

May 14, 2003

THIS IS A CLARIFICATION FOR THE PETITION SUBMITTED ON MARCH 7, 2003

Honorable William Lyons, Jr.
Secretary of Agriculture
California Department of Food and Agriculture
1220 N Street
Sacramento, California 95814

Dear Secretary Lyons:

Land O' Lakes petitions the Department to hold a hearing on transportation credits and allowances. The reasons for the petition are explained in the next paragraph. We are petitioning to hold a hearing on both transportation credits and allowances, which would require a hearing both in milk pooling and in milk stabilization. We hope that serious consideration will be given to these proposals.

There have been significant changes in the structure of the dairy industry in California in the last couple of years. From a processing standpoint, the California dairy industry has become significantly more concentrated. But, one factor has not changed and that is that significant amounts of milk are moved from the South Valley into Southern California. California sources of milk need to be more competitive with in-state and out-of-state sources of milk. In order to facilitate servicing the Class 1 market it is our position that it is essential to not only adjust the transportation credit from the South Valley to Southern California but to add a separate higher transportation credit into Riverside County. The hauling cost from the South Valley into Riverside County is significantly larger than it is from the South Valley into Los Angeles, Orange and Ventura Counties. Land O' Lakes has serviced Southern California for more than 50 years and we have serviced an account in Riverside County for many years. Our proposal is to adjust the transportation credit from the South Valley to Southern California, to expand the transportation allowances from the South Valley to Southern California and to amend the transportation allowances for milk in San Bernardino, Inyo, Los Angeles, Mono, Orange, Riverside and Ventura Counties in Southern California.

Hauling rates increased significantly. The shortfall is tremendous and Land O' Lakes is simply not competitive with in-state nor with out of -state sources of milk. Therefore, we are making the following proposal with no shortfall to be more competitive.

Proposal number 1: Adjust the transportation credit from 50 cents to 74 cents for milk shipped from Tulare County to Riverside County and to San Diego from 50 cents to 66 cents for milk shipped from Tulare County to LA county, Orange County or Ventura Counties. The hauling cost from Tulare to LA County, Orange or Ventura Counties is 93 cents per cwt. The math is as follows: The current area differential is 27 cents per cwt

and so the difference between 93 cents and 27 cents is 66 cents. The hauling cost from Tulare to Riverside County is \$1.01. The difference between \$1.01 - .27 = \$.74 per cwt. There has usually been a shortfall in moving milk on a plant-to-plant basis from the South Valley to Southern California. Our proposal is that we remove the shortfall so that milk can move to Southern California plants so that we can be competitive in the market place with other sources of milk from both in-state and out-of-state. Today, the shortfall from Tulare to Riverside County is 24 cents and LA and Orange Counties it is 16 cents and that is the largest shortfall in history for moving milk on a plant-to-plant basis from the South Valley to Southern California. We, of course, recommend that the area differential be maintained at 27 cents per cwt between Northern and Southern California.

In addition, we are requesting that the transportation credit apply to condensed skim as well. The difference in the Class 1 price between Northern California and Southern California amounts to \$.21 per cwt for condensed skim assuming a solids percentage of 32 percent. The hauling cost from Tulare to LA county customers is \$.93 per cwt, which means there is a shortfall of (.93 - .21) of \$.72. There is a tremendous shortfall with condensed skim. California has fluid standards and the customers we serve need to purchase condensed skim to meet those milk standards. Without a shortfall, we are recommending a transportation credit of \$.72 for condensed skim from Tulare to LA and Orange County plants. The hauling cost from Tulare to Riverside County is \$1.01, which means there is a shortfall of (1.01 - .21) of \$.80. Again, without a shortfall, we are recommending a transportation credit of \$.80 for condensed skim from Tulare to Riverside County. Our analysis clearly shows that the South Valley is not competitive with out-of-state sources of condensed skim.

The specific language would be as follows:

Section 300.2. Each handler located in counties designated herein as a supply county may deduct from the applicable minimum prices pursuant to Section 300.00, paragraph (A), a transportation credit for quantities of market milk and market skim milk shipped in bulk form to a plant located in a designated county. Shipments of cream are excluded from such transportation credits. Such deduction shall not exceed amounts shown for such bulk transfers in the following schedule:

Maximum Deduction	For Shipments to	
	Per cwt	Designated Deficit Counties
Los Angeles County	\$.24	San Diego, Riverside, Orange, Or Ventura Counties

Tulare County	\$.74	Riverside or San Diego
Tulare County	\$.66	Orange, Los Angeles or Ventura Counties
Fresno County and Kings County	\$.77	Riverside or San Diego
Fresno County and Kings County	\$.69	Orange, Los Angeles or Ventura Counties

The schedule for condensed skim would be as follows:

Tulare County	\$.80	Riverside or San Diego
Tulare County	\$.72	Orange, Los Angeles or Ventura Counties

The remainder of the transportation credits specifically for Northern California would remain unchanged.

Proposal 2. To make California more competitive with out-of-state sources and to provide more producer equity, we are recommending three important changes in the transportation allowance. One is to expand the transportation allowance to Riverside County, the second is to adjust the current transportation allowance in San Bernardino County to reflect the difference between the cost of the milk haul to a manufacturing facility and to the Class 1 market and third as in earlier versions of the transportation allowance, we are recommending that the supply counties be limited. We recommend the elimination of Fresno County as a supply county for the transportation allowance system. As usual we believe the transportation allowance should be available only to producers who have the option of shipping their milk to a manufacturing facility.

Section 921. Producers, including producer-members of cooperative associations, will receive transportation allowances on shipments to plants which are located within designated areas and which, during the immediately preceding 12-month period actually processed more than 50 percent of the total pounds of milk processed at the plant location into products other than Class 4a or Class 4b. For purposes of this section, a “plant” includes one of more pool plants under single ownership within a designated area.

For plants located in the Southern California receiving area which shall consist of the counties of Los Angeles, Orange, Ventura and **Riverside**:

(1)From Inyo, Los Angeles, Mono, Orange, Riverside, San Bernardino, and Ventura counties the following transportation allowance will apply:

From zero through 89 miles	0
Over 89 miles	\$.12 per Cwt

(2)From Santa Barbara, San Diego, Imperial, Kern, Kings and Tulare Counties

From zero through 89 miles	0
Over 89 through 139 miles	\$.43 per CWT
Over 139 miles	\$.58 per CWT

For plants located in the San Diego receiving area, which consist of the County of San Diego:

(1)From Inyo, Los Angeles, Mono, Orange, Riverside, San Bernardino, and Ventura counties:

From zero through 89 miles	0
Over 89 miles	\$.12 per Cwt

(2)From Santa Barbara, San Diego, Imperial, Kern, Kings and Tulare Counties

From zero through 89 miles	0
Over 89 miles through 139 miles	\$.43 per Cwt
Over 139 miles	\$.58 per Cwt

Justification for the proposals:

1. One of the reasons for the adjustments in the transportation credits is to provide equity among Class 1 milk supplying firms from the surplus producing areas into the deficit market areas in Southern California. There are certainly adequate amounts of milk available to meet the Class 1 needs in this state. These adjustments will help to make California sources to be more competitive with out-of-state sources for Class 1 markets in California. A second reason is producer equity. A producer should not incur higher costs to move milk to a Class 1 plant than to a local manufacturing facility.
2. There is a need for more than a single transportation credit makes because it is much easier to achieve equal raw product costs among firms if the transportation

credit is applied in two locations. It simply costs more to move milk from the South Valley into Riverside County than it does from the South Valley into Los Angeles, Orange or Ventura Counties.

3. The use of more than one transportation credit is in accord with what is being done in Federal order markets. The Federal order markets that use the transportation credit use the mileage from the supply plant to the Class 1 plant wherever it is located. That concept has logic. In fact, we are recommending one transportation credit from Tulare to Riverside County and another transportation credit from Tulare to Los Angeles, Orange and Ventura Counties.
4. One of the advantages of moving milk on a plant-to-plant basis from the South Valley is that the milk can be tailored to match the utilization of fat and solids not fat in milk used for Class 1 purposes. In fact, most of the milk moved to Southern California from the South Valley on a plant-to-plant basis has been tailored milk. The tailoring of milk avoids the costly process of separating the milk into skim and into cream in the Southern California bottling plant and from shipping surplus cream from Southern California to the South Valley for processing such cream into butter.
5. Economic theory supports the concept that price differences in milk reflect costs of transportation when moving milk from surplus to deficit markets. In California such costs of transportation are compensated for through the use of transportation allowances and credits.
6. From a historic standpoint, California has always had an area differential or a combination of an area differential and a transportation credit to reflect the cost of moving milk from surplus producing areas to deficit markets. The same is true in Federal order markets.
7. Land O' Lakes has served customers in Southern California for 50 years or more. Land O' Lakes has been meeting its commitment to serve the Class 1 market and they have done that for years.
8. The transportation allowances should be adjusted to reflect the additional cost for serving Class 1 markets than local manufacturing facilities in San Bernardino and Imperial County. The current transportation allowances for San Bernardino and Imperial Counties are larger than should be the case.
9. The expansion of the transportation allowance into Riverside County also makes sense. Milk is being moved into Riverside County from the South Valley and it makes sense to allow producer milk to move on a ranch to plant basis from the

South Valley into Riverside County. The expansion of the transportation allowance from the South Valley into Riverside County also makes California sources of milk more competitive with milk from other sources.

10. The transportation credit for condensed needs to be added in order to make the South Valley competitive in supplying condensed skim for Class 1 fortification in Southern California plants. The current area differential of \$.27 per cwt is achieved by setting the Southern California fluid price .0031 higher than the Northern California fluid price ($87.8 \times .0031 = \$.27$ per cwt). However, the condensed skim has only 68 pounds of fluid carrier and so the area differential for condensed skim is ($68 \times .0031 = \$.21$ per cwt). Therefore, with the freight cost of \$1.01 from Tulare County to Riverside County, for the South Valley to be competitive, it was necessary to request a transportation credit of \$.80 per cwt for condensed skim for Riverside County. Since the freight cost to LA county from Tulare County is \$.93 to be competitive, it was necessary for us to ask for a transportation credit of \$.72 for condensed skim shipped plant to plant from Tulare to LA, Orange or Riverside Counties. It is essential that a transportation credit be applied to condensed skim so that Land O' Lakes can supply this product to Southern California plants to fortify Class 1 milk to meet California standards. Furthermore, the shipment of condensed from the "South Valley" saves hauling cream back from the Southern California area. If the supplying firm paid the freight, our analysis shows that it is actually advantageous for a Southern California Class 1 plant to buy out-of-state condensed skim rather than from in-state South Valley sources especially if the California Class 1 processor pays less than the modified quota price.

We urge that the Department call a hearing on these important issues. Thank you.

Sincerely,

James W. Gruebele
Consultant for Land O' Lakes

CC: Kelly Krug
David Ikari
John Lee