MPC

MILK PRODUCERS COUNCIL

"Serving the Dairy Industry for Over 50 Years"

June 12, 2006

David K. Ikari, Dairy Marketing Branch Chief
California Department of Food and Agriculture
1220 N. Street
Sacramento CA, 95814

Re: Post Hearing Brief for the June 1, 2006, Class 4a/4b hearing

Dear Mr. Ikari,

Thank you for the opportunity to file this post hearing brief.

During questioning, Mr. Gossard asked about the percent of protein we had used in calculating the value of protein in skim whey powder used on our Graph 1 attached to our testimony. We used 13%.

You asked us, in reference to our suggestion that cheese prices be snubbed at support, about the impact on non-cheddar cheese plants (such as mozzarella) for whom there is no support price. Our answer was in two parts that we restate here perhaps with more clarity. First, non cheddar cheese production is nearly always market driven and production is accordingly adjusted to market need, no matter what the price levels. Market balancing of milk supplies is currently mostly done by nonfat dry milk plants but to the extent cheese plants need to be used for balancing, the balancing is done by cheddar plants because of the long-term storability of cheddar as opposed to nearly all other cheeses. Secondly, nearly all other cheeses are priced based on the CME cheddar market. This is certainly true for mozzarella, the largest single volume cheese made in California. It is our firm conviction backed up by observation (illustrated by the jump in prices from below support to above support at the CME almost the instant California installed a snubber at support in 2003), that the cheddar volumes produced in California are so important to the national market that prices will adjust to (or stay above) support the instant the market (CME) is aware that no cheese will be available from California at less than support price. There is no price risk for the mozzarella producer in this situation. They will simply operate as they always have.

While we agree that plant capacity was an issue early this year, we point out that it was not a disaster. Instead, plant capacity proved to be adequate and continues to be and new capacity will be added by CDI next year. Proponents of decreasing the 4b milk price repeatedly referred to "dumping of milk" while not providing *for the record* a single documented instance thereof nor even a hint of the volume that may

have been "dumped". The record contains no evidence that supports the dumping claim.

Several proponents suggested that there is some level of proof that 4b prices were too high in the fact that several cheese plants (which some of them kindly listed) have either closed down in California or decided to not locate in California. There are many reasons why this suggestion has no merit in this discussion. First, there is not a single closed plant that comes anywhere near the definition of "high volume, modern plant". In most cases there probably is no price of milk (short of nearly free) that could justify the investment required to keep pace with the competition. It is the normal course of business in this country that those that cannot keep up will indeed drop out. Second, some plants closed because they are no longer located where success is possible. San Jose (Sorrento) and Petaluma (DFA/Spring Hill) are not the right cities in which to invest large sums to money in a cheese plant – milk supplies are just too far away. There are more cheese plants in this state that are no longer properly located and more closures can be expected – but these closures are not because the 4b price is too high. The milk supplies are (or will be) too far away. Third, with regard to those who considered California for expansion but did not come, we point out that each of these was considering California because the price of milk was good (lower than Federal Order). That pricing relationship did not change. Clearly California was not chosen for reasons other than price of milk, such as politics (Tillamook Cheese), better deal from local government agencies (Gossner, Hilmar), and partnership opportunities with producer groups in a different area (Glanbia). It is a bit curious that Blue Ribbon Cheese is added to this list because they have "not built a planned plant" – yet. We are not sure how this plays in the current discussion. It also appears that Hilmar Cheese is confident that they can pay for milk in Texas in the same manner they pay for milk in California. To the extent that is true, how can the 4b price be a factor in their decision?

It would appear that the overall business climate of California far more fixing than does the 4b milk price. It is disingenuous for the proponents to argue that the lack of planning for new cheese plants is caused by a 4b price that is, in their eyes, too high. The plants that passed over California are all being built in areas that could be subject to Federal Order prices, which are higher than the California 4b price. Yet they go there anyway.

Indexing of price formulas, as proposed in two different alternative proposals, are attractive in times of unfavorable or rapid price changes. Those are precisely the times, however, when indexing is most likely to generate unacceptable and extreme results. Therefore, we cannot support either of the indexing proposals. In addition, we feel that indexing becomes a crutch to management in that instead of "working to resolve" a problem (to the good of their company or dairy and therefore the entire dairy industry) they will consider it "covered by the index". It is not in the best interest of this industry to remove incentive and innovation. By and large, California has avoided that with the current system and the result has been good for all parts of the California dairy industry.

Over the years the percentage of raw whey available in this country that has been processed has steadily increased. This occurred while cheese production was rapidly increasing (and even more impressively in California). The supply of whey that needed to be processed during much of the past 4 decades has seemed to be endless. That situation is rapidly coming to a close and the growth in supplies of whey will now be limited only to the growth in cheese production. Cheese plants have done a wonderful job of developing whey markets and continue to do so. The worldwide need for high quality

proteins will not abate but will grow. Thus, we are approaching a time where the demand for whey proteins will drag prices higher but the supply will simply not be there to knock those prices down again. It will be a maturing market that will have a more stable and on the average higher value. The light of this it is impossible to argue, as do the proponents, that the real value of whey is zero. It is not zero now and there is every reason to believe it will have even greater value in the future. We stand by our testimony that the value of whey is in its protein. It is the same protein in each of the various forms of WPC and isolates. Prices for these items will always move together. Either SWP alone or a combination of SWP and WPC 34 will be satisfactory as the base point of valuing whey.

There were two charts inserted into the record that we feel cannot be left there unchallenged. Each, while based on accurate data, does not tell the whole story and leads to incorrect impressions. The first is Attachment A to the testimony of Land O' Lakes. This chart leaves the impression that its patrons are required to pay into the pool (settle with the pool) as part of the whey factor in the 4b formula a certain amount (4b benefit) of which the patrons only receive 15% back (because they represent only 15% of the total milk in the pool). This is misleading because their patrons also get to share the "4b benefit" from all the other cheese plants reporting to the pool. This sharing is the essence of pooling. In 2005 overall 48.3% of milk in California was used to make cheese (4b), thus the pool price for each cwt of pooled milk contained 48.3% 4b price (including the 4b benefit). Each cwt of 4b price settled with the pool returned an equal cwt containing 48.3% 4b benefit. There also was no recognition of the fact that the plant (owned by the patrons) was allowed to keep 20 cents per lb of whey solids before calculation of the "4b benefit".

The second chart that must the challenged is Appendix B attached to the testimony of Hilmar Cheese. The clear implication of this chart, bolstered by comments in their testimony, is that the presence of a whey factor in the 4b formula has cut into their cheese make allowance. Because this chart's time frame crosses over the April 2003 addition of the whey factor to the 4b formula it is a classic case of comparing apples (before the whey factor) and oranges (after the whey factor). We have constructed (Exhibit 1) a graph put together in a manner similar to the one prepared by Hilmar except it adds just one factor – the value of whey. Now the chart yields a correct, complete and comparable result over the two time periods. The dramatic apparent dips in "make allowances" shown after April 03 completely disappear because they are exactly offset by the values of whey. The result is a consistent total make allowance of near $3.00 per cwt. Prior to April 03 the 'implied assumption' is that the value of whey is equal to the make allowance. We have been unable to explain the anomaly in the data for August 04.

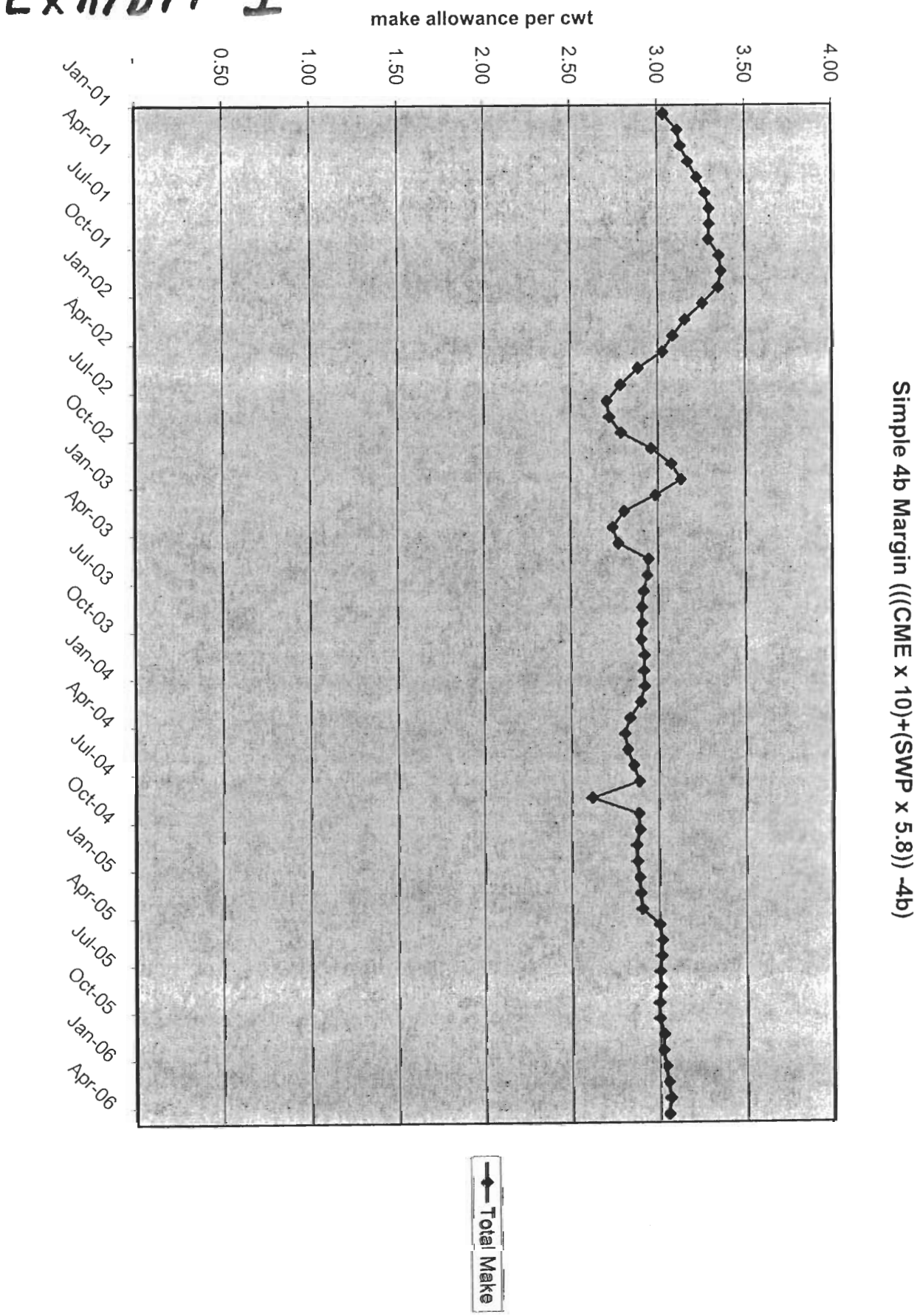
Thank you for your consideration of the above. Should you have need for the back up data that we used in preparing this brief or have other questions, please feel free to call.

Sincerely,

William C. Van Dam
Executive Director

Attachment: Exhibit 1 – Simple 4b Margin (((CME x 10)+(SWP x 5.8) – 4b)

Exhibit 1


Simple 4b Margin (((CME x 10)+(SWP x 5.8)) -4b)
make allowance per cwt
4.00
3.50
3.00
2.50
2.00
1.50
1.00
0.50
-
Jan-01
Apr-01
Jul-01
Oct-01
Jan-02
Apr-02
Jul-02
Oct-02
Jan-03
Apr-03
Jul-03
Oct-03
Jan-04
Apr-04
Jul-04
Oct-04
Jan-05
Apr-05
Jul-05
Oct-05
Jan-06
Apr-06
Total Make