
WHEREAS, a consolidated public hearing on the Stabilization and Marketing Plans for all milk marketing areas in the State was held in Sacramento, California on June 1, 1982, concurrently with a hearing on the Pooling Plan for Market Milk, for the purpose of considering:

1. The incorporation into the Stabilization and Marketing Plans and the Pooling Plan for Market Milk the requirements of AB 903 which establishes Class 4a and Class 4b designations for milk in place of the single Class 4 designation;

2. The replacement of the Real Net Spendable Earnings index in the Class 1 pricing formula with the Average Weekly Earnings index; and

3. An alternative for the Cost of Production index factor and the Class 4 price factor used in the Class 1 price formula in the event that either factor is not available; and

WHEREAS, a public hearing on the Stabilization and Marketing Plan for Southern California was held in Ontario, California on June 18, 1982 for the purpose of considering an area price decrease in order to maintain a reasonable and sound economic relationship between the Southern California Marketing Area and the marketing areas in the remainder of the State; and

WHEREAS, a consolidated public hearing on the Stabilization and Marketing Plans for all milk marketing areas in the State, except for the Southern California Marketing Area, was held in Sacramento, California, on June 22, 1982 for the purpose of considering amendments to the South Valley, Northern California, Del Norte-Humboldt and Central Valley Marketing Areas in order to maintain a reasonable and sound economic milk price relationship between such areas and the Southern California Marketing Area; and

WHEREAS, a second consolidated public hearing on the Stabilization and Marketing Plans for all milk marketing areas in the State was held in Sacramento, California on June 22, 1982 for the purpose of considering amendments to the Stabilization and Marketing Plans with respect to amendments to the Pool Obligation Credit provisions of such Plans, and;

WHEREAS, pursuant to the provisions of Chapter 2 and Chapter 3, Part 3, Division 21 of the Food and Agricultural Code, full and proper notice of said hearings were regularly given by mail in accordance with the provisions of Section 61994 of said Code, to all producers, producer-handlers, and handlers of record with the California Department of Food and Agriculture, who may be subject to the provisions of the Stabilization and Marketing Plans for Market Milk for said marketing areas and the Pooling Plan for Market Milk; and

WHEREAS, said hearings were called at the instance of the Director and pursuant to petitions from the dairy industry; and

WHEREAS, at said hearings, all persons were afforded an opportunity to be heard and testimony and evidence, both oral and documentary, were offered and received; and
WHEREAS, as set forth with more particularity in the administrative record of the proceedings herein, based on evidence at said hearings, and as supplemented in the record thereafter, it is hereby found and concluded that:

1. A minimum price for milk utilized as Class 4a be established in the same manner as the current Class 4 price is established.

2. The new Class 4a price be used as an element in the Class 1 price formula in place of the current Class 4 price.

3. The new Class 4b price be established at the same level as the new Class 4a price at this time.

4. The current Los Angeles-Long Beach RNSE factor be replaced with the Average Weekly Earnings factor, as made available by the Employment Development Department of the California Health and Welfare Agency, as an element in computing the Class 1 price.

5. The data from the most recent time period available on inputs to the Class 1 pricing formula be used in the event that the cost of production index factor or the Class 4a price factor, as set forth in the Stabilization and Marketing Plans, is not available.

6. The Class 1 price for milk fat in all marketing areas be reduced by $.00597 per pound to offset the average $.0209 per hundredweight increase in the Class 1 price caused by the amendments to the Class 1 pricing formula.

7. The Class 1 fluid carrier component price be increased by $.0018 per pound ($.16 per hundredweight) in all marketing areas in the State except the Southern California Marketing Area.

8. All other prices and price differentials be retained at current levels in the Stabilization and Marketing Plans.

9. The Pool Obligation Credits between the designated supply counties in the South Valley Marketing Area and the designated deficit counties in the Southern California Marketing Area be increased by $.16 per hundredweight.

10. Extension of the Pool Obligation Credit to any milk products not now covered be denied.

11. The request to establish Pool Obligation Credits by a formula rather than by the current hearing process be denied; and

WHEREAS, the Director hereby adopts concurrent Economic Basis for Findings and Conclusions on Material Issues;

NOW, THEREFORE, after due deliberation upon the full consideration of the facts and evidence adduced, the Director of the California Department of Food and Agriculture hereby finds that the Stabilization and Marketing Plans and the Pooling Plan for Market Milk now in effect in said Marketing Areas are no longer in conformity with the standards prescribed in said Chapters 2 and 3, and that the same will not tend to effectuate the purposes of said Chapters 2 and 3 without amending said Plans and that amendments to such Stabilization and Marketing Plans and such Pooling Plan for Market Milk are proper and necessary in order that said Plans shall continue to conform with the standards prescribed in, and shall continue to tend to effectuate the purposes of, said Chapters 2 and 3; and
The Director of the California Department of Food and Agriculture further finds that amendments to the Stabilization and Marketing Plans for Market Milk for said Marketing Areas, and each and every part of said plans, identified as Central Valley Order Number Nine (9), Del Norte-Humboldt Order Number Ninety-six (96), Northern California Order Number Five (5), South Valley Order Number Twenty-two (22), and Southern California Order Number Twenty-one (21), and Pooling Plan Order Number Thirty-eight (38) are necessary to accomplish the purposes of said Chapters 2 and 3 and hereby determines that said Plans, as Amended, will tend to accomplish the purposes of said Chapters 2 and 3 within the standards therein prescribed.

All testimony and items of evidence submitted by all parties to these proceedings, whether or not specifically mentioned herein, have been considered in rendering these findings and conclusions.

Richard E. Rominger
Director of Food and Agriculture

By V. L. Shahbazian

V. L. Shahbazian, Chief
Bureau of Milk Stabilization

Date July 20, 1982

R. A. Abbott
Senior Agricultural Economist
Bureau of Milk Stabilization
ECONOMIC BASIS FOR FINDINGS AND CONCLUSIONS ON MATERIAL ISSUES PRESENTED FOR
CONSIDERATION FOR AMENDMENT OF STABILIZATION AND MARKETING PLANS FOR MARKET
MILK FOR THE CENTRAL VALLEY, DEL NORTE-HUMBOLDT, NORTHERN CALIFORNIA,
SOUTH VALLEY AND SOUTHERN CALIFORNIA MARKETING AREAS

General Background

A series of hearings were held which would amend both the Stabilization and Marketing
Plans and the Pooling Plan for Market Milk. The first hearing, which was held on June 1
in Sacramento, was a concurrent consolidated statewide hearing on the Stabilization and
Marketing Plans and the Pooling Plan for Market Milk.

The purpose of the first hearing was to determine (1) the method to incorporate into the
Stabilization and Marketing Plans and Pooling Plan for Market Milk the requirements of
AB 903, (2) a feasible replacement for the present Real Net Spendable Earnings factor
used in the California Class 1 price formula, and (3) alternatives for the Cost of Pro-
duction Index factor and the Class 4 price factor used in the Class 1 price formula,
in the event that either factor is not available.

The second hearing, which was held on June 18 in Ontario, was a single area hearing to
consider amendments to the Stabilization and Marketing Plan for the Southern California
Marketing Area.

The third and fourth hearings were held in Sacramento on June 22, one following the
other. The first of these was a consolidated hearing on the Stabilization and Marketing
Plans for all marketing areas in the State other than the Southern California Marketing
Area. The other was a consolidated statewide hearing on the Stabilization and Marketing
Plans for all marketing areas in the State with a view to making adjustments in the Pool
Obligation Credit, should there be price changes in the various marketing areas resulting
from the other hearings in the same series.

In recent years the Class 1 prices in all marketing areas of the State have been adjusted
under an automatic price formula. The function of this formula is to adjust uniformly
either upward or downward all Class 1 prices in all marketing areas within the State
each two-month period. The uniformity of change between the areas does not take into
consideration cost of production differences which occur in the individual areas, changing
modes of distribution and marketing within individual marketing areas, nor does it con-
sider necessary changes which may occur as a result of marketing area consolidations.
It is for these reasons that the series of hearings were held to review individually any
adjustments that may be needed in any given marketing area.

The standards by which minimum Class 1 prices in each marketing area are established
take into consideration similarities in production and distribution within a given
marketing area and do not necessarily consider price differences between the various
markets. However, since there are areas of surplus production and other areas of
deficit production, the inter-area relationships cannot be ignored.

The Issues

1. On March 25, 1982, AB 903, Chapter 132, Statutes of 1982, established Class 4a
and 4b designations for milk in place of the single Class 4 designation. The 4b
classification is confined to milk used in making cheese other than cottage cheese.
The remainder of the current Class 4 items are classified as Class 4a. This change
in classification requires that the Stabilization and Marketing Plans and the
Pooling Plan be amended in order to conform to the statute.
2. Real Net Spendable Earnings (RNSE) which has been one of the three factors of the California Class 1 pricing formula is no longer available. The California Employment Development Department discontinued the calculation of the RNSE factor after publishing the one for December 1981. The back-up or alternative provisions of the Stabilization and Marketing Plans provide for the using of the most recent month. This provision has enabled the Department to continue to operate the Class 1 formula for the short run. However, for the long run, a substitute for the RNSE must be developed.

3. Besides RNSE, the other two factors in the Class 1 price formula are the Cost of Production Index and the Class 4 price. In the event the data for these inputs are not available for the calculation of the Class 1 formula for the prescribed time period, the Department presently has no alternative or back-up measures.

4. Currently the Class 1 price paid to producers by handlers is $14.12 per hundredweight in the Southern California Marketing Area and $13.50 per hundredweight in the South Valley Marketing Area, or a differential of 55¢ per hundredweight. Consideration needs to be given to amending the Class 1 prices so that the price relationships between the various marketing areas are more nearly in line with the cost of producing and marketing of milk in the various areas.

5. Currently the Class 2 prices paid to producers by handlers is $12.97 per hundredweight in the Southern California Marketing Area and $12.74 in the rest of the State (excluding the Del Norte-Humboldt Marketing Area), or a differential of 23¢ per hundredweight. The Class 3 price differential between the Southern California Marketing Area and the rest of the State (excluding Del Norte-Humboldt) is only one cent per hundredweight. Testimony was presented at the hearing requesting termination of these differentials.

6. Consideration should be given to the adjustment of the Pool Obligation Credit between marketing areas if Class 1 prices are adjusted as a result of this series of hearings.

7. Condensed skim milk and cream do not qualify for the Pool Obligation Credit which is available to shipments of bulk milk for Class 1 usage. The inclusion of condensed skim milk shipments for eligibility for pool obligation credit also was requested at the hearing.

8. The request by a handler to reduce the Class 2 price statewide was made at the hearing.

9. A request by a handler to establish a formula to automatically adjust pool obligation credits was made at the hearing.

Issue No. 1: Class 4a and Class 4b designations

The Department made the following proposals:

a. Establish a minimum price for milk utilized as Class 4a in the same manner as the current Class 4 price is established.

b. Use the new Class 4a price as the element in the Class 1 price formula in place of the current Class 4 price.

c. Establish the new Class 4b price at the same level as the new Class 4a price at this time.
In the testimony presented, it was pointed out that the intent of the legislation was not to cause immediate changes in the pricing of milk used for butter, powder and cheese, but instead to provide the mechanism whereby changes can be made as the cheese industry expands in California.

The Department's proposals were supported by the testimony with the understanding that there be further review by hearing if later the Class 4b price is to be established at a different level than the Class 4a price. No testimony was presented requesting the establishment of separate prices for Class 4a and Class 4b at this time.

Establishing Class 4a as the price element in the Class 1 formula in place of the Class 4 price is more suitable than using the Class 4b price, especially if separate prices for these classes are later adopted. The current Class 4 price reflects federal support prices and open market prices for butter and nonfat dry milk (powder), which are the major products used in California to clear the market. Using the Class 4a price would allow for the continued use of these butter and powder prices.

Issue No. 2: RNSE Replacement

The Department proposed substituting the RNSE factor with an Average Weekly Earnings (AWE) factor for California production workers - 1967 dollars. A statistical report, "A Replacement for the Real Net Spendable Earnings Component of the California Class 1 Milk Price Formula" comparing the current RNSE factor and the AWE factor was used as a basis for the departmental position.

The analysis was conducted over the Class 1 pricing periods August-September 1978 through February-March 1982. The results showed that:

1. On the average, over the 44 months the formula Class 1 price calculated with the AWE is $0.0146 per hundredweight more than the formula Class 1 price calculated with the RNSE.

2. If past trends continue, there is a 99 percent confidence that the future value of the average difference referred to in Item 1 will remain in the range of $0.0010 per hundredweight to $0.0283 per hundredweight.

3. The coefficient of correlation between RNSE and AWE is 0.94, which is considered a very high correlation.

4. The coefficient of correlation between the formula Class 1 price calculated with RNSE and the formula Class 1 price calculated with AWE is 0.99, which is considered an extremely high correlation.

The RNSE utilized a monthly average weekly earnings figure and a monthly Consumer Price Index (CPI). However, the AWE - 1967 dollars factor utilizes a CPI that is calculated by the California Department of Industrial Relations on a bimonthly basis and only corresponds to the month in question. Therefore, even though the Employment Development Department calculates a monthly AWE, only bimonthly AWE figures that correspond to the CPI were used in the development of the AWE - 1967 dollars factor.

A minority of the testimony pointed out that using only a single bimonthly AWE figure in the calculations may leave out critical data. A subsequent analysis, using a bimonthly average of AWE divided by the corresponding bimonthly CPI, showed a 0.98 regression correlation with the RNSE and an average formula Class 1 price difference of $0.0209 per hundredweight.
Testimony also recommended the use of a constant for the 15% RNSE factor because real net spendable earnings has appeared to have had a small impact on price changes.

A portion of the testimony also recommended an adjustment to take care of any upward biases in the Class 1 price resulting from the adoption of the RNSE substitute.

The continued use of the most recent RNSE figure available, December 1981, is no longer relevant to the time frame of the formula and therefore a substitute must be found. As an alternative the adoption of a constant in place of the 15% RNSE factor is simple, but is contrary to the economic intent of that portion of the Class 1 price formula, taking into consideration consumer purchasing power along with Class 4 prices and Cost of Production figures. Using a constant figure would constitute a change in the formula policy.

The Department's proposed replacement, Average Weekly Earnings - 1967 dollars, using a single bimonthly Average Weekly Earnings figure corresponding to a bimonthly Consumer Price Index, showed statistical acceptance as a substitute for the current RNSE factor, and was supported by the majority of the testimony. Even though the AWE - 1967 dollars factor using monthly average weekly earnings figures showed a slightly higher, but insignificant, correlation, it led to a slightly higher ($0.0209/cwt vs. $0.0146/cwt.) formula Class 1 price when compared with the RNSE formula Class 1 price. In order to use all the relevant data available, it will be economically justifiable to use a bimonthly average of AWE divided by the corresponding CPI.

The $0.0209 per hundredweight difference obtained in the statistical analysis is relatively insignificant. However, a one-time adjustment should be made in one of the Class 1 minimum price components to accommodate the $0.0209 per hundredweight increase. A reduction in the price of milk fat of $.00597 per pound, when rounded off, will accomplish the adjustment. A one-time adjustment, instead of an ongoing bimonthly adjustment to the Class 1 price, would be the simplest and most efficient method and would accomplish the purpose.

Issue No. 3 - Substitute Factors for the Class 1 Formula

Cost of Production

In the event that current data are not available to calculate the Cost of Production Index for the Class 1 price formula, data from the most recent two-month period should be used. The Cost of Production Index is calculated on a bimonthly basis and therefore precludes the use of only the most recent month's data. Incorporating Cost of Production data from earlier periods would generate a Class 1 price that would not likely reflect current economic conditions.

Class 4a Price

A Class 4a price will be determined monthly. The Class 4a prices established for prescribed months will be used as input to the Class 1 milk pricing formula, the same as has been done with the Class 4 prices until now. In order that there be a back-up for the data input to the Class 1 pricing formula it is necessary to provide a back-up procedure for establishing the Class 4a price. Once the Class 4a back-up procedure is in place, there will be a Class 4a price available for all months. It will therefore be unnecessary to prescribe a separate procedure for determining a back-up system with respect to the Class 4a price input into the Class 1 pricing formula. The procedure for establishing a current Class 4a price when the data input to the Class 4a pricing formula is unavailable will be to use the Class 4a price established for the most recent month.
Testimony was presented recommending that when missing data become available such data should be used in subsequent pricing periods to correct any inequities that may have occurred as a result of using prior historical data. These alleged inequities would be minor and would be difficult to determine. It would require weighted calculations on a dollar per hundredweight basis since the volume of production fluctuates from one period to the next. In addition, once current data become available, the intent is to have milk prices established by normal operation of the Class 1 pricing formula as soon as possible. Correcting for such minor inequities would decrease the functional intent of the formula and prolong the time period before the formula is allowed to operate normally.

There should be no correction for inequities, and upon the availability of current data the Class 1 price formula should resume normal operation from the time period for which the current data are obtained.

Issue No. 4: Class 1 Price Levels - Southern California vs. Remainder of the State.

Currently the Class 1 price differential between the Southern California and South Valley Marketing Areas is 55¢ per hundredweight. Recent cost of production studies by the Department have indicated that the cost of producing milk between the Southern California and South Valley Marketing Areas have been coming progressively closer together, as evidenced by the following table:

<table>
<thead>
<tr>
<th>Period Covered</th>
<th>Marketing Area Comparison</th>
<th>Class 1 Price/Cwt. Differential</th>
<th>Production Cost By Area And The Differential per Cwt.</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Valley</td>
<td>12.60</td>
<td>11.70</td>
<td>+ $ 0.55</td>
<td>+ $ 1.35</td>
</tr>
<tr>
<td>Differential</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Valley</td>
<td>13.96</td>
<td>13.40</td>
<td>+ $ 0.55</td>
<td>+ $ 0.98</td>
</tr>
<tr>
<td>Differential</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Valley</td>
<td>13.57</td>
<td>13.75</td>
<td>+ $ 0.55</td>
<td>+ $ 0.39</td>
</tr>
<tr>
<td>Differential</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In the recent past, prices between these two areas have been maintained at levels which would allow milk to move from plants located in the South Valley Marketing Area to plants located in the Southern California Marketing Area by adjusting the price differential to approximately the same level as the cost of transporting milk between the areas. In 1981, a new system, called a plant-to-plant override or a Pool Obligation Credit, was established which reimburses out of the statewide pool a substantial part of the difference between the actual price differential and the cost of shipping between areas. Since the introduction of the Pool Obligation Credit (POC), the marketing area prices between areas need not reflect transportation cost differences in order that milk be encouraged to move. Therefore, the prices established for each marketing area should be more in line with the cost of production and distribution within each marketing area in conformity with the standards prescribed by statute specifically by reference to Section 62062(a) of the Food and Agricultural Code.
The current 55-cent price differential between the South Valley and Southern California Marketing Areas, as shown in the above table, should be reduced to 39c per hundredweight. This would be a reduction of 16c per hundredweight in the differential. Most testimony of industry supported this position. One major handler opposed any change in any price level, requesting that the status quo on all issues be maintained.

Effective August 1, the April 1, 1982, suspension of the Class 1 price formula will be lifted and the formula will once again be utilized to adjust prices throughout the State based on inputs to the formula. Departmental data indicate a Class 1 formula price decrease of about 27c per hundredweight will occur statewide when the ANE factor is utilized in the formula. The two-cent per hundredweight reduction in the Class 1 base price for the milk fat component referred to earlier in reference to substituting the Average Weekly Earnings for the Real Net Spendable Earnings in the Class 1 pricing formula will bring the total decrease in Southern California to about $.29 per hundredweight and to about $.13 per hundredweight in the rest of the State.

The 16c per hundredweight reduction in the price differential between the South Valley and Southern California Marketing Areas should be accomplished by allowing the full reduction to occur in the Southern California Marketing Area and to allow a decrease of 13c per hundredweight to occur in the rest of the State. With the exception of the $.0209 per hundredweight equivalent adjustment downward to the milk fat price, all the adjustment in the Class 1 prices will be made on the fluid carrier component.

Issue No. 5: Class 2 and Class 3 Price Differentials Between Southern California and the Remainder of the State.

Class 2 and Class 3 price differentials between Southern California and the remainder of the State have been in effect historically from the mid-fifties. The establishment of these differentials at the time were made to accommodate a country plant system which was in effect at that time. These country plants were standby facilities which had milk supplies available for movement to deficit areas for Class 1 uses as well as for products such as cottage cheese curd, condensed skim milk for making ice cream and some cream items. These price differentials existed not only between the southern metropolitan markets and the South Valley Marketing Area but also between the northern and central California inland valley production regions and the San Francisco Bay metropolitan region. The price differential between the inland valley regions and the San Francisco Bay region has been eliminated, since it was no longer needed.

Economic conditions for production and processing of milk since the beginning of pooling have changed most of the original purposes for having this differential. Southern California is no longer a year-round deficit market. The country plant system which existed at the time is no longer in effect. Class 2 and Class 3 items, with the exception of cottage cheese, are principally processed in Southern California, where there are now facilities available for this purpose.

There is some question as to the continued need to maintain a price differential at the Class 2 and the Class 3 level.

However, handlers were divided on the issue depending on plant location and the type of Class 2 or Class 3 product made by each individual handler. Though the elimination of the differential may have merit, a broad review with respect to types of products produced, the location of the markets for these products, and the effects of unequal raw product costs on competitive positions, should be made before making any changes.
The Class 2 price differentials between areas and Class 3 price differentials between areas as well as overall Class 2 and Class 3 price levels may well be an issue for a hearing. At this time, however, there should be no adjustment to the existing Class 2 or Class 3 price differentials.

**Issue No. 6: Pool Obligation Credit (POC) Adjustment.**

Since the Class 1 price differential between the South Valley and Southern California Marketing Areas is being reduced by 16¢ per hundredweight, a commensurate adjustment in the POC should be made. The call of the hearing was to determine the appropriate price levels in the various markets and to adjust the POC in accordance with area price differential changes. There were several individuals who suggested basic changes in the POC levels. The POC may or may not be in need of review, based on changes in transportation costs. If an overall review of the POC is necessary, it should be done through a hearing called for this purpose. Any adjustment made in the POC at this time should be done entirely to accommodate changes made in current price levels. The POC should be increased for those counties serving the Southern California Marketing Area by the full 16¢ per hundredweight change in the differential.

**Issue No. 7: Inclusion of Condensed Skim Milk in the Pool Obligation Credit.**

Testimony was entered by some handlers that condensed skim milk be eligible for the Pool Obligation Credit. Currently condensed skim milk and cream are specifically exempted from receiving credit out of the pool. The initial POC was established for bulk market milk moved by the various supply areas into deficit receiving areas. It was not designed for processed products. Testimony was divided on this issue and the inclusion of other products to be covered under the POC was not in the call of the hearing. If other products are to be included, sufficient advance declaration should be made and a hearing should be held to consider the merits.

No change should be made in the products now covered by the POC system.

**Issue No. 8: Reduction of Class 2 Price Statewide.**

As an alternative to Issue No. 5, one handler testified in favor of an overall reduction in the Class 2 price of five cents per hundredweight statewide. Such a reduction would maintain the existing differentials but would accommodate an overall lower raw product cost for Class 2 milk products.

The general price level on a statewide basis was not in the call of this hearing. The intent of the hearing was to adjust prices in the various marketing areas to more appropriately reflect the needs of each individual marketing area. An overall adjustment in the Class 2 price should not be made as a result of these hearings. However, as mentioned above, a review of the overall Class 2 and Class 3 price levels statewide may be in order.

**Issue No. 9: Adjustment of the Pool Obligation Credit to an Automatic Formula.**

On handler proposed that the POC be formularized so that changes in cost of transportation could automatically trigger changes in the POC's. Currently any adjustments in the POC are made through the hearing process that take into consideration not only changes in transportation credit but also the need for movement of milk. The difficulty in establishing a formula as requested would be the development of criteria
which would apply uniformly and yet accommodate regional differences. Special care would be needed in order to assure that the POC system would not be abused. The establishment of the POC was the first exception since the beginning of pooling that would allow a pool payment for a second haul beyond the plant of first receipt. Any liberalization of these credits should be studied carefully before inauguration.

Richard E. Rominger
Director of Food and Agriculture

By V. L. Shahbazian
V. L. Shahbazian, Chief
Bureau of Milk Stabilization

Date July 20, 1982

R. A. Abbott
Senior Agricultural Economist
Bureau of Milk Stabilization