.
  - CDI supported LOL's proposal for adjustments in transportation credits
  - Both Driftwood Dairy and Dairy Institute supported the concept of no shortfall for milk shipments from Tulare to Southern California.
  - Only major opposition came from Western United Dairymen and Milk Producers Council, neither of have any experience in supplying milk to Class 1 plants.
- The correct rates as reflected in Exhibit A attached to James Gruebele's testimony for shipments from Tulare to Driftwood is $1.0275 and from Tulare to Swiss Dairy should be $1.175 not the numbers James incorrectly used in his testimony ($1.0225 for Driftwood Dairy). LOL would therefore request that the Department adjust the TC from $0. 60 to $0.7575 per cwt for milk shipments from Tulare to LA, Orange and Riverside counties, and from $0.68 to $0.8475 per cwt from Tulare to Riverside and San Diego counties
- Correction of 23 typographical errors in the written August 4, 2004 testimony. (The correction is underlined in a revised attachment of the written testimony.
- Regarding LOL's proposal for transportation credit for condensed skim.
  - CDI and Dairy Institute opposed LOL's proposal for condensed skim.
  - Western United Dairymen opposed LOL's proposal arguing that condensed skim is a manufactured product. However, LOL argued that pasteurization is a manufacturing function or that fortification of 1 percent or 2 percent milk involves a manufacturing process.
- Area differentials, which were as high as $0.55 per cwt, were used as a milk movement incentive for plant-to-plant shipments. Freight rates were lower then

the differentials at that time. These area differentials not only helped to move whole milk, they provided incentives to move condensed skim. When the differentials were reduced to $0.27, it made it less competitive to ship condensed skim.

- Eliminating the transportation credit on condensed skim would leave only one firm to serve the condensed skim market in Southern California. One reason that the Southern California Class 1 processors sought out of state condensed skim products is to avoid having a sole supplier.
- Quoting from its testimony in last year's transportation credit/allowance hearing:
  - Because of freight costs, LOL simply cannot compete with instate suppliers of condensed skim
  - The statute that mandate California's fluid milk standards requires that farm milk be fortified by adding solids.
  - The only effective competition for the sale of condensed skim for a Southern California buyer is out of state sources.
  - LOL is not competitive with out of state sources.
  - LOL was informed by two of its customers that at least three loads of condensed skim were moving from out of state sources into Class 1 plants in Southern and Northern California. LOL believes this situation could escalate, causing further negative impact on the California Pool.
  - The Federal orders charge processing plants Class 4 price for condensed used to fortify Class 1 products, while California system charges processors modified quota price. The difference between the modified quota price and the federal order Class 4 value has been as much as $6.54.
- Between August 2001 and July 2002, the total advantage for the shipment of three loads per day of condensed skim from an out of state plant amounted to $2.7 million. The competitive disadvantage to the south valley is even larger without a milk movement program for condensed skim.
- Consistent with Section 61801 and 61082 of the Food and Agriculture Code, LOL strongly believes that it makes sense to enact prudent milk movement programs that provide the most efficient means of supplying milk to the consumers of this state. This can be done by adopting fair and reasonable milk movement programs for milk moved ranch-to-plant and plant-to-plant.
- Transportation allowances and transportation credits are based on different principles or economic criterions. The economic criterion for ranch to plant transportation allowance program is the difference between the short distance haul to a manufacturing plant and the longer distance haul to a Class 1 plant. The criterion for the appropriate compensation for plant to plant movement is the cost of the milk haul from the supply plant to the Class 1 plant less any difference in the area differential.
- The decision of this hearing plus additional legislative activity or lack thereof will have significant effects on California producers in the short and long run. There is a real threat of losing Class 1 sales to out of state plants; in fact some already has occurred.

Milk Producers Council
Signed by Robert Feenstra, August 13, 2004

- The MPC witness testified in favor of reestablishing specific supply counties for the Southern California receiving area. The 2 page brief was written in response to a question from the Hearing Panel on whether MPC would consider simply adjusting the mileage brackets for the Southern California receiving area.
- Eliminating the designation of supply counties for southern California receiving area has lead to increases in the cost to the pool by overcompensating certain producers (specifically the High Desert milk).
- While it may be possible to tinker with mileage brackets to address this problem, MPC's analysis shows that the distance between Barstow area producers and the various Southern California fluid plants is roughly the same as the distance between Southern San Joaquin Valley producers and eligible Southern California plants. For example, the distance between Lenwood, CA and Artesia, CA is 115 miles according to Map Quest. The distance between the Bear Mountain Blvd. Exit Highway 99 South of Bakersfield and Artesia, CA is 118 miles.
- South Valley region is the nearest milk supply area which has sufficient volume to supplement Southern California's needs.
- South Valley producers have manufacturing plant alternatives that make their local hauls relatively low. Since the Barstow producers do not, the allowance needed to attract the Barstow production is lower. If the transportation rate was established to attract the Barstow milk to Southern California, the rate would not be high enough to attract sufficient supplies of milk from the South Valley.
- In order to minimize the cost to the pool- these differences need to be recognized and specific supply counties need to be reestablished.

Security Milk Producers Association
Signed by Hank Perkins, August 16, 2004

Attached a Fuel Surcharge Schedule which reflected that:

Price of Fuel Including taxes $	Surcharge %
1.76-1.80	8
1.86-1.91	9
1.91-1.95	10
1.96-2.00	11
2.01-2.05	12
2.06-2.10	13
2.11-2.15	14
2.16-2.20	15
2.21-2.25	16

Producers Dairy
Signed by Richard Shehadey, August 16, 2004

- As a producer (Bar 20 Dairy Farms) and Dairy processor (Producer Dairy) we are concerned about the increased cost to the pool.
- With rising fuel costs, increasing movement of farms from Southern California into the San Joaquin Valley, and increasing movement of milk into Southern California, Producers Dairy questions if the increases in transportation allowances and credits will ever stop? Also questions the value of what the producer receives in return for the cost?
- Producers Dairy/Bar 20 Dairy Farms believe that the market, not the producer, should be responsible for the movement of milk. The natural forces of a freer market will cause the milk to move from supply to deficit areas by definition.
- Testify in favor of significant changes to Transportation Allowance and Credit system.
- Per his testimony at the hearing, Producers Dairy indicates that they move a majority of their products into the deficit urban areas, without receiving any TA or TC subsidies from the Pool. They state they are at a competitive disadvantage in the market place and have an economic incentive to locate their processing facility in the urban area. Such a move is an abuse of the system, lacks equity, and creates economic waste.
- Questions the subsidizing the shipment of significant amounts of milk from supply areas in the valley into the urban areas, where it is processed and their competitors are moving significant amount back to retail stores in the valley.
- Questions why Producers Dairy should not receive a TA or TC subsidy for the milk products they ship to the urban areas.
- Maintains that the program should be reevaluated and a system more reflective of an efficient and freer market should be implemented.
- Cite sections 61802(e) and (h) and 61805 of California Food and Agricultural Code and indicate that they attach (no attachment was received) a copy of Federal Class I Price Structure. Producers Dairy believes that a system modeled after the Federal system in which market area or location differentials are used would resolve the need to move milk into deficit areas; would resolve competitive inequities in the marketplace; would resolve the issues Clover presented; would allow a more market driven system to exist; would remove the burden of the haul from producer to the market; and would endeavor under like conditions to achieve uniformity of costs to handlers for market milk within the marketing areas (61805(b).

California Dairy Campaign
Signed by Xavier Avila

- Methodology of CDC Haul Rate survey- used sample CDFA rates to calculate the cost per load. Then they divided the cost per load by the total miles of the haul to calculate the cost per mile. Contacted numerous transportation companies who specialized in hauling liquid bulk, temperature controlled freight.

CDC requested a range of companies to provide their average rate quote for the designated hauls. CDC's survey found CDFA transportation rates to be fair and equitable.

- Were advised that the quoted rates per load are negotiable if higher volumes of deliveries (load per day) were involved. CDC indicated that CDFA rates are based on round trip loads with on way dead head "empty".
- CDC's survey caused them to question whether some processors are using the CDFA transportation allowances and credits to give them an advantage in the actual contracted rate between processor and hauler indifferent of CDFA posted rate structure to the processor.
- CDC does support the pooling program, but believes that reforms to the pooling program and transportation allowance and credit system are necessary.
- Other agricultural industries do have pooling programs such as almonds, peaches, and various other commodities.
- Multiple classes of milk create an artificial barrier between the producer and consumer price and as a result make the system less market oriented. The system does not allow the producers to respond to market signals because the producer prices are based on the average revenue from all dairy usages. In the past, producers were able to market their milk to consumers, but currently there is no incentive for direct marketing to occur. The transportation allowance is responsible for this shifting of milk to a certain class regardless of market conditions.
- CDC believes it is important to close the widening gap between retail and farm prices. Lack of antitrust enforcement that allowed mergers to go on unchecked and reliance on volatile market prices to drive milk prices allow retailers to stair step retail prices upward.
- CDC indicates that the current transportation allowance system is subsidizing the movement of milk into Class 1 plants. As a result producers are losing market share. Under the current system the producers could feasibly subsidize it until it is as low as Class 4b.
- CDC questions why producers should subsidize Class 1 milk sales given the high retail milk price.

Dairy Institute of California
Signed by William Schiek, August 16, 2004

- Dairy Institute's proposal with respect to Bay Area was that producers in the North Bay region should have the same net haul cost, regardless of where they shipped their milk. Dairy Institute's members that operate fluid plants in the Bay Area and Western United Dairymen both expressed concern about their ability to acquire milk from the North Bay if the current allowance rate of 24 cents cwt from that area is reduced.
- Draw panel's attention to written testimony of DFA which shows the average cost of milk from Petaluma area to Solano area to be 54.43 cents per cwt, an amount derived at by combining DFA's higher haul cost of 63.87 per cwt using its own fee with a lower cost of 45 cent per cwt charged by contract hauler.

- Dairy Institute attached a revised table that reflects the proposed allowance implied by Dairy Institute's proposal would be 13.7 cents per cwt for the North Bay Receiving Area in the 0+ miles mileage bracket, 24 cents per cwt for the Solano Receiving Area in the 0-99 miles mileage bracket, and 19.7 cents per cwt for the Solano Receiving Area in the 0-44 miles mileage bracket.
- Dairy Institute does not support a federal order-type system of location differentials to move milk to deficit markets in California.
    - In federal order system, the Class I price paid by a fluid processor varies according to the county where its plant is located. Contrary to the testimony of one of the hearing witnesses, requiring the plants in deficit areas to pay higher prices into the pool is not sufficient incentive to move milk to deficit markets.
    - The federal system also adjusts the price received by producers according to the location of the plant of first receipt. A producer shipping to milk to a deficit area, where the Class 1 differential is higher, will receive a higher blend price. If the producers ships to a local manufacturing plant, he will receive a lower price (the exact difference will depend on the difference between the Class 1 differential in the deficit market and the Class 1 differential in the county where the local manufacturing plant is located).
- Any increase in prices paid by Class 1 plants in deficit areas without reducing prices to producers that do not ship to deficit areas (or alternatively, increasing prices to producers that serve the deficit areas) will only make it more difficult for Class 1 plants in deficit areas to obtain milk.
- This proposal is simply a means of increasing the Class 1 milk costs for fluid plants in deficit areas. While the witness stated some concerns about fluid milk plants in deficit areas selling packaged milk into the valley, some valley fluid plants have advantages over other Class 1 plants in the market in the form of the Option 70 Producer-Distributor Exemptions that enable them to encroach on the natural market of fluid milk plants in deficit areas.