

DAIRY INSTITUTE
of California

September 24, 2006

The Honorable A.G. Kawamura, Secretary
California Department of Food and Agriculture
1220 N Street
Sacramento, CA 95814

Re: Alternative Proposal for the October 10, 2007 Class 4a and 4b Hearing

Dear Secretary Kawamura:

The attached extracts from the current Stabilization and Marketing Plans for Northern California and Southern California reflect Dairy Institute's proposed amendments to the Class 4a, and 4b price formulas in the two marketing areas of the state. These proposals respond to the Notice of Public Hearing dated August 23, 2007. The Department of Food and Agriculture called the hearing in response to a petition from F & A Dairy of California and other cheesemakers.

Description of requested changes:

The proposed changes to the Class 4a and Class 4b formulas are shown below. Items that have changed relative to the current formula are *highlighted*.

Class 4a

Current Formula

Fat = (CME Butter Price - \$0.0168 - \$0.156) x 1.2
SNF = (CA Weighted Average NFDM Price - \$0.16)

Proposed Formula

Fat = (CME Butter Price - **\$0.028** - \$0.156) x 1.2
SNF = (CA Weighted Average NFDM Price - **\$0.1664**)

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We are suggesting that CDFA employ a longer timeframe in computing the *f.o.b.* butter adjuster. Our proposal calculates the average difference between the monthly CME and California Weighted Average butter prices from January 2001 through August 2007 and uses this value (~~-\$0.028~~) as the *f.o.b.* adjuster for butter. The proposed make allowance for butter is unchanged from the current formula. The manufacturing allowance for nonfat dry milk we propose equals the most recent CDFA weighted average cost for making nonfat dry milk (\$0.1664).

Class 4b

Current Formula

$$\begin{aligned} \text{Cheese CWT} = & (\text{CME 40\# Cheddar Block Price} - \$0.0252 - \$0.178) \times 10.2 \\ & + (\text{CME Butter Price} - \$0.10 - \$0.156) \times 0.27 \\ & + (\text{Western Dry Whey Price} - \$0.267) \times 5.8 \end{aligned}$$

Fat = Class 4a Fat Price

$$\text{SNF} = (\text{Cheese CWT} - (3.72 \times \text{Class 4b fat price})) / 8.8$$

Proposed Formula

$$\begin{aligned} \text{Cheese CWT} = & (\text{CME 40\# Cheddar Block Price} - \$0.027 - \$0.1988) \times 10.2 \\ & + (\text{CME Butter Price} - \$0.10 - \$0.156) \times 0.27 \\ & - (\text{Western Dry Whey Price} - \$0.267) \times 5.8 \end{aligned}$$

Fat = Class 4a Fat Price

$$\text{SNF} = (\text{Cheese CWT} - (3.72 \times \text{Class 4b fat price})) / 8.8$$

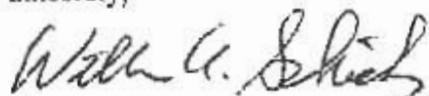
A change in the *f.o.b.* price adjuster for cheese is proposed because we believe that the current adjuster does not accurately reflect the true basis between California and CME cheddar block prices. Our proposal changes the *f.o.b.* adjuster for cheese to ~~-\$0.027~~ per pound, reflecting the average difference between California and CME cheddar cheese prices during the period *January 2001 – August 2007*. The proposed make allowance for cheddar cheese is the weighted average manufacturing costs for cheese from the most recent CDFA cost survey (\$0.1988).

Based on January 2001-June 2007 commodity price data, the proposed changes would have decreased the Class 4b price by an average of 27 cents per hundredweight over the six and a half year period, while Class 4a prices would have decreased by 10 cents per hundredweight. The requested changes are needed to keep the pricing formulas reflective of current economic conditions and to address the serious problems outlined by the hearing petitioners with respect to the dry whey factor. The revenue side of the cheese business has not been keeping up with the increases in milk costs attributable to the dry whey market.

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It is our understanding that the California milk market has not been clearing and milk has been placed in out-of-state plants at a substantial discount to California's regulated prices. California cheese plants could process additional milk volumes, but they have no economic incentive to do so given the poor cheesemaking economics imposed on them by the current formula. At the same time, milk output at California dairy farms is growing rapidly. These marketing conditions are characteristic of a regulated price that is too high. Our proposed changes to the pricing formulas will squarely address the problems that are facing the industry.

Sincerely,



William Schiek
Economist

cc G. Gomes, Undersecretary
Kelly Krug
David Ikari

Northern and Southern California Stabilization and Marketing Plan (Plans 43 and 59), Proposed Changes:

I. Article III - Class Prices

Section 300.0.

(D) The minimum prices to be paid for components used for Class 4a shall be computed as follows:

- (1) For all milk fat, not less than the price per pound computed by the formula using the butter price, less an f.o.b. California price adjuster of ~~one and sixty-eight hundredths cents (\$0.0168)~~ *two and eight tenths cents (\$0.028)*, less a manufacturing cost allowance of fifteen and six tenths cents (\$0.156), and the result multiplied by a yield factor of one and two-tenths (1.2).
- (2) For all milk solids-not-fat, not less than the price per pound computed by the formula using the nonfat dry milk price, less a manufacturing cost allowance of ~~sixteen cents (\$0.16)~~ *sixteen and sixty-four hundredths cents (\$0.1664)*, multiplied by a yield factor of one (1.0).
- (3) The butter prices used in calculations pursuant to this Paragraph shall be the simple average of the Grade AA butter price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.
- (4) The nonfat dry milk prices used in calculations pursuant to this Paragraph shall be the weighted average price per pound for all Grade A and extra grade nonfat dry milk for human consumption sold f.o.b. California manufacturing plants for the period beginning the 26th day of the previous month and concluding the 25th day of the current month, as reported by the California Department of Food and Agriculture for the month.
- (5) In the event that the Chicago Mercantile Exchange Grade AA butter price is not available to calculate the current Class 4a fat price, pursuant to Subparagraph (D)(1), then used in its place shall be the Chicago Mercantile Exchange Grade AA butter price used in the prior month's calculation of the Class 4a fat price. All other Paragraphs that use the Class 4a fat price shall operate as if the price had been established pursuant to Subparagraph (D)(1).
- (6) In the event that the California weighted average nonfat dry milk price is not available to calculate the current Class 4a solids-not-fat component price, pursuant to Subparagraph (D)(2), then used in its place shall be the California weighted average nonfat dry milk price used in the prior month's calculation of the Class 4a solids-not-fat price. All other Paragraphs that use the Class 4a

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solids-not-fat price shall operate as if the solids-not-fat price had been established pursuant to Subparagraph (D)(2).

(E) The minimum prices to be paid for components used for Class 4b shall be computed as follows:

(1) The Cheese hundredweight price shall be the price per hundredweight computed by the sum of the following:

(a) The price per hundredweight computed by the formula using the Cheddar cheese price, less an f.o.b. California price adjuster of ~~two and fifty-two hundredths cents (\$0.0252)~~ *two and seven tenths cents (\$0.027)*, less a Cheddar cheese manufacturing cost allowance of ~~seventeen and eight tenths cents (\$0.178)~~ *nineteen and eighty-eight hundredths cents (\$0.1988)*, all multiplied by a yield factor of ten and two tenths (10.2).

(b) The price per hundredweight computed by the formula using the butter price, less a manufacturing cost allowance of fifteen and six tenths cents (\$0.156), less ten cents (\$0.10), all multiplied by a yield factor of twenty-seven-hundredths (0.27).

~~(c) The price per hundredweight computed by the formula using the dry whey price, less a manufacturing cost allowance of twenty-six and seven tenths cents (\$0.267), all multiplied by a yield factor of 5.8~~

(2) For all milk fat, not less than the price per pound computed pursuant to Subparagraph (D)(1) of this Section.

(3) For all milk solids-not-fat, not less than the price per pound computed by the formula using the Cheese hundredweight price established pursuant to Subparagraph (E)(1) less the product of three and seventy-two hundredths (3.72) multiplied by the Class 4b fat price established pursuant to Subparagraph (E)(2), all divided by eight and eighty hundredths (8.80).

(4) The Cheddar cheese prices used in calculations pursuant this Paragraph shall be the simple average of the 40 pound block Cheddar cheese price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.

(5) The butter prices used in calculations pursuant this Paragraph shall be the simple average of the Grade AA butter price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.

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- (6) ~~The dry whey prices used in calculations pursuant to this Paragraph shall be the simple average of the Dry Whey—West Mostly prices as published in Dairy Market News between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.~~
- (7) In the event the Chicago Mercantile Exchange 40 pound block Cheddar cheese price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the cheese price used in the prior month's calculation of the Cheese hundredweight price.
- (8) In the event that the Chicago Mercantile Exchange Grade AA butter price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the Grade AA butter price used in the prior month's calculation of the Cheese hundredweight price.
- (9) ~~In the event that the Dry Whey—West Mostly price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the Dry Whey—West Mostly price used in the prior month's calculation of the Cheese hundredweight price.~~