



# The California Dairy Industry

## A Historical Review of the Dairy Regulations and Statutes Specifically Related to the California Milk Pricing and Pooling Programs

*The intent of this historical review is to assist in the understanding of the issues raised at a public hearing, within the context of the economic regulation of the dairy industry. It applies specifically to the California Milk Pricing and Pooling programs and is also useful in understanding both the operation of federal milk marketing orders and the operation of the federal dairy income protection programs. These federal dairy programs are important for their impact on the California dairy industry.*

### ECONOMIC DAIRY REGULATIONS

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

The Gonsalves Milk Pooling Act, California Food and Agricultural Code Section 62700, *et seq.*, authorizes the Secretary to operate a statewide pooling system under specified guidelines. These statutes provide for the formulation and adoption of Milk Pooling Plans for Market Milk (Pool Plan).

These statutes identify legal requirements and public policies that the Department is charged with implementing and enforcing. The determinations resulting from any hearing are made pursuant to the authority vested in the Department by statute and in furtherance of the important State purposes embodied in the governing statutes.

Some 90 percent of the market grade (Grade A) milk produced in the U.S. is subject to regulation under federal orders (67 percent) or state marketing programs (23 percent). The remaining Grade A and all Grade B milk is not subject to minimum price regulations. All grades of milk are impacted by the federal dairy income protection programs.

To promote stability in the dairy industry, both the federal government and eleven individual states have established milk-marketing programs. The eleven states with their own marketing orders are California, Hawaii, Maine, Montana, Nevada, New Jersey, New York, North Dakota, Pennsylvania, Vermont, and Virginia. Of these

eleven states, six have a mixture of state and federal orders. Only California, Hawaii, Maine, Montana, and Nevada have no federal orders within their boundaries. Uniquely, Alaska and Utah have neither a federal nor a state order. These milk-marketing programs establish minimum prices, based on ultimate utilization, that processors must pay for market-grade (Grade A) milk received from dairy farmers. These prices are established on a regional basis within marketing areas where milk production and marketing are similar.

### CALIFORNIA MILK PRICING SYSTEM

California is not part of a federal milk-marketing order; like ten other states, it has its own state-specific milk-marketing program. Currently there are two marketing areas: Northern California and Southern California. Each marketing area has a separate but essentially identical Stabilization and Marketing Plan. Each plan provides formulas for pricing five classes of milk. In California, the classes of milk are established legislatively. In federal milk-marketing orders, they are established administratively.

- Class 1:** Milk used in fluid products, including half-and-half.
- Class 2:** Milk used in heavy cream, cottage cheese, yogurt and sterilized products.
- Class 3:** Milk used in ice cream and other frozen products.
- Class 4a:** Milk used in butter and nonfat dry milk (NFDM).
- Class 4b:** Milk used in cheese, other than cottage cheese, and dry whey products.

In comparison, there are four classes of milk in the 10 federal milk-marketing orders administered by the USDA.

- Class I:** Milk used in fluid products, excluding half-and-half.
- Class II:** Milk used in half-and-half, heavy cream, cottage cheese, yogurt, sterilized products, ice cream,

and other frozen products.

**Class III:** Milk used in cheese, other than cottage cheese.

**Class IV:** Milk used in butter and NFDm.

Milk has four basic components: butterfat (fat), protein, other solids (OS), and fluid carrier (water). In both California and federal orders, milk is priced on these four components or combinations of them: solids-not-fat (SNF) is a combination of protein and OS; and skim is a combination of SNF and fluid. In California, Class 1 milk is priced on fat, SNF and fluid; Class 2, 3, 4a and 4b milk is priced on fat and SNF. In all federal orders, Class IV is priced on fat and SNF; Class III is priced on fat, protein and OS; and Class I is priced on fat and skim. Class II is priced on fat and SNF in six orders; in the remaining four orders, it is priced on fat and skim.

In California, Class 1, 4a, and 4b farm prices are adjusted monthly by their formulas, but Class 2 and Class 3 farm prices are adjusted bimonthly. All federal order farm prices are adjusted monthly. A detailed description of the California pricing formulas is located at the back of this document. In summary, the California Class 4a and 4b pricing formulas and the federal Class III and IV pricing formulas all use commercial market prices for butter, NFDm, Cheddar cheese, and dry skim whey (federal only). These prices are adjusted by specific manufacturing cost allowances and yields to determine component prices:

$$\text{Farm Price} = (\text{Commodity Price} - \text{Allowance}) \times \text{Yield}$$

Both the California orders and federal orders use differentials to establish minimum milk prices for all other classes: California Classes 1, 2, and 3, and federal Classes I and II.

The current Class 2 and 3 component prices are established by adding specific amounts to the Class 4a component prices. The specific amounts are contained in the Stabilization Plans and are commonly referred to as the Class 2 and 3 differentials. These Class 2 and 3 differentials range in value from \$0.64 to \$0.92 on a hundredweight equivalent basis.

The Class 1 farm prices are established by adding specific differentials to the Commodity Reference Price (CRP).

$$\text{Commodity Reference Price} = (\text{Commodity Price}) \times \text{Yield}$$

The CRP is based on Cheddar cheese prices or butter and NFDm prices, whichever has more value. A differential of \$0.464 is added to the CRP for both Northern California and Southern California. Component prices are established on a fat, SNF and fluid basis. The fat price

is based on butter prices. The SNF and fluid prices are calculated as residuals. To maintain the \$0.272 per hundredweight spread between Northern and Southern California, the fluid carrier price in Northern California is reduced by \$ 0.0031 per pound.

Across the U.S., federal Class I prices are established as differentials above the higher of Cheddar cheese prices or butter and NFDm prices. The Class I differentials range in value from \$1.60 to \$4.30 per hundredweight. Every county in the U.S. has a specific differential, even those not part of a federal order. For example, the federal differentials for California range from \$1.60 to \$2.10. The differentials range from \$1.60 to \$2.35 per hundredweight, in those states adjoining California. Federal Class II farm prices are established as a differential above the advanced Class IV prices. The Class II differential is \$0.70 per hundredweight in all federal orders.

Like California, most of Nevada operates under its own state marketing program (the Nevada State Dairy Commission). In Northwestern Nevada (Reno), the Commission sets the Class I price equal to the Northern California Class 1 price. In Clark County (Las Vegas), the Commission uses the federal pricing formula with a differential of \$1.40 per hundredweight.

To assist in establishing farm prices, the Department conducts milk production cost surveys on 179 California Grade A dairies. The Department also conducts manufacturing cost studies of all major California plants manufacturing butter, NFDm, Cheddar cheese, and dry whey. The Department compiles and publishes monthly and annual dairy statistics including production, usage, sales, and trends. In addition, other statistical data on the California dairy industry is compiled periodically as needed. The Department monitors and maintains information on milk trends, programs, and policies used in other parts of the nation.

## **CALIFORNIA POOLING PLAN FOR MARKET MILK**

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 which are the same as the federal Class 1 differentials.

Unlike 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 depends 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. In 2007, approximately 60% of all market milk producers held 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. Finally, for pool obligations, milk from out-of-state sources is credited at a plant blend price.

## 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. The price they received depended on the utilization of the plant they shipped to under a plant pooling and contract system. Thus, producers shipping to a plant with high Class 1 usage received more than producers shipping to a plant with high Class 4 usage. There was competition for Class 1 contracts among producers. Also, there was an imbalance of market power between a large number of small and disorganized producers and a small number of large fluid processors. These factors tended to lead to market instability and price inequity.

Passage of the Gonsalves Milk Pooling Act in 1967, with its implementation in 1969, corrected many of these problems. However, it removed the incentives 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. The incentive to ship to a Class 1 plant still exists for exempt producer-distributors and option exempt producer-distributors.

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. Over time, overbase milk became a larger and larger share of the milk produced and therefore, location differentials based solely on quota milk were no longer able to ensure that adequate milk was made available to Class 1 plants.

In 1982, location differentials were replaced by transportation allowances and regional quota adjusters (RQA's). The RQA's do not encourage milk movement to Class 1 plants. They were developed to deal with equity issues arising out of the elimination of the location differentials. In addition to the transportation allowances, two other methods to encourage the movement of milk to Class 1 plants were established: call provisions (1979) and transportation credits (1981). At one time Class 1 area differentials were large enough to cover the cost of moving milk plant-to-plant; Class 1 area differentials are the differences in the hundredweight prices between marketing areas. However, with marketing area consolidation and improvements in relative costs of moving milk ranch-to-plant, Class 1 area differentials were no longer sufficient to cover the cost of plant-to-plant milk movement. These conditions resulted in the establishment of transportation credits. All three methods of encouraging milk movement are detailed below:

- (1) Call provisions — Can require that manufacturing plants release milk to Class 1 plants when insufficient milk supplies are available to meet the demand for fluid milk.
- (2) Transportation credits — 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.

- (3) Transportation allowances — These allowances partially compensate for the cost of hauling milk from

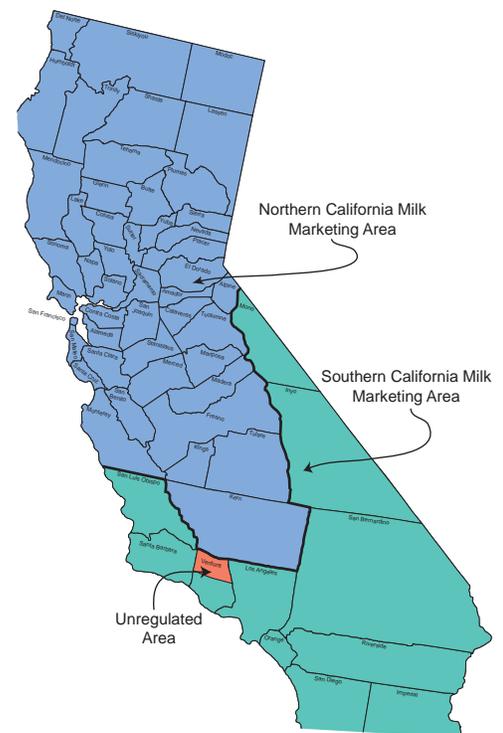
a producer's ranch to qualified plants in designated receiving areas and they are funded from the producer pool.

Transportation allowances apply to some market milk moving from the dairy farm to processing plants. This occurs when the receiving plant is located in certain deficit areas and processes more than 50 percent of its production into Class 1, Class 2, and/or Class 3 products. The allowances are set: (1) to reflect distance considerations; (2) to reflect local alternative hauling costs; and (3) to encourage close-in milk to be shipped first. In addition, cooperative members receive transportation allowances on shipments to their cooperative plant, which is located in a deficit area, if that plant supplies 40 percent of its receipts for Class 1 usage.

Most federal orders have location-based differentials based on the federal Class 1 differentials. These differentials apply to producer payments based on the location of the plant of first receipt. 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.

## MARKETING AREAS

To achieve the objectives of milk pricing and milk pooling, both the Department and USDA establish, modify, and consolidate marketing areas. Marketing areas are established on a regional basis where milk production and marketing are similar. When marketing areas were first established in the 1930's, the ability



to ship milk was limited. Therefore, milk production and processing tended to be local in nature. Milk supply areas (milksheds) were small and so were the marketing areas.

In the mid-1950's, there were 37 marketing areas in California, each typically composed of one to three counties or sections of counties. In addition, some areas of the state were unregulated. Marketing areas were consolidated and unregulated areas were brought into existing marketing areas as technology improved the ability to ship bulk and packaged milk greater distances. Currently, there are two marketing areas and one unregulated area in California. The Southern California Marketing Area includes the eleven counties of Imperial, Inyo, Los Angeles, Mono, Orange, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, and Ventura (except the northern portion of Ventura which is unregulated).

This pattern of consolidation has also occurred in federal milk marketing orders (federal orders). In 1960, there were 80 federal orders. Currently, there are only 10 federal orders.

## FEDERAL DAIRY INCOME PROTECTION PROGRAMS

In addition to federal and State milk-marketing programs which cover some of the nation's Grade A milk, the federal government also maintains two income protection programs that cover all of the nation's Grade A and Grade B milk: the Dairy Support Price Program and the Milk Income Loss Contract Program.

### Dairy Support Price Program: \$9.80 Floor

The federal government establishes a minimum target support price as a floor price for the milk dairy farmers sell to processors. This price is currently \$9.80 per hundredweight for milk testing at 3.5 percent fat. The federal government does not buy milk from dairy farmers at the target support price. Instead, through the Commodity Credit Corporation (CCC), the federal government stands ready to buy unlimited quantities of butter, NFD, and Cheddar cheese from processors. It purchases these products at prices that, on average, should enable processors to pay dairy farmers the target price. The prices are currently \$1.05, \$0.80, and \$1.13 per pound, respectively, for butter, NFD, and Cheddar cheese.

### Milk Income Loss Contract Program:

The Milk Income Loss Contract Program was in effect until September 2007. The newly adopted Farm Bill makes numerous revisions to the previous program and is in effect through September 2012.

## STATUTORY CRITERIA FOR ESTABLISHING AND AMENDING THE STABILIZATION AND MARKETING PLANS AND THE POOLING PLAN

In evaluating the operation of the Plans, and in considering proposed modifications to those Plans, the Department seeks to further the legal requirements and important public policies set forth in the Food and Agricultural Code.

**61801.** The production of market milk is hereby declared to be a business affected with a public interest. The provisions of this chapter are enacted in the exercise of the police powers of this state for the purpose of protecting the health and welfare of the people of this state.

**61802.** The Legislature hereby declares all of the following:

- (a) Market milk is a necessary article of food for human consumption.
- (b) The production and maintenance of an adequate supply of healthful market milk of proper chemical and physical content, free from contamination, is vital to the public health and welfare, and the production, transportation, processing, and storage of market milk in this state is an industry affecting the public health.
- (c) Because of the perishable quality of milk, the nature of milk production, the varying seasonal production and demand factors, and other economic factors affecting the milk industry, the potential exists for economic disruption, in the absence of regulation, in the production, marketing, and sale of market milk which may constitute a menace to the health and welfare of the inhabitants of this state and may tend to undermine sanitary regulations and standards of content and purity, however effectually the sanitary regulations may be enforced.
- (d) Health regulations alone are insufficient to prevent economic disturbances in the production of milk which may disrupt the future supply of market milk and to safeguard the consuming public from future inadequacy of a supply of this necessary commodity.

(e) It is the policy of this state to promote, foster, and encourage the intelligent production and orderly marketing of commodities necessary to its citizens, including market milk, and to eliminate economic waste, destructive trade practices, and improper accounting for market milk purchased from producers.

(f) It is recognized by the Legislature that the economic factors concerning the production, marketing, and sale of market milk in California may be affected by the national market for milk for manufacturing purposes.

(g) It is recognized by the Legislature that in recent years the supply of manufacturing milk in California, as defined in Section 32509, has consistently declined and continues to decline, and that market milk has virtually supplanted manufacturing milk for manufacturing purposes in this state, and that it is therefore necessary to conform the pricing standards governing minimum producer prices for market milk established under this chapter to current economic conditions.

(h) It is recognized by the Legislature that the levels of retail prices of milk and milk products paid by consumers are affected by a large number of economic and other factors apart from minimum producer prices for market milk established under this chapter, many of which factors are not within the power of the director to regulate or control, particularly since the Legislature repealed provisions concerning establishment of minimum wholesale and retail prices. It is further recognized by the Legislature that, in order to accomplish the purpose of this chapter and to promote the public health and welfare, it is essential to establish minimum producer prices at fair and reasonable levels so as to generate reasonable producer incomes that will promote the intelligent and orderly marketing of market milk in the various classes, and that minimum producer prices established under this chapter should not be unreasonably depressed because other factors have affected the levels of retail prices paid by consumers.

**61805.** The purposes of this chapter are to do all of the following:

(a) Provide funds for administration and enforcement of this chapter, by assessment to be paid by producers and handlers of market milk in the manner prescribed in this chapter.

(b) Authorize and enable the director to prescribe marketing areas and to determine minimum prices to

be paid to producers by handlers for market milk which are necessary due to varying factors of costs of production, health regulations, transportation, and other factors in the marketing areas of this state. In determining minimum prices to be paid producers by handlers, the director shall endeavor under like conditions to achieve uniformity of costs to handlers for market milk within any marketing area. However, no minimum prices established or determined under this chapter shall be invalid because uniformity of cost to handlers for market milk in any marketing area is not achieved as a result of the minimum producer prices established determined.

(c) Authorize and enable the director to formulate stabilization and marketing plans, subject to the limitations prescribed in this chapter with respect to the contents of the stabilization and marketing plans, and to declare the plans in effect for any marketing area.

(d) Enable the dairy industry, with the aid of the state, to develop and maintain satisfactory marketing conditions, bring about and maintain a reasonable amount of stability and prosperity in the production of market milk, and provide means for carrying on essential educational activities.

**61806.** It is the intent of the Legislature that the powers conferred in this chapter shall be liberally construed.

**61807.** Nothing in this chapter permits or authorizes the development of conditions of monopoly in the production of market milk. In the establishment of the terms and conditions under which market milk shall be purchased from producers, the terms and conditions are those which will, in the several localities and markets of the state, and under the varying conditions of production, insure an adequate and continuous supply of pure, fresh, wholesome market milk to consumers of the market milk.

**61961.** The director shall designate marketing areas which he deems necessary or advisable to effectuate the purposes of this chapter, and in which he finds the conditions affecting the production, handling, and sale of market milk, are reasonably uniform.

**61962.** The director may establish additional areas, or modify areas previously established, if he deems the establishment or modification of such areas necessary or advisable to effectuate the purposes of this chapter.

61963. If the director finds, after a public hearing in and for each particular marketing area under consideration for consolidation, that conditions of production and handling are reasonably uniform in two or more such marketing areas in which stabilization and marketing plans are in effect, he may consolidate the areas.

62062. Each stabilization and marketing plan shall contain provisions whereby the director establishes minimum prices to be paid by handlers to producers for market milk in the various classes. The director shall establish the prices by designating them in the plan, or by adopting methods or formulas in the plan whereby the prices can be determined, or any combination of the foregoing. If the director directly designates prices in the plan, the prices shall be in reasonable and sound economic relationship with the national value of manufactured milk products. If the director adopts methods or formulas in the plan for designation of prices, the methods or formulas shall be reasonably calculated to result in prices that are in a reasonable and sound economic relationship with the national value of manufactured milk products.

In establishing the prices, the director shall take into consideration any relevant economic factors, including, but not limited to, the following:

- (a) The reasonableness and economic soundness of market milk prices for all classes, giving consideration to the combined income from those class prices, in relation to the cost of producing and marketing market milk for all purposes, including manufacturing purposes. In determining the costs, the director shall consider the cost of management and a reasonable return on necessary capital investment.
- (b) That prices established pursuant to this section shall insure an adequate and continuous supply, in relation to demand, of pure, fresh, wholesome market milk for all purposes, including manufacturing purposes, at prices to consumers which when considered with relevant economic criteria, are fair and reasonable.
- (c) That prices, including the prices of components of milk, established by the director for the various classes of market milk bear a reasonable and sound economic relationship to each other.

In establishing the prices, the director shall also take into consideration all the purposes, policies, and standards contained in Sections 61801, 61802, 61805, 61806, 61807, 62076, and 62077.

62062.1. Any designation of a class 1 price by any method or formula that is used to develop class 1 prices paid to producers in the various marketing areas, shall provide, on a calendar year basis, a statewide weighted average minimum price level for a hundred weight of milk testing 3.5 fat and 8.7 solids not fat that is in reasonable relationship with minimum class 1 milk prices paid to producers in contiguous states. If the statewide weighted average class 1 prices paid to producers are not in a reasonable relationship with the class 1 prices paid to producers in contiguous states, the Department shall immediately hold a hearing to consider adjustments to the class 1 prices.

62074.5 A stabilization and marketing plan may contain provisions necessary to encourage the availability of market milk for those usages for which class 1 and class 2 milk is mandatory.

62076. In establishing prices to be paid by handlers to producers for class 2, class 3, class 4a, or class 4b market milk, the director shall take into consideration any relevant economic factors, including, but not limited to, the following:

- (a) The relative market value of the various products yielded from such market milk.
- (b) The market price of other milk which may be used for the same purposes that are set forth in such respective classes.
- (c) The value of milk used for manufacturing purposes giving consideration to any relevant factors, including, but not limited to, product prices, product yields, and manufacturing costs of class 4a or class 4b.

62077. A handler shall not pay any producer less than the applicable price established for the usage to which the market milk, purchased from him is applied pursuant to accounting procedures established by the director. If the market milk is not applied to any purpose set forth in Article 5 (commencing with Section 61931), then a handler shall not pay any producer less than the lower of the prices established under the applicable stabilization and marketing plan for class 4a and class 4b usage.

62700. The production and distribution of fluid milk and fluid cream is hereby declared to be a business affected with a public interest. The provisions of this chapter are enacted in the exercise of the police powers of this state for the purpose of protecting the health and welfare of the people of this state.

**62701.** It is hereby declared that fluid milk and fluid cream are necessary articles of food for human consumption; that the production and maintenance of an adequate supply of healthful milk of proper chemical and physical content, free from contamination, is vital to public health and welfare, and that the production, transportation, processing, storage, distribution and sale of fluid milk and fluid cream in the State of California is an industry, in whole and in part, affecting public health and welfare; that unfair, unjust, destructive and demoralizing trade practices have appeared within this industry and these practices constitute a menace to the health and welfare of the inhabitants of this state by threatening the stability of this industry and by thereby endangering the assurance to the people of the State of California of the maintenance of an adequate supply of this necessary commodity; that it is a policy of this state to promote, foster and encourage the intelligent production and orderly marketing of commodities necessary to its citizens, including fluid milk and fluid cream, and to eliminate speculation, waste, improper marketing, unfair and destructive trade practices, and improper accounting for milk purchased from producers.

**62702.** It is recognized by the Legislature that currently the powers conferred upon the director by Chapter 2 (commencing with Section 61801) are inadequate to enable the dairy industry to develop and maintain satisfactory marketing conditions and bring about and maintain a reasonable amount of stability and prosperity in the production of fluid milk and fluid cream; and that to accomplish these purposes, and particularly to insure to consumers within California an adequate and continuous supply of pure, fresh, and wholesome milk at fair and reasonable prices, including a reasonable estimate of the additional supply which is needed to provide for normal fluctuations in production and in consumer demand for those products, those powers must be supplemented by the powers conferred in this chapter upon the director to equalize gradually the distribution of class 1 usage among the producers of this state.

**62702.1.** It is recognized by the Legislature that the provisions for equalization of usages among producers and entry of new producers contained in the Gonsalves Milk Pooling Act, as originally enacted, and the pooling plan adopted thereunder, tended to achieve the purposes of that act; however, the provisions for more rapid equalization and additional new entry would more rapidly and effectively achieve the purposes of this chapter.

It is also recognized that some holders of pool quota and production base initially issued under the Gonsalves Milk Pooling Act have waited for several years for equalization, and that equalized producers have for a number of years not shared in any of the benefits of new quota created by new usage.

It is further recognized that it is necessary to promote and to attempt to assure more rapid equalization of the holders of pool quota issued subsequent to the initial allocation of production bases and pool quota pursuant to this chapter, and to provide for a program for entry and for equalization of new producers.

It is the purpose of the amendments to this chapter to provide a reasonable and equitable mechanism to permit more accelerated equalization; to equalize the holders of pool quota and production base initially issued under the Gonsalves Milk Pooling Act who are not yet equalized; and to legislatively allocate in a fair and reasonable manner a share of new pool quota, created by new usage, to existing pool quota holders who are not equalized, to new producers, and to equalized pool quota holders who have not shared in the benefits of the growth of new usage since the original enactment of the Gonsalves Milk Pooling Act and the pooling plan thereunder.

**62720.** No pooling plan formulated pursuant to this chapter shall restrict the free movement of fluid milk and no pooling plan shall result in an unequal raw product cost between distributors in the same marketing areas.

**62724.** This chapter does not modify the provisions of Chapter 1 (commencing with Section 61301) nor Chapter 2 (commencing with Section 61801) of this part, except as may be necessary to effect the purposes of this chapter. If necessary to effect the purposes of this chapter, the director, in establishing the minimum prices which shall be paid for fluid milk to producers, may establish minimum producer prices applicable at the producer's place of production.

**62727.** It is the intent of the Legislature that the power conferred in this chapter shall be liberally construed. The provisions of this chapter or subsequent amendment are severable. If any section, subdivision, paragraph, sentence, clause, or phrase of this chapter should be declared or held unconstitutional or invalid for any reason, such unconstitutionality or invalidity shall not affect the validity of any other provision of this chapter. The Legislature hereby declares that it would

have enacted each other such section, subdivision, paragraph, sentence, clause, or phrase of this chapter irrespective of the fact that one or more sections, subdivisions, paragraphs, sentences, clauses, or phrases has been declared unconstitutional or invalid. Provided further that any such finding of invalidity or unconstitutionality shall not invalidate, affect or impair pool quotas and production bases heretofore issued under the Gonsalves Milk Pooling Act or pooling plan promulgated thereunder.

# California Milk Pricing Formulas

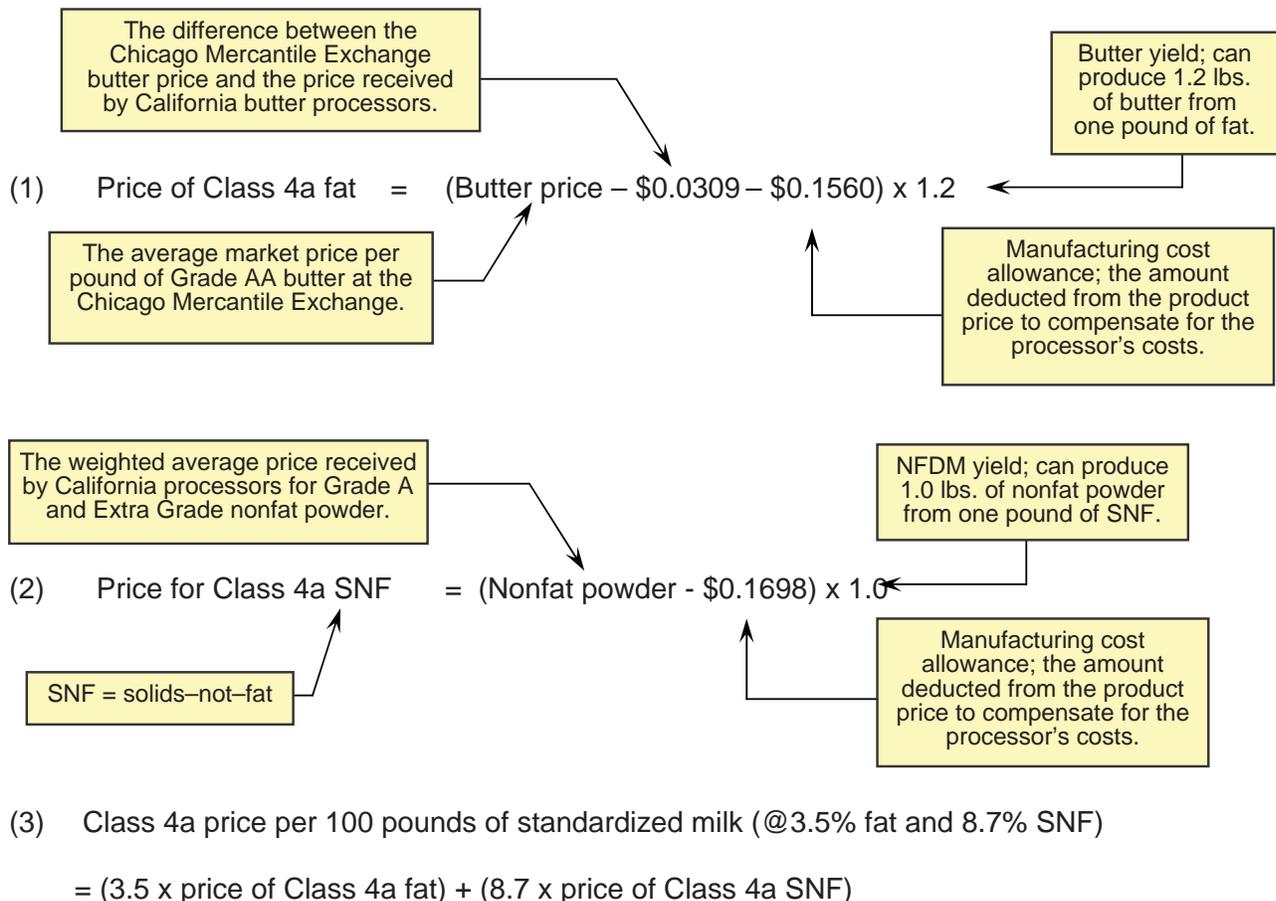
California's milk marketing program establishes minimum prices that processors must pay for Grade A milk received from dairy farmers. For the purposes of setting prices, there are five classes of milk that are established depending on the type of dairy product. In California's milk pricing system, commercial market prices for dairy product commodities are the most significant factor in determining the minimum price that processors must pay for milk.

Milk consists of three basic components: butterfat (fat), solids-not-fat (SNF), and fluid carrier (water). Prices are assigned to all three components in the determination of the Class 1 milk price. Only the fat and SNF components are used to set the Class 2, 3, 4a, and 4b milk prices. Because prices are determined for individual milk components, a simple calculation must be performed to obtain the implied hundredweight price. Class 1, 4a, and 4b prices are adjusted monthly, and Class 2 and 3 prices are adjusted bimonthly.

## The Five Classes of Milk

- Class 1: Milk used in fluid products, including whole, reduced fat, lowfat, and nonfat milks.*
- Class 2: Milk used in heavy cream, cottage cheese, yogurt, and condensed products.*
- Class 3: Milk used in ice cream and other frozen products.*
- Class 4a: Milk used in butter and dry milk products, such as nonfat dry milk.*
- Class 4b: Milk used in cheese, other than cottage cheese, and whey products.*

### Class 4a Price Formula (butter and dry milk products)



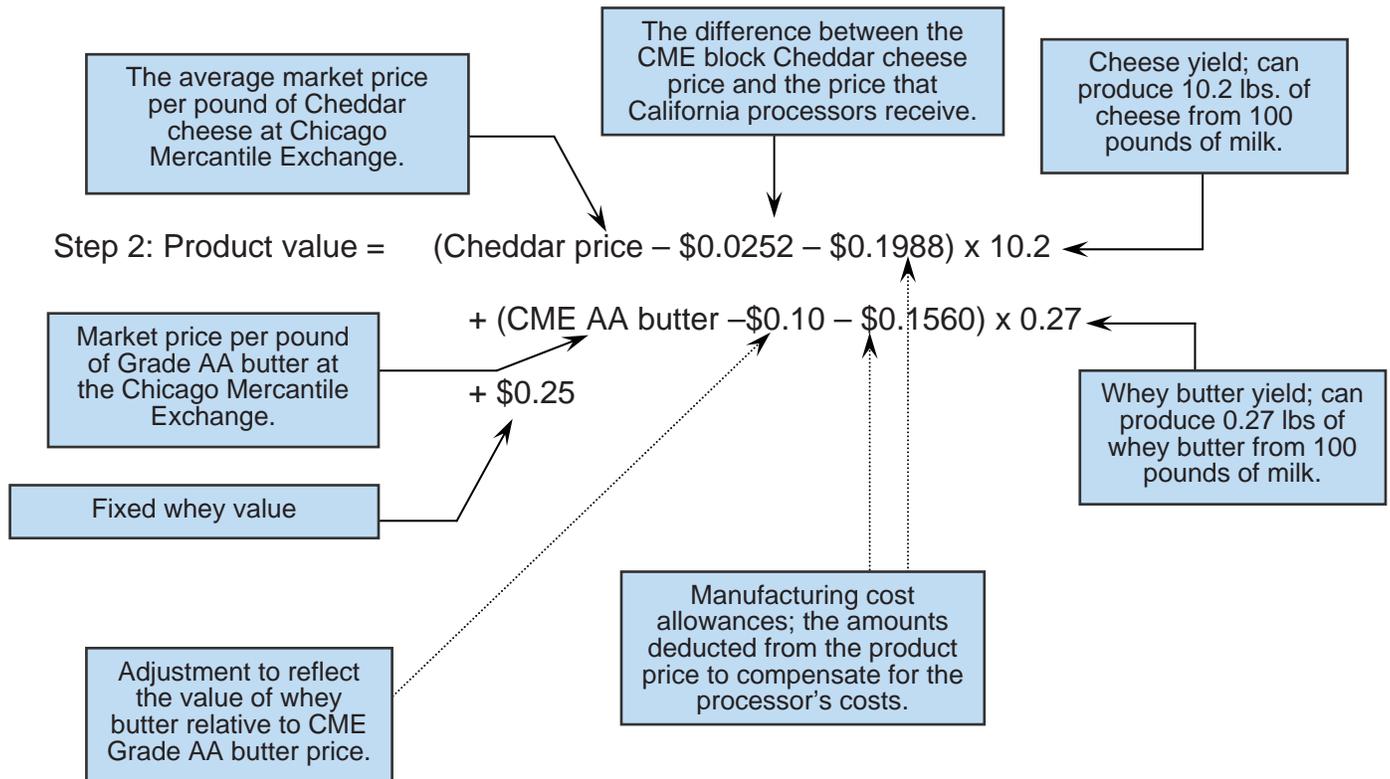
For any month in which the Secretary implements the collection of charges for the Milk Producers Security Trust Fund, the minimum Class 4a price shall be increased by:

- \$0.0032 per pound of fat, and
- \$0.0013 per pound of SNF

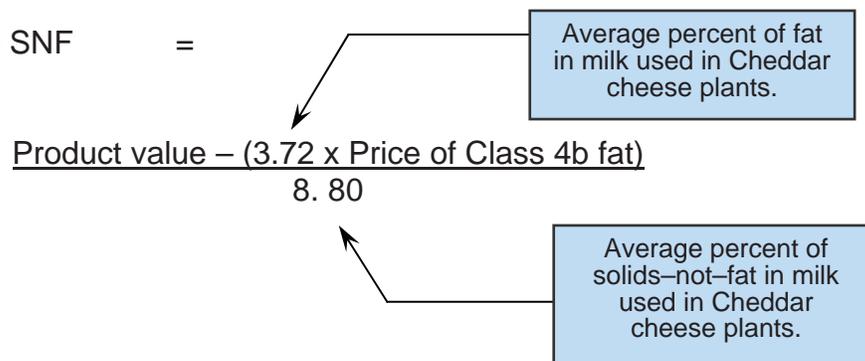
## Class 4b Price Formula (cheese)

The Class 4b price calculation consists of four steps. The first step sets the fat component price in 4b milk to that of 4a milk. The second step determines the product value of cheese and Grade B butter per hundred pounds of milk. The third step identifies the 4b SNF price. The fourth step converts the component prices to a standardized milk price.

Step 1: Price of Class 4a fat = Price of Class 4b fat



Step 3: Price of Class 4b SNF =



Step 4: Class 4b price per 100 pounds of standardized milk (@3.5% fat and 8.7% SNF)

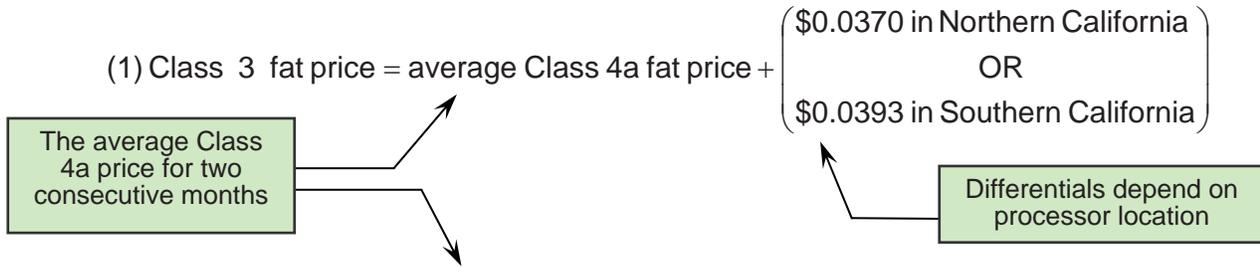
$$= (3.5 \times \text{price of Class 4b fat}) + (8.7 \times \text{price of Class 4b SNF})$$

For any month in which the Secretary implements the collection of charges for the Milk Producers Security Trust Fund, the minimum Class 4b price shall be increased by:

- \$0.0032 per pound of fat, and
- \$0.0013 per pound of SNF

## Class 3 Price Formula (frozen dairy products)

Class 3 prices are established on a bi-monthly basis prior to the beginning of each even month. For example, the February–March pricing period for Class 3 milk uses the average Class 4a component prices for December and January.



(2) Class 3 SNF price = average Class 4a SNF price + (\$0.0586 throughout California)

(3) Class 3 price per 100 pounds of standardized milk (@3.5% fat and 8.7% SNF)

= (3.5 x price of Class 3 fat) + (8.7 x price of Class 3 SNF)

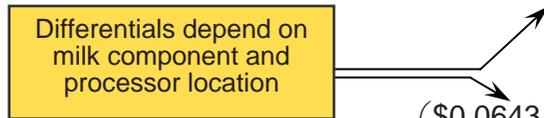
For any month in which the Secretary implements the collection of charges for the Milk Producers Security Trust Fund, the minimum Class 3 price shall be increased by: \$0.0032 per pound of fat, and \$0.0013 per pound of SNF

## Class 2 Price Formula

(sour cream, heavy cream, cottage cheese, and yogurt)

Like the Class 3 prices, Class 2 prices are established on a bi-monthly basis prior to the beginning of each even month. For example, the February–March pricing period for Class 2 milk uses the average Class 4a component prices for December and January.

(1) Class 2 fat price = Average Class 4a fat price +  $\left( \begin{array}{c} \$0.0370 \text{ in Northern California} \\ \text{OR} \\ \$0.0393 \text{ in Southern California} \end{array} \right)$



(2) Class 2 SNF price = Average Class 4a SNF price +  $\left( \begin{array}{c} \$0.0643 \text{ in Northern California} \\ \text{OR} \\ \$0.0901 \text{ in Southern California} \end{array} \right)$

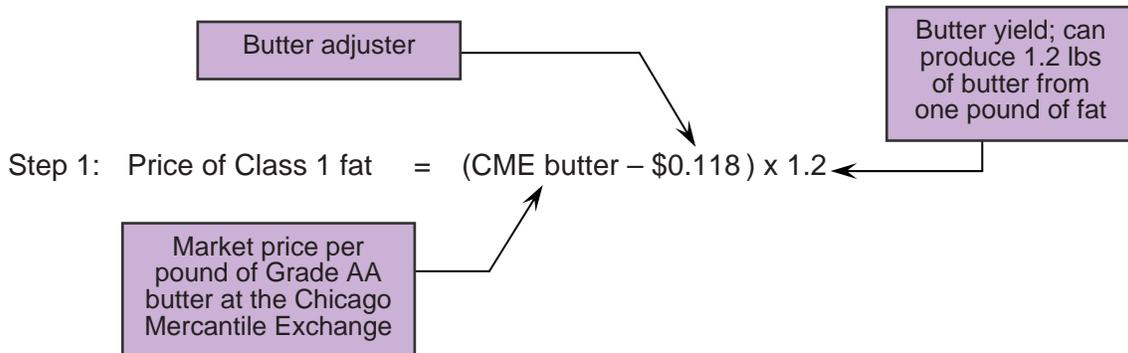
(3) Class 2 price per 100 pounds of standardized milk (@3.5% fat and 8.7% SNF)

= (3.5 x price of Class 2 fat) + (8.7 x price of Class 2 SNF)

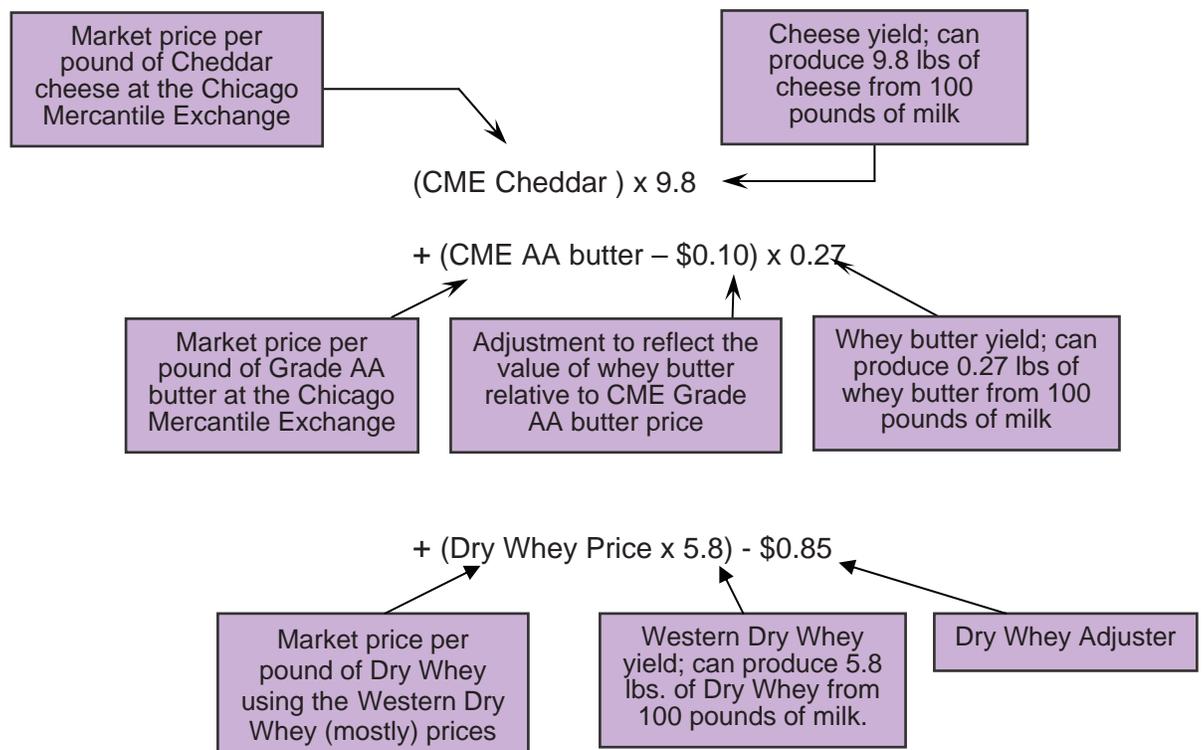
For any month in which the Secretary implements the collection of charges for the Milk Producers Security Trust Fund, the minimum Class 2 price shall be increased by: \$0.0032 per pound of fat, and \$0.0013 per pound of SNF

## Class 1 Price Formula for Fluid Milk Products

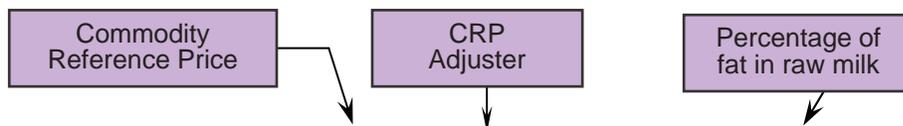
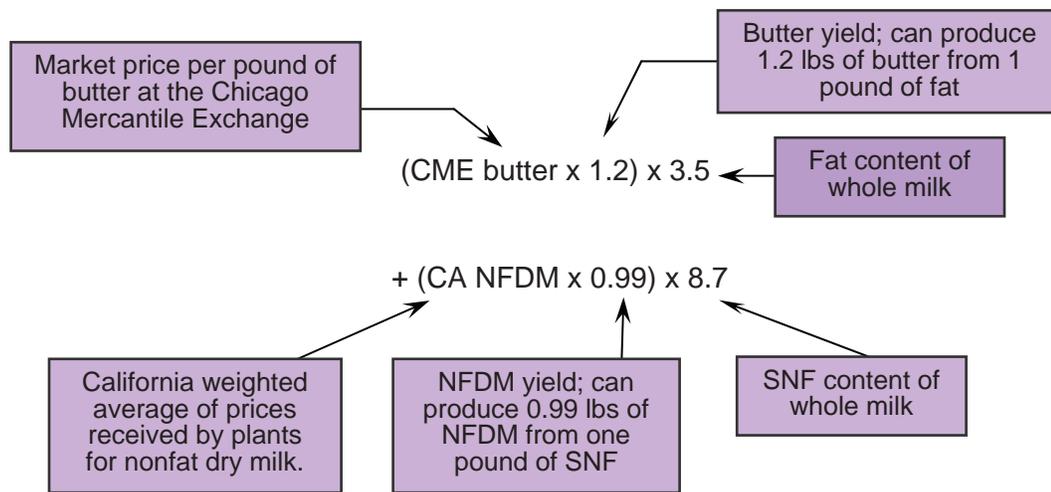
Determining the price for fluid milk products involves several steps. The Class 1 fat price in the fluid milk pricing formula is set directly and uses the Chicago Mercantile Exchange (CME) butter price with an adjuster. The SNF and carrier prices are calculated as residuals. They rely on a basic price mover called the commodity reference price (CRP) which is based off the higher of the price for CME Cheddar cheese and Mostly Western Dry Whey or the CME Grade AA butter and California weighted average price for nonfat dry milk. The value of the Class 1 fat price is subtracted from the CRP and the remaining residual value is allocated to SNF and carrier. Once the component prices have been assigned to fat, SNF, and fluid carrier portions of milk, these component prices are converted to a standardized hundredweight milk price.



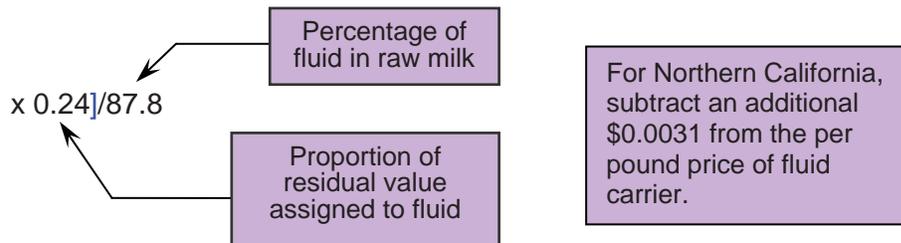
Step 2: Commodity Reference Price = the **higher of** two price calculations:



OR



Step 4: Price of Class 1 fluid = [(CRP + \$0.147) - (Class 1 fat price x 3.5)]



Step 5: Class 1 price per 100 pounds of milk (@3.5% fat and 8.7% SNF)

$$= (3.5 \times \text{Class 1 fat}) + (8.7 \times \text{Class 1 SNF}) + (87.8 \times \text{Class 1 carrier})$$

For any month in which the Secretary implements the collection of charges for the Milk Producers Security Trust Fund, the minimum Class 1 price shall be increased by: \$0.0017 per pound of fat, \$0.0009 per pound of SNF, and \$0.0001 per pound of carrier