PUBLIC HEARING

STATE OF CALIFORNIA

DEPARTMENT OF FOOD AND AGRICULTURE

DAIRY MARKETING BRANCH

DEPARTMENT OF FOOD AND AGRICULTURE

1220 N STREET

AUDITORIUM

SACRAMENTO, CALIFORNIA

WEDNESDAY, OCTOBER 10, 2007

9:05 A.M.

TIFFANY C KRAFT, CSR, RPR
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APPEARANCES

HEARING OFFICER

Ms. Kelly Loyer

PANEL MEMBERS

Mr. Hyrum Doegey, Senior Agricultural Economist, Dairy Marketing Branch

Ms. Candace Gates, Research Manager I

Mr. Tom Gossard, Agriculture Economist

Mr. David Ikari, Chief, Dairy Marketing Branch

Mr. John Lee, Branch Chief

Ms. Venetta L. Reed, Supervising Auditor I

Mr. Donald Shipplehoute, Senior Agricultural Economist

STAFF

Ms. Annie Pelletier, Assistant Agricultural Economist

ALSO PRESENT

Mr. Kevin Abernathy, California Dairy Campaign, California Farmers Union

Mr. Eric Erba, California Dairies

Mr. Rich Ghilarducci, Humboldt Creamery Association

Mr. Dean Hatch, F&A Dairy of California, Inc.

Mr. Joe Heffington, California Dairies

Mr. Scott Hofferber, Farmdale Creamery, Inc.

APPEARANCES CONTINUED

ALSO PRESENT

Mr. John Jeter, Hilmar Cheese Company

Ms. Tiffany LaMendola, Western United Dairymen

Mr. David Larsen, Imperial Valley Cheese

Mr. Jose Maldonado, Marquez Brothers International

Mr. Barry Murphy, Bestwhey, LLC

Mr. Joe Paris, Gallo Cattle Company, dba, Joseph Gallo Farms

Mr. William Schiek, Dairy Institute of California

Mr. Robert Vandenheuvel, Milk Producers Council

Mr. John Vlahos, Legal Counsel, Western United Dairymen

Mr. Tom Wegner, Land O'Lakes

Mr. Jay Wilverding, Mozzarella Fresca

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PROCEEDINGS

HEARING OFFICER LOYER: Good morning. If I can have everybody's attention. If you would please be seated. The hearing will come to order shortly. First, a few preliminary matters. Please turn off your cell phones or turn them to vibrate.

If you are planning to testify, please note the place you will testify is the last chair right over there at the end.

We'll probably break for lunch around 11:30 or so, depending on the flow of testimony.

If you have something that you would like considered as an exhibit, please bring it to me before you sit down to speak. Unless you want to read from it, in which case you can bring it to me after you testify.

The room has to be vacated today before 5 p.m., so we are shooting to end the hearing at approximately 4:30. If there is testimony remaining to be presented after approximately 4:30 or so, the hearing will be continued until tomorrow at 8:00 a.m. in this room.

The hearing will now come to order. The California Department of Food and Agriculture has called this public hearing at the Department's Auditorium, 1220 N Street, Sacramento, California, on this day, Wednesday, October 10th, 2007, beginning at actually 9:05 a.m.

My name is Kelly Loyer. I've been designated as the hearing officer for today's proceedings. I am a disinterested party here and here for the purposes of facilitating the proceedings only. All decisions shall be made by the hearing panel. I'm not a member of the hearing panel and will not be taking part in any discussion relative to the hearing.

The call of the hearing is as follows. On August 15th, 2007, the Department received a petition from F&A Dairy of California and a group of other California cheese processors requesting a public hearing to consider amendments to the Stabilization and Marketing Plans for market milk for the northern and southern California marketing areas. The Department also received a petition from the Alliance of Western Milk Producers, Western United Dairymen, and Milk Producers' Council requesting a public hearing to consider amendments to the pool plan and the stab. plan.

This hearing will consider proposed plans to the Class 4a and 4b pricing formulas and changes to the pool plan. This hearing will also consider the factual basis, evidence, and the legal authority upon which to make any and/or all of the proposed amendments to the stab. plan and the pool plan.

The Department will also receive alternative proposals from the Diary Institute of California, Land O'Lakes, Humboldt Creamery, and California Dairies.

Each of the two petitioners, F&A Dairy, together with other cheese processors included in that petition, and the Alliance of Western Milk Producers, together with Milk Producers' Council and Western United Dairymen, will have a total of 45 minutes to submit testimony and relevant material to support their petition, which will then be followed by any questions from the panel. Those submitting alternate proposals will each be provided 30 minutes to give testimony and evidence followed by any questions from the panel.

Anyone else wishing to testify must sign in on the hearing roster located in the back of the room and will be allowed 20 minutes to testify and submit any evidence. Witnesses will be called in the order they sign up first come first serve.

The time clock to my right has been established to assist you when testifying. The yellow light means you have five minutes remaining. Oral testimony will be received under oath or affirmation. Only those individuals who have testified under oath during the hearing may request a post-hearing brief period to amplify, explain, or withdraw their testimony. Only those individuals who have requested a post-hearing brief period may file a post-hearing brief with the Department.

The opportunity to submit a brief amplifying, explaining, or withdrawing testimony is granted to all witnesses who request a post-hearing briefing period. However, in order for the Department to consider the brief, the Department must receive it by Wednesday, October 17th, 2007, no later than 4:00 p.m.

The post-hearing brief may be sent or submitted to the Department's Branch office located at 560 J. Street, Suite 150, Sacramento, California, 95814. Alternately, the brief may be faxed to area code 916-341-6697 or sent by e-mail to dairy@cdfa.ca.gov.

Those who testify must speak only to the issues presented by the petitions. Members of the audience may not question witnesses nor spontaneously respond to the content of anyone's testimony. Please remain quiet unless you have been called upon to testify. Questioning of witnesses by anyone other than the members of the panel is not permitted.

The hearing panel has been selected by the Department to hear testimony, receive evidence, question witnesses, and make recommendations to the Secretary. The panel is composed of David Ikara, Branch Chief; Candice Gates, Research Manager II; Thomas Gossard, Senior Agricultural Economist; Hyrum Doegey, Senior Agricultural

Economist; Venetta Reed, Supervising Auditor; and Donald Shipplehoute, Senior Agricultural Economist; and John Lee, Branch Chief.

The recording of the hearing will be handled by the firm of Peters Shorthand Reporting Corporation located at 3336 Bradshaw Road in Sacramento. The telephone number is 916-362-2345. Additional copies of the transcript may be purchased by contacting them directly.

In addition, a transcript of today's hearing will be available for review at the Marketing Branch Headquarters located in Sacramento at 560, J. Street, Suite 150.

Testimony and evidence pertinent to the call of the hearing will now be received. At this time, Annie Pelletier, Assistant Agricultural Economist with the Dairy Marketing Branch, will introduce the Department's exhibits. The audience may ask questions of Ms. Pelletier only as they relate to the exhibits.

Ms. Pelletier, will you please state and spell your name for the record?

ASSISTANT AGRICULTURAL ECONOMIST PELLETIER: It's Anne Pelletier spelled A-n-n-i-e, P-e-l-l-e-t-i-e-r.

HEARING OFFICER LOYER: And Ms. Pelletier, do you swear for affirm to tell the truth and nothing but the truth?

ASSISTANT AGRICULTURAL ECONOMIST PELLETIER: Yes, I do.

HEARING OFFICER LOYER: You may proceed.

ASSISTANT AGRICULTURAL ECONOMIST PELLETIER: Ms. Hearing Officer, my name is Annie Pelletier. I'm an Assistant Agricultural Economist with the Diary Marketing Branch of the California Department of Food and Agriculture.

My purpose here today is to introduce the Department composed hearing exhibits numbered 1 through 43. Relative to these exhibits, previous issues of exhibit 8 through 43 are also hereby entered by reference. The exhibits entered here today have been available for review at the Office of the Diary Marketing Branch since the close of business on October 2nd, 2007. An abridged copy of the exhibits is available for inspection at the back of the room. A copy of the exhibit list is also available at the back of the room. Additionally, I would like to enter a letter from the Department dated October 5, 2007, and signed by Kelly Krug as Exhibit 44.

Also I would like to enter as Exhibit 45 revised title pound of milk processing to cheese five pound utilize of Class 4 and nonfat pounds solid utilized as Class 4a. Copies of this exhibit will be available at the back of the room.

I also ask at this time that the composite exhibits be received. And I would request the opportunity to provide a post-hearing brief.

HEARING OFFICER LOYER: Your request to file a post-hearing brief is granted.

ASSISTANT AGRICULTURAL ECONOMIST PELLETIER: Ms. Hearing Officer, this concludes my testimony.

HEARING OFFICER LOYER: Thank you.

Are there any questions from the Department's witnesses regarding the Department's exhibits?

You can come up to this microphone right there please, sir.

MR. VLAHOS: Good morning. My name is John Vlahos, V-l-a-h-o-s. And I'm legal counsel for Western United Dairymen.

I come not to ask a question, but rather for the record to state an objection to the completeness of the record. And I don't know if this is the appropriate time to do it. If that's correct, I will do so. There will be no testimony as to the merits of any petition or alternative, but rather an objection to the completeness of the record and the denial of the request by Western United Dairymen of the Department for some additional information. If this would be appropriate time to state the objection for the record, I'm prepared to do so.

HEARING OFFICER LOYER: You may state your objection.

MR. VLAHOS: Orally, at the pre-hearing workshop on October 3rd, 2007, Mr. Michael Marsh of Western United Dairymen requested information concerning the financial impact upon the nine petitioners of the inclusion of the dry whey factor in the Class 4b formula. At the same hearing, Mr. William Van Dam on behalf of the Alliance of Western Milk Producers made a request for information concerning the volume of cheese produced by those processors who are denying petitioners so that the financial impact of the inclusion of the dry whey factor in the Class B formula could be ascertained.

Those oral requests at the pre-hearing workshop were then repeated in an e-mail of the same date, October 3rd, from Mr. Marsh to Mr. Krug of the Department. Mr. Krug by letter dated October 5, 2007, denied those requests. And I don't know if the exhibit that was introduced by the witness of a letter of October 5, 2007, is the same letter that I'm referring to. If it is, then I don't need to introduce that letter again.

I would like to introduce, however, the e-mail of October 3rd from Mr. Marsh to Mr. Krug repeating the request that was made at the pre hearing workshop. May I do so at this time?

HEARING OFFICER LOYER: Yes, you may. Mark that as Exhibit 1.

MR. VLAHOS: As I indicated our objection is to the denial?

HEARING OFFICER LOYER: Excuse me one moment. This will be Exhibit 46.

(Exhibit marked)

MR. VLAHOS: Thank you. And may I ask what was the exhibit number of the letter from Mr. Krug?

ASSISTANT AGRICULTURAL ECONOMIST PELLETIER: 44.

MR. VLAHOS: Thank you very much. To make the record clear as to why we believe the denial of the request contained made by Western United Dairymen and by the Alliance for the volume of cheese produced by the petitioners and the dollar impact of the inclusion of the dry whey component in the formula, just let me briefly state why we think that was important information for the adequate presentation of my client's position.

Essentially -- and I am not commenting on the merits at all. I'm not testifying as to that. But one of the thrusts of the original petition was to the inclusion of that component in the formula caused great economic damage to the petitioners. In turn, the objection to the petition by Western United and indeed the thrust of the alternate proposal that was submitted by Western United, the Alliance, and Milk Producers' Council was simply that assuming there has been severe financial impact upon these nine petitioners, we need to know the volume of that impact. Because it was the position of those parties that there were simpler and less intrusive ways of dealing with that impact. That in essence to throw out the inclusion of that factor in the formula was to use the vernacular using a sledge hammer where a fly swatter would have been able to do the job. I'm not testifying as to whether there was right or wrong. But that was their position.

That being their position, it became increasingly important in order to adequately present their case that they know actually the real financial impact of the inclusion of that formula -- that component in the formula had upon the nine petitioners. And that was the very information that was requested by Mr. March and indeed by Mr. Van Damn and denied by the Department.

I just might mention that the Department in the letter that has been identified Exhibit 44 indicates that the reason for the denial was that certain exhibits were introduced as a standard practice and that standard practice and the procedures would not be changed because of their request by these parties.

For the record, I would like to state the fact that information that is otherwise relevant and in the possession of the Department and not barred by any legal proposition cannot be denied to a petitioner merely on the ground that that's not our standard practice.

Indeed, perhaps the standard practice doesn't produce enough information. And for that reason, the petitioners object to the denial of their request -- excuse me. Not the petitioners. But Western United Dairymen objects to the denial of that request and for that reason feels that the record is not complete.

HEARING OFFICER LOYER: Your objection is dually noted.

ASSISTANT AGRICULTURAL ECONOMIST PELLETIER: Thank you.

HEARING OFFICER LOYER: Ms. Pelletier, I received your exhibits. Not hearing any further objections for comments, the Department's exhibits are now entered into the record as exhibits 1 through 43 and 44.

At this time, I'd like to call petitioners F&A Dairy to testify. You will have a total of 45 minutes to submit your testimony. You will notice we have a time clock running here to my right.

The testimony of Barry Murphy is marked Exhibit 47. The testimony of Jose Maldonado is marked Exhibit 48. The stabilization and marketing plans for market milk for northern California and southern California presented by

Dean March is marked Exhibit 49. The Farmdale Creamery, Incorporated, as petitioner document is marked as Exhibit 50.

(Exhibits marked)

HEARING OFFICER LOYER: Sir, will you please state and spell your name for the record?

MR. MURPHY: Good morning. I'm Barry Murphy, B-a-r-r-y, M-u-r-p-h-y.

HEARING OFFICER LOYER: Sir, do you solemnly swear or affirm to tell the truth and nothing but the truth today?

MR. MURPHY: Yes, I do.

HEARING OFFICER LOYER: Mr. Murphy, are you affiliated with any organization?

MR. MURPHY: I'm here as an independent consultant for the whey industry.

HEARING OFFICER LOYER: Okay. And can you identify the process by which that organization finalized your testimony today?

MR. MURPHY: I finalized it myself. I'm an independent consultant.

HEARING OFFICER LOYER: Thank you. You may proceed.

Should we swear them all in? Next, sir.

MR. HOFFERBER: I'm Scott Hofferber, S-c-o-t-t, H-o-f-f-e-r-b-e-r. I'm here from Farmdale Creamery as a petitioner. I'm here on the authority of the Board of Directors of Farmdale Creamery.

HEARING OFFICER LOYER: Do you solemnly swear or affirm to tell the truth and nothing but the truth?

MR. HOFFERBER: I do.

MR. MALDONADO: My name is Jose T. Maldonado. J-o-s-e, M-a-l-d-o-n-a-d-o. I'm here for Marquez Brothers International, Inc., and here as a petitioner as well.

HEARING OFFICER LOYER: Are you just as an individual petitioner?

MR. MALDONADO: Individual petitioner, yes.

HEARING OFFICER LOYER: Do you solemnly swear or affirm to tell the truth and nothing but the truth today?

MR. MALDONADO: Yes.

MR. HATCH: My name is Dean Hatch, D-e-a-n, H-a-t-c-h, with F&A Dairy of California.

HEARING OFFICER LOYER: Do you swear or affirm to tell the truth and nothing but the truth today?

MR. HATCH: Yes.

I'm going to start. Ms. Hearing Officer and members of the hearing panel, my name is Dean Hatch. I'm Vice President of F&A Dairy of California, Incorporated.

F&A is a manufacturer of mozzarella and provolone cheese and dry whey powder. We are located in the San

Joaquin Valley in the town of Newman. We are the largest business in town, employ over 120 great people and provide substantial revenue to the city and the community. We process over two million pounds of milk a day provided by 50 great dairy families. We pride ourselves in receiving the highest quality milk and producing one of the highest quality cheeses in the nation. We have national brand recognition and have a great reputation of providing excellent service and producing a quality cheese. We have paid our dairy producers and suppliers on time and with discount until recently.

F&A Dairy of California, Incorporated, is a family-owned business with its initial beginnings over 50 years ago. The current Class 4b milk price formula structure with its whey cost component has caused substantial losses to F&A and has served to ruin F&A's long standing excellent reputation in the cheese industry. As I speak here today, many people including dairy milk producers, suppliers, customers, and friend of the industry are waiting anxiously to hear the results of these hearings and its impact on the financial viability of cheese manufacturers in California.

Since the disastrous impact of the whey cost component in the milk price formula, F&A has been fighting to hang on to be a voice at these hearings. I'm now on a first name basis with several employees at Milk Pooling who have been very helpful during these trying times. Our dairy producers and suppliers have stuck by us as we have required their cooperation to give us extended payment terms as we struggle due to the losses caused by the whey component in a Class 4b formula. Without their help, we would not be here today.

We would like to make three main points:

1. We recognize and understand the financial hardships California dairy farmers have endured in the past two years. We are not just looking to solve the cheese processors' problems, but also the problems of the best dairymen in the United States.

2. The whey component in the Class 4b milk formula does not work. It does not do what is intended to do; create a proper balance of competing interests of all California dairy stakeholders including processors, dairy producers, and consumers. The long-term viability of California's dairy industry is at stake.

3. The whey cost component in the Class 4b milk formula must be removed.

This is not an us against them issue. This is an us and them issue. All stakeholders must work together with dairy producers and processors given a chance to make a fair return on their investment.

To rebuild F&A's whey manufacturing facility in Newman, California, it would cost approximately $20 million. The current whey component in the milk price formula allows for a $.267 per whey pound make allowance. This gives F&A no ability to make a profit. What business model would justify an expenditure of the magnitude of $20 million or any dollar amount for that matter with absolutely no return on investment? And this is the best case scenario.

The reality is what F&A has recently experienced. With the whey price increasing to $.82 a pound, F&A has realized over $3 million in losses to date this year through the month of August due to its whey manufacturing alone.

A third of the loss is attributable to paying the increased whey price based on the formula's 5.8 yield factor when F&A is only able to realize a 4.7 yield factor. The balance of the loss is due to the whey market accelerating to $.82, obtaining resistance by buyers to purchase at this price and then rapidly descending. F&A lost over $2 million during the whey price decline. F&A will continue to lose money even with the current whey market price of approximately $.40 cents per pound.

A note to those who think F&A did make a profit when the market was going up. We did. However, it was rapidly lost when the market began its descent with the ensuing losses netting the over $3 million for the year to date. Gains on the way up will always be offset by the losses on the way down.

Since April of 2003, F&A has not had the benefit of realizing revenues in the up whey markets. That is why we continually ask to have the whey cost component taken from the formula. Up to this year, F&A has endured without a return on its investment and has had no accumulation of funds to reinvest in improvements and modifications to equipment. This situation is even worse for those cheese manufacturers who have no dry whey to sell to at least mitigate some of the loss. F&A would like to consider alternative manufactured whey products with possibly better returns, but there is no incentive to make such an investment and no capital generated by the current operation to make such an investment. The current losses experienced by F&A will never be recovered with the current milk price formula. Not to mention the risk of this current scenario repeating itself again and exacting additional disastrous damage.

If you think this occurrence of rapidly rising whey prices in the last few months is just something to get over, then you are missing the point. The problem is still there when whey prices are low and there is no profit to be made and again no return on investment. The last few months just exacerbated an already bad situation.

For those of you who think we can go to the market and ask for a price above the market price to improve our situation, you are again missing the point. If we ask for ten cents over the market price and get it, then that becomes the new market price. We can never get an overage. There is no whey to create additional margin as the new price always becomes the price in the whey cost formula.

It will be beyond me if these simple economic principles are not recognized which explain why the current whey cost formula in the Class 4b milk formula is a failed formula:

1. There is no return on investment.

2. There's no ability to increase the margin.

3. There is potential for huge losses on whey product manufactured at high prices with resistance in the market to buy at the highest price and resistance to buy when the market is falling.

I ask you, Ms. Hearing Officer and members of the hearing panel, please listen to the voice of the dairy industry. All stakeholders are one voice with the same need, to be given the opportunity to make a fair return on their investment. This holds true for the dairy producers and the processors. The current whey cost component in the milk price formula is detrimental to the dairy producer and the processors. Please remove the whey cost component from the Class 4b milk formula.

Thank you for your time.

MR. MALDONADO: Mr. Hearing Officer and members of the CDFA hearing panel, good morning, and thank you for giving us the opportunity to be here on this very important issue that has affected many cheese manufacturers like Marquez Brothers International, Inc.

Marquez Brothers International has as its primary business focus the manufacturing and distribution of Hispanic cheese products. We're located in El Hambra, California. And over the years, we have managed milk price swings. However, the milk price levels seen today as the result of the whey component of the 4b formula are having a serious adverse effect on cheese manufacturers. The most troubling attribute of the current Class 4b price formula is the way that it incorporates the dry whey values in the calculations.

The current formula assumes that cheese plants recover revenue from the whey side of their operation equal to the midpoint of the western dry whey mostly spot price range as reported in the USDA's Dairy Market News. In fact, the majority of cheese plants in the state do not earn revenues from their whey operations that equal or even directly proportional to the revenue assumed in the formula. Cheese manufacturers are just that, they manufacture cheese. Whey is merely a byproduct of the cheese manufacturer's operations. Whey is a byproduct of the cheese manufacturing process that is unlike the other dairy products that are manufactured in the state. And as such, there is no single product or combination of products that can reasonably approximate the revenue stream that each individual cheesemaker may receive from the whey side of its operations, if any.

The current pricing formula incorrectly assumes that a cheese manufacturer is necessarily in the business of processing its whey byproduct from its cheese making operations. Even assuming that a cheese manufacturer does process its whey byproduct, the whey component in the 4b price distorts the margins and pricing mechanisms of cheese manufacturers. The whey component factor in the 4b formula significantly increases the price of the number one raw material, milk, even though whey prices have no correlation to the CME cheddar cheese price. Given the recent unprecedented increase in the dry whey prices, the cost of milk has increased this in addition of the milk cost increase that have resulted from increase the cheese. This places an undue burden on the cheese manufacturers to pay a price increase without revenue to offset this cost. In effect, the cheese manufacturer is being required to bear increased costs while many milk producers are being handed increased profits.

Today, the dairyman receives 100 percent of the whey values above the make allowance, without any capital risk and without concern for the cheesemakers' ability to process whey. Milk producers have never assisted with allowances for whey disposal, have not made environmental-based investment to whey disposal, and have not contributed to the capital investment required to develop a whey or whey protein business. Yet, they now receive a huge premium for whey whether or not the cheese producing plant actually has a whey or WPC plant. Cheese producers handling less than one million pounds of milk per day will not economies of scale to process whey. The milk producer is taking no risk on the plant investment and yet can receive a three dollar per hundred weight whether whey is dumped or processed and sold at a profit or a loss by the cheesemaker. This is clearly an inequitable scenario.

The simple inequity with the current whey component of the 4b milk formula is that many cheesemakers invest tens of millions of dollars to process WPC, while the dairy farmers get paid for the whey irrespective of what the processor does and without taking any capital risk. Furthermore, the system does not encourage additional investment into the whey processing and whey technology development, but rather discourages it. The scale of investment needed to achieve the economies necessary to market whey products competitively is enormous and well beyond the financial means of many cheesemakers. In the normal course of business, entrepreneurs make the investments, such as Marquez Brothers International. We take risks. And then reap benefits from such operations. In the current pricing model, the milk producers are being handed profits without any associated risk.

Our proposed solution will address the problem. Eliminating the whey component from the 4b price will provide margins for cheesemakers to invest the millions needed to keep the plants operating, to invest funds in research and development that will lead to innovation, new products, expanded markets for cheese and milk. It will also provide an incentive to maintain and increase plant capacity. Further, it will allow those cheese manufacturers who elect to process their whey byproducts to reap the benefits of their investment. Those cheese manufacturers that do not process the whey byproduct will not be penalized.

In conclusion, the current pricing formula is not only crippling the smaller California and U.S. cheese manufacturers, but it is also generally placing an undue economic burden on all the cheese manufacturers. Continuation of the current pricing policy is not only inequitable because it places an undue burden on the cheese manufacturer, but it also discourages cheese plant investment and puts current plant capacity at risk, at a time when plant capacity growth is essential to the continued health of both producers and processors.

Whey is a byproduct of cheese manufacturers' operations and as such should not be made a component of the raw milk pricing Class 4b for its cheese manufacturing operations. Profits should be based on the investments made and risks taken by business entrepreneurs. In the current pricing model, milk producers are handed benefits with no downside. Unless the milk producers are prepared to contribute capital investments required for the processing and sale of whey, we would like to see the whey component removed from the 4b price.

In your role as regulators and policy administrators from the California Department of Food and Agriculture, we are asking you for your assistance in this grave matter. Given the serious threat that continuation of the current pricing formula poses to California cheesemakers, we urge the Department to adopt our petition and the Dairy Institute proposal which would truly address the problems in the Class 4b formula. CDFA must protect the dairy industry, and the inclusion of the whey factor in the 4b price is a recipe for catastrophic disaster by threatening the ability for cheese manufacturers of all sizes to continue in the dairy business. Thank you very much.

We respectfully request the opportunity to submit a post-hearing brief. This testimony is respectively submitted on behalf of the petitioners.

HEARING OFFICER LOYER: Request granted.

MR. HOFFERBER: Good morning, Ms. Hearing Officer and members of the hearing panel. I'm Scott Hofferber, the controller at Farmdale Creamery, Inc., and I'm making this presentation at the direction and on the authority of our Board of Directors.

Our Board is represented here by Norm Shotts and Michael Shotts. Norm is a second generation owner of Farmdale with the working role of President and Chairman of the Board of Directors. Due to a flight cancellation, he's en route to the site right now. Mike is a third generation owner with the working roles of Vice President, Treasurer, and General Manager. He's seated in the audience right now.

Farmdale is a family-owned and operated dairy product manufacturing facility in San Bernardino, near the diminished Chino Dairy Preserve in southern California. With 68 employees currently, Farmdale creates block jack and cheddar cheeses, sour cream, buttermilk, and butter from about 25 million pounds of milk and cream per month. We are here today to gratefully take advantage of the opportunity to present a matter of grave concern to the survival of our cheesemaking operation.

In response to a threat of needing to shut down our cheese operations -- and in fact we did do that for a week in the month of August -- Farmdale banded together with a few other cheesemakers in mid-August to file the petition at hand. The petition is asking for the elimination of the whey factor in the 4b minimum regulated price formula. Farmdale will confine its testimony at this time to the presentation of the petition itself and our understanding of the issues surrounding the whey factor. We understand this presentation is being made on be all nine signors to the petition and thus we need to confine the issues to those relating directly to the petition. We will avail ourselves of a later opportunity to provide Farmdale's own perspective on the second petition and alternative proposals.

We began receiving calls from other so-called small cheesemakers in the early part of this June asking what experience we were having. We must confess we felt like something was amiss, but our own internal analysis wasn't providing us with answers we believed in at the time. We had fallen asleep at the wheel not recognizing that the artificial gains we were experiencing in cheese sales were being all by offset and actually more than offset by the whey component cost in the 4b milk.

As the markets peaked in June however, the real crisis became apparent. More cheesemakers began surfacing with the same issue and we began to realize that individually and collectively we were in real financial trouble in the cheesemaking business because the minimum regulated price was just higher than what we could realize on the finished products.

The Department granted us a meeting in late July to discuss the facts of the situation, and although it was apparent that the situation was understood by the Department's representatives in attendance, it was re-affirmed to us by our only avenue for relief was in the call of the hearing. The hearing process is at least a three-month exercise and the petitioners recognized our troubles would reach a very critical stage sooner than that.

After exploring the possibilities of any other relief, we found that the emergency call of a hearing was going to be our only remedy. With concessions from our suppliers and customers and radical cutbacks in staff and processing volumes, including the one week shut down of our own cheesemaking operations, Farmdale has elected to attempt to wait out the hearing process before deciding whether we can remain a viable entity as a cheesemaker. Our petitioners have taken their own steps and will tell their own situations over the course of this hearing. Time will tell if we survive long enough for a favorable hearing decision to adequately correct the inequity of the 4b formula resulting from the inclusion of the whey factor.

The petition asks for the removal of the whey factor from the Class 4b formula used for calculating the minimum regulated price of milk used in cheese. Leaving whey out of the formula has been our position since at least 2001 when I first testified before the Department's panel, because we knew including it would create chaos out of an otherwise reasonably stable Stabilization Plan. Adding the whey factor in 2003 set the stage for the current chaos and we are here now to say we told you so.

Referring to our prior testimonials at the hearings March 28, '01, January 29 & 30, '03, February 1 and 2, '05, and June 1 and 2, '06, we re-assert all of our previous points. We find nothing in those prior presentations requiring material modification to remain exactly on point to the matter at hand. Our testimony today could read as the greatest hits including:

Whey is a waste product created in the cheesemaking process.

Whey has little or no value in itself except that which is created by valued-add processing.

There are widely varying methods of disposing of the whey stream ranging from paying to have it dumped to creating food grade product, each method with equally varying costs of capital and risk of investment, all of which are borne by the cheesemaker.

The hearing panels have consistently recommended the removal of all the whey factor, and we don't understand why the Secretary did not concur.

In his Cheese Market News article dated August 3rd, 2007, titled, "The Dry Whey Gap," John Umhoefer, Executive Director of Wisconsin Cheese Makers' Association examines the state of the whey disarray nationwide. He concludes his comments with, "The real commodity, produced by at least half of Wisconsin's cheese plants, is skimmed, wet whey. Dry whey is a valued-add product mistakenly added to a base milk price." We agree. The value of the producer of the wet whey stream off of cheese plants in the market is of course zero or even negative since the cheesemaker must incur costs of some sort to get rid of it. Any and all value attributable to the whey stream beyond that belongs to those cheesemakers who, by their own innovation and capital investment, have found a way to make something out of nothing.

If I owned a stand of trees in Oregon and I sold them to someone who had cut them down, who in turn sold them into a milling operation, then to a lumber company and contractor -- so ultimately to the homeowner, I wouldn't have the gall or the economic right to show up at escrow and demand 70 percent of the purchase price of the home just because the home was made up of 70 percent wood products. This is exactly what is going here with end-product pricing, especially where the whey factor is concerned. It is absurd.

And what about the particle board made from the saw dust? Who gets that revenue? In order for me to have a right to the end-product value of the wood, I would have to set myself up as a developer and retain the entire process under my own control and at my risk.

In situations around California where producer co-operatives have tried this approach with cheese, we find they have gotten and are getting out of the cheese business entirely. Curious, but not so curious as the continuing fact that no one is knocking down our door to get at this gold mine of a whey stream we are throwing off. Surely the producer community has the capital to construct a stand-alone whey plant whereby I could load their wet whey stream, apparently only on loan to me since I have to buy it separately, into their milk delivery trucks, returning it to them. If the stuff is so valuable, show me the money in terms of the capital investment necessary to make it so.

There is always a fear on the part of any private enterprise in disclosing information about the results of operations. Nevertheless, we are so disenchanted with being a cheesemaker at this point we feel like we have nothing to lose in disclosing a few facts about the impact of the whey factor on our operation.

Farmdale does not allocate any cost of raw milk to our whey process. That's in difference to what some of the other testimony you already -- this is our process. This is how we deal with it. We stand by our operational premise that whey is not a split-off product or a byproduct, but rather a waste material to be discarded. We can offset our costs of disposal by converting the liquid into an annual feed dried popcorn whey material and sell that into an ingredient environment, ultimately incorporating that result into the our cost of making cheese.

We might be the only plant in the state doing this. Our results do not even approach the presumed elements of the whey factor. We sell our material at a discount off of the central mostly market, so we do not achieve the value in the marketplace presumed in the whey factor. We yield only two and a half, maybe three percent at best of our whey stream into the popcorn whey material, again not nearly achieving the presumed value in the marketplace -- presumed in the formula 5.8 yield. Our cost to process the material roughly matches the current make allowance at $.267 cents, so it's not like our production method is any cheaper to operate. Here are the results of our recent cheesemaking operations:

For 2005, we lost $439,000 making cheese. This includes a 260,000 loss processing and selling off our whey stream.

For 2006, we lost $413,000 making cheese. This includes a 142,000 loss from processing and selling our waste whey stream.

In 2007, through August, we lost $347,000 making cheese. This included a $1.383 million gain from processing and selling our waste whey stream. Remember, the entire gain from whey processing is transferred to the cheese operation in the cost of milk resulting in the overall loss of $347,000.

For each $.10 drop in the price on the CME for block cheddar after August 31 when the price was at 2 dollars and change, we expect to lose another $160,000 on inventory valuation adjustments in addition to the continuing operational deficit.

Why have we subsidized these losses in these years? We did this because we are proud of what we have built at Farmdale, and because we have believed that the Department would ultimately do the right thing and regulate the industry in accordance with sound economic principles applied to competent hard data. With the manifestation of the current crisis, we have lost faith.

We are disheartened by the rhetoric going around that says "the small specificity cheesemakers can make up this problem by getting it out of the market." This is insulting and evidences a lack of real understanding of the cheesemaking business for so-called small organizations. First, and specifically to Farmdale, we are not a specialty cheesemaker. And to be dismissed as one only indicates a lack of due consideration. We make block jack and cheddar cheeses and compete with economies of scale five to ten times our size within a commodity market that is strictly tied to the CME and have been able to compete here for a number of years prior to the implementation of the whey factor.

Second, specialty cheese price elasticity bears no resemblance to the commodity cheese demand curves and the consumer will certainly take a less expensively priced product from other states or off-shore. Being "Real California Cheese" isn't all that anymore, it seems to us.

The petition is simple and straightforward. The continuing inclusion of the whey factor in the 4b formula, against the repeated recommendation of the Department's only hearing panel experts, was a mistake that must now be corrected. The first step in this correction is to remove the whey factor and restore the formula its pre-2003 construct. This may preserve the viability of the small cheesemakers including Farmdale who appears is classed as small in this context and who by my estimation account for 47 of the 60 cheese plants operating in the state. Or if you take into consideration F&A's testimony today and include them as small cheesemakers as part of the petition, it would account for 52 of the 60 plants operating around the state would be considered part of the class of the petitioners. And those numbers are based on the Department's "Pounds of Milk Processed into Cheese" sorted by plant size; MPB handler data from May, June, July 2007 report that was handed out at the pre-hearing workshop.

These 47 plants accounted for 11.3 percent of the accumulated total milk processed into cheese during these three months. At a time when high prices to producers continue growing the milk supply by three percent to five percent and plant capacity is certainly not expanding in a manner necessary to accommodate this growth, it seems plain that this measure should be adopted as a first step in maintaining the health of the cheese industry in California. Further, this measure needs to be implemented with all haste as we are seeing milk going to ground and being sold at below minimum prices in adjoining states.

With our request for the opportunity to submit a post-hearing brief, this testimony is respectfully submitted on behalf of the petitioners.

HEARING OFFICER LOYER: The request is granted.

MR. MURPHY: Good morning, Ms. Hearing Officer and members of the hearing panel. I'm Barry Murphy, and I'm an independent whey consultant helping the smaller cheese players in California.

The 4b whey component factor is the most critical milk pricing issue and concern facing the future, the growth, and forward planning of California's cheese industry. All cheese companies are in the cheese business. And for those who have entered the whey business have done so via a substantial investment to solve environmental and disposal problems associated with whey such that they could grow their cheese businesses.

Disposal costs range from 100 to 400 per load for whey depending on the company and its location. A company with 20 loads a day is looking at a million and a half dollars a year in disposal.

Any cheese company not processing all its whey solid is under severe financial strain -- 100 percent of its whey solid.

Eliminating the whey component of the 4b pricing will place the entire cheese industry at parity or break even with respect to whey handling and will provide an incentive to invest in whey processing.

Investing in whey plants is not the desire or interest of most cheese plants but is seen as a way forward with the cheese business expansion given the enormous potential consequence that could result with whey disposal and its environmental impact.

The current 4b component price for whey is stifling our cheese industry's growth.

The whey business has always been the stepchild of the cheese business. Raw whey has zero or negative value in its unprocessed form. Try shipping a few loads. Nobody will buy it, and the freight charges are prohibitive. Whey is a waste product of cheesemaking.

Over the years, the cheese industry has saved the dairy farmers from environmental catastrophe by processing whey, against their will.

Whey economies begin with greater than one million pounds of raw whey per day. Without 4b component prices, it is a risky and at best a mediocre investment decision. Greater than 80 percent of California's cheese plants come nowhere near a million pounds of whey per day. And for those that do, the investment is substantial, costing more than cheese plant investments.

Of the 60 or so plants cheese plants in California, three produce whey powder and the value of this whey powder is applied to all plants, most of which do not process their whey and in addition to that pay disposal costs. Therefore, these plants pay a disposal cost and on one hand and a 4b component price on the other. Is this fair? Of course not.

I have some comments here on two proposals, one by the Alliance of Western Milk Producers and one by Land O'Lakes.

Number one, the Alliance states that the cheesemakers' petition "involves the assumptions that the whey has a net value of zero." This is correct. Whey has a negative or zero value in its unprocessed form.

2. The Alliance notes that the "whey stream has

returned millions of dollars annually to the pool." Yes, at the expense of small cheese companies and the growth of California's cheese industry. Where are these new cheese plants? There are none.

3. "The proposal allows a credit for all plants in the first 100,000 pounds of bulk milk they process daily." This indicates very clearly that the Alliance does not understand the cheese industry. A small plant is a plant processing less than three million pounds of bulk milk daily. Do we see any new plants thinking about less than three million pound of raw milk per day? The answer is no. New plants or potential plants are considering multiple five to six million pounds of milk per day.

And for example, ten million pounds of milk per day growth in this industry represents about a half a billion dollars a year in raw revenue. And I believe that's what we ought to be focused on.

4. The Alliance has not done its homework. Cheese plants are asking for price relief and they are proposing price increases.

Comments on Land O'Lakes proposal. The make allowance proposed doesn't even come close to the recently published manufacturing costs for whey if we are making whey powder.

My conclusions.

One, the only way forward for an expansionary cheese industry is to eliminate the 4b whey component price. It's stifling our cheese industry and doesn't apply to 80 percent of California's cheese plants.

The concept of producer entitlement is inequitable given that the producer is not concerned about the potential catastrophic environmental issues associated with whey, producers do not cover whey disposal costs for greater than 80 percent of California's cheesemakers, producers do not make investments in whey assets, not to mention taking capital risks and yet they expect to reap 100 percent of the benefits in high markets.

Finally, 4b component pricing for whey is the equivalent of being severely penalized from investing in a waste treatment plant for California's cheese industry, while the cheese industry is addressing a serious environmental problem. Thank you.

HEARING OFFICER LOYER: Will you be filing a post-hearing brief?

MR. MURPHY: Yes. I would like to have the opportunity for a post-hearing brief.

HEARING OFFICER LOYER: It's granted.

Anything further? Any questions from the panel?

PANEL MEMBER IKARI: Mr. Murphy, I wonder if you can give us some background on your qualifications. You indicate you're a whey expert.

MR. MURPHY: My background is whey chemistry from University of Ireland. I specialize in protein chemistry over the last 15 years, 17 years. Working in California, I became involved solely in whey processing, economics, and the business of whey marketing and of plant construction and development.

PANEL MEMBER IKARI: So in your past, were you employed as a whey expert?

MR. MURPHY: Yeah. I've been an independent now for several years, but I've worked -- the last co-op I worked with was California Gold Dairy Products in Petaluma where we built two whey plants -- two WPC plants.

PANEL MEMBER IKARI: Have you done extensive consulting in the California dairy industry?

MR. MURPHY: Yes.

PANEL MEMBER IKARI: And the bottom of your page you indicate whey economies will begin with greater than one million pound of whey per day. Where does that data come from

MR. MURPHY: Again, I've been in the business as I said for 17 years now and I've built a total of seven or eight whey plants. And I've worked with numerous other plants. And you know, I know from experience it's -- below a million pounds it's extremely difficult to get a return on investment.

PANEL MEMBER IKARI: So that's from experience. Can you cite any academic papers?

MR. MURPHY: Offhand right now I cannot. But in the post-hearing brief --

PANEL MEMBER IKARI: It would be helpful to put your work experience in terms of the companies that you worked for either directly or consulted with I think would be helpful, too.

PANEL MEMBER IKARI: Mr. Maldonado, you indicated in your testimony milk producers were handed benefits with no downside risk. Are you aware that early after the incorporation of the whey factor that the factor actually added or took away from the price?

MR. MALDONADO: Yes, I'm aware of it.

PANEL MEMBER IKARI: So it wasn't all just positive in the -- under the current formula.

MR. MALDONADO: Yeah. I'm not sure, but I think the difference was -- I don't know what the numbers are offhand.

PANEL MEMBER IKARI: Mr. Hatch, I understand of the three firms that are represented, your firm is the only firm that processes dry whey.

MR. HATCH: Yes.

PANEL MEMBER IKARI: So unlike the other firms who simply dispose of it as a cost, you're actually getting a revenue. Wouldn't you be in a better situation to face the economic situations?

MR. HATCH: Relative to them, yes.

PANEL MEMBER IKARI: I've got other questions, but I'll defer at this point.

PANEL MEMBER GOSSARD: I'd like one follow up question on what Mr. Ikari was talking about with Mr. Murphy that you say you need a million pounds of liquid whey a day to be viable. And Marquez Brothers, they say it's a million pounds of milk per day to be viable. Now could I get a consensus? Is it a million pounds of milk going into a cheese plant or a million pounds of the whey stream coming off the table? Which kind is it?

MR. MURPHY: In my million pounds of whey -- given a million pounds a day whey plant, you're looking at 20-plus million dollars investment.

PANEL MEMBER GOSSARD: That million pounds of waste would represent how many pounds of milk coming into the plant?

MR. MURPHY: One. One million.

PANEL MEMBER GOSSARD: I have a couple other questions. Mr. Hofferber, on page 5 of your testimony toward the middle, you say we yield only two and a half, maybe three percent at best of your whey stream. And you say this is much less than what is indicated by the yield of 5.8 in the formula. Are you saying that your effective yield is 2.5 to three or --

MR. HOFFERBER: Yes.

PANEL MEMBER GOSSARD: So the 2.523 is more representative than the 5.8?

MR. HOFFERBER: Yeah. By our operation, that's correct.

PANEL MEMBER GOSSARD: As opposed to say the operation Mr. Hatch spoke of F&A where they get 4.7 instead of 5.8?

MR. HOFFERBER: Right.

PANEL MEMBER GOSSARD: Mr. Hatch, did you ask for the right to file a post-hearing brief or did you want to --

MR. HATCH: I did not. I probably should. Can I request that?

HEARING OFFICER LOYER: Absolutely. Granted.

PANEL MEMBER GOSSARD: And the final question for Farmdale. You mentioned at the end of your testimony that we've seen milk going to ground or be sold below minimum prices in adjoining states. Do you have any details that you could supply in your post-hearing brief as to the volumes and prices of milk that is involved in this?

MR. HOFFERBER: I don't have that specific data here to supply. I can try to get it together for a post-hearing brief. I have a feeling we're going to hear some of that testimony as the hearing progresses from other sources. It's a little surprising to me maybe the Department isn't aware of some of those things, some of those milk movements itself already. But I don't know your business any more than you know mine.

PANEL MEMBER IKARI: Well, numbers were reported to the Department, but they're not details as to what happens. So if milk is leaving the state, it doesn't say where and why.

MR. HOFFERBER: I'll see what I can do about coming up with some details. We don't talk a lot about our operations among each other and we're not on the producers' side knowing exactly what they're doing.

PANEL MEMBER IKARI: If you can't get data where you heard it or the sources of the information would be helpful.

MR. HOFFERBER: Okay. I can do that.

PANEL MEMBER REED: Mr. Murphy, I just have one question. Just for clarification where you say on the back side of your paper that of the 60 cheese plants in California three produce whey powder. Are you saying three in total, or are you speaking of the three that we account for in our exhibit information?

MR. MURPHY: As far as I'm aware, there are only three plants in California that are producing. There might be four, but there's going to be three in January.

PANEL MEMBER REED: I just wanted to -- be going to be three. Okay.

PANEL MEMBER IKARI: Mr. Murphy, when you respond, how familiar are you with the California cheese industry? I'm not clear on that.

MR. MURPHY: I'm very familiar with it. I've worked with it for 17 years. I mean, I'm thoroughly familiar with the California cheese industry.

PANEL MEMBER IKARI: Could you tell us how many firms you might have consulted with within the cheese industry?

MR. MURPHY: Within California?

PANEL MEMBER IKARI: Yes.

MR. MURPHY: Six or seven. Six or seven in total probably or more. I can get you a list of those in the post-hearing brief. I would --

PANEL MEMBER IKARI: I would like to address a question to all four of you. But I ask you to -- perhaps you may want to file your response in the post-hearing brief.

The dry whey factor in the Class 4b formula obviously has been an issue for a number of years. It's probably been a controversy for over five years. Today, the Department and the hearing panel are considering two distinct choices. One from the processors to eliminate the dry whey. The second one from producers that would propose a credit from the pool. Obviously, each group is seeking adoption of their proposal. There seems to be no middle ground. Each proposal has its strengths and weaknesses.

Whatever the choice the Department makes and this panel recommends, one thing seems certain: That the choices do not reflect a long-term solution since you have no consensus between producer and processors whatever decision we made the other side is going to appeal. One of the questions I would ask first is what did small cheese processors do to reach out to producers to get their input in terms of your proposal?

The second question: If you could go back and look at your records, is there some middle ground between the two proposals where small cheese processors could afford some value in the 4b pricing that would not cause you financial ruin, but at the same time provide some added value for the whey stream? Because obviously until 2007, the whey value of the formula did provide value. And it wasn't until 2007 that you had problems. So that's one of the questions I would ask you to look at and comment in your post-hearing brief, Mr. Hatch.

MR. HATCH: Looking at this as only a loss situation is when it's detrimental to this industry. It's also detrimental even proceeding this period when we had the losses to not be able to recover any of the revenue passing directly through to the dairy producers. So we don't look at it as just a situation of how do we mitigate the losses.

My point is there's no return on investment in the way the system is set up. It's not just the loss situation. And we have been asking for this milk formula to be changed and the whey cost component taken out. But I think a lot of us just kind of tried to make it work while we still had it in the formula as we proceeded along and really just had a slow bleed through all the years. And it finally was just bated by the recent events that hit us hard because of the rapid increase in the prices. And the impact it had to us when we had to sell at lower prices after paying for it at higher costs.

Personally, I just don't like the viewpoint of just looking at how can we just prevent this loss situation. It's not just that. It's just basic business principles of allowing us to have a return on investment.

It also I think needs to be noted there's no margin -- there's no way to increase our margin. Any time we try to add on an overage to the price, it goes right back into the formula. It becomes a cost to us.

PANEL MEMBER IKARI: Well, in my question I'm asking you to go back, take a look at what can be in terms of the manufacturers' cost allowance in terms of setting that allowance and perhaps providing -- some of the make allowance is higher. You have more margins. But perhaps there can be an partial offset for the whey stream value.

MR. HOFFERBER: And to engage in that debate is to give up in some measure on the premise that there is any value in the wet whey stream coming off the cheese process. And if the premise is there isn't any value in that in the first place, which is the body of evidence I'm trying to build, to me, that's more or less the end of the debate.

If we can convince the Department that that really is the nature of the beast, then looking at any of those other alternatives you know becomes more or less an academic exercise. If that's what you're asking us to engage in, we'll consider doing that.

PANEL MEMBER IKARI: I'm equally concerned. And I will ask producers on their proposal whether or not the producer and processors can start forming a consensus where we can arrive at a long-term solution. And we're not here year after year on the whey make allowance issue.

MR. HOFFERBER: I see the question differently. The only other side I would make to that in some of the alternative proposals -- we're seeing them trying to come in with some kind of minimum amount recognition. And clearly with 57 -- whatever my number was -- 52 out of 60 plants in the game that we're talking about here, those numbers that are being proposed don't even approach addressing the problem for the bulk of the cheesemakers in the state. That would be my comment at this point about that. But with your question we'll go back and see what bet are answer we might be able to come up with.

PANEL MEMBER IKARI: One other question. When you cut back on -- did all of you cut back on your milk production that you were taking? You're all nodding yes. What happened to the milk that you were taking?

MR. HOFFERBER: It's our understanding it went to Idaho indirectly.

PANEL MEMBER IKARI: Can you confirm that in your --

MR. HOFFERBER: We'll try.

PANEL MEMBER IKARI: Mr. Maldonado, do you know what happened to the milk?

MR. MALDONADO: I don't. At one point we did curtail back.

PANEL MEMBER IKARI: If you could find out what

happened to the milk and how was it marketed.
And Mr. Hatch, did you cut back?
MR. HATCH: Yes. We have a certain amount of milk that's directly under contract and we balanced with outside milk purchases from brokers and co-ops. So we were not -- we are not currently doing outside purchases. What the co-ops and brokers are doing with the milk at the current time I don't know exactly. All I know is we're not receiving it.
PANEL MEMBER IKARI: Okay. Thank you.
PANEL MEMBER SHIPPLEHOUTE: Mr. Hatch, you testified that your producers and suppliers have stuck by you. Do you know if any of your producers have tried to find another home for their milk?
MR. HATCH: Well, there's been lots of rumors about F&A and producers and so forth. You know, we've heard everything from we closed our doors to we filed bankruptcy. We got out. We are still here today. You have heard rumors to that effect. But I think that's what it is, it's a rumor. Anything material I do not have.
MR. HOFFERBER: Tom, Dan, we had one of his shippers call us to see if we could take their milk.
PANEL MEMBER SHIPPLEHOUTE: And your response?
MR. HOFFERBER: We were in the same mode at this point. Sorry.

PANEL MEMBER SHIPPLEHOUTE: The other questions I had have already been asked and answered.

HEARING OFFICER LOYER: Any further questions from the panel? Thank you. At this time I'd like to call the second petitioners, Alliance. You with also have a total of 45 minutes to submit your testimony. I'll mark that as Exhibit 51 then.

(Exhibit marked)

HEARING OFFICER LOYER: Ma'am, will you please state and spell your name for the record?

MS. LAMENDOLA: Tiffany LaMendola, L-a-m-e-n-d-o-l-a.

HEARING OFFICER LOYER: And Ms. LaMendola, do you swear or affirm to tell the truth and nothing but the truth?

MS. LAMENDOLA: I do.

HEARING OFFICER LOYER: And you're testifying today on behalf of an organization?

MS. LAMENDOLA: We'll be testifying on behalf of Western United Dairymen, Milk Producers' Council, and the Alliance in terms of our jointly filed proposal and then at the conclusion of our testimony will be just Western United testimony.

HEARING OFFICER LOYER: Thank you. And then, sir, are you also testifying today?

MR. VLAHOS: Yes. I've been asked to address one technical point at the end of Ms. LaMendola's testimony. And as I indicated for the record before, my name is John Vlahos. I'm legal counsel to the Western United dairymen.

HEARING OFFICER LOYER: Thank you, Mr. Vlahos.

Ms. LaMendola, you may proceed.

MS. LAMENDOLA: Thank you. Ms. Hearing Officer and members of the hearing panel, my name is Tiffany La Mendola. I'm Director of Economic Analysis for Western United Dairymen. With me today with is our legal counsel, John Vlahos.

Our association is the largest dairy producer trade association in California representing approximately 1,100 California dairy families. We are a grassroots organization headquartered in Modesto, California. An extensive process was used to arrive at the position we will present here today. Western United Dairymen starts the process with a committee of dairy leaders from around the state. The committees recommendations are presented to the Board of Director for review, modification, and approval. The committee met September 20th, 2007, and the Board of Directors met September 21st, 2007, to approve our position.

Additionally, a great deal of effort was put forth amongst our co-petitioners to develop our proposal.

Staff and the Board of Directors for Western United Dairymen, Milk Producers' Council, and the Alliance conducted long and thoughtful considerations of the issues at hand. I should clarify that testimony relating to the F&A, et al. petition to eliminate the dry whey component and to specifics included in our jointly filed proposal is reflective of the views of the Alliance, MPC, and WUD. However, our concluding testimony pertaining to the other alternative proposals should be viewed solely as Western's position.

Petitioner's request. The petitioner's request to eliminate the dry whey component from the California Class 4b formula is indefensible. There may be issues to address for some cheese manufacturers, but those issues need to be handled directly, as we have done in our alternative proposal, not with an approach that voids the value of the whey stream for every pound of milk used to manufacture cheese in the state.

Our estimates show that the dry whey component contributed over 300 million to the California pool in the first eight months of 2007 alone. This value was driven by historically high dry whey prices which were reflective of tremendous demand for the product and dairy protein in general. As California is the second largest producer of cheese in the nation, surely domestic and international buyers have looked the California cheese makers to source the product. According to CDFA data, California produced 23 percent of the nation's cheese in 2006. As a byproduct of this cheese, California manufacturers produced ten percent of the nation's dry whey and 38 percent of the nation's whey protein concentrate. These shares have grown from just 15 percent, 7 percent, and 21 percent respectively just ten years ago. These figures illuminate the magnitude of California's presence in these markets.

Section 62062 of the Food and Agriculture Code contains provisions that require the Secretary to establish formulas in California that result in prices that are "in a reasonable and sound economic relationship with the national value of manufactured milk products." The F&A proposal would have resulted in a California Class 4b price that averaged $2.32 per hundredweight below Federal Class III prices for the 2006-2007 period. Though there has often been dispute over the definition of reasonable, this deviation is clearly unreasonable. Even if the dry whey prices remain at a moderate level of $.40 per pound, a $.76 per hundredweight discrepancy would be created by the removal of the dry whey component alone.

Given the total elimination of the dry whey for all milk processed into cheese would be illogical and contrary to the provisions of the code, but at the same time recognizing an expressed concern regarding small manufacturers with little asserted ability to process their whey stream, we offer a compromise. Specifically, a dry whey credit that will both address the small to mid-size cheesemakers' concerns and provide some relief to the remainder of the cheese manufacturers in the state.

Alliance, Milk Producers' Council, and Western United alternative proposal. We would like to make clear that our proposal is comprised of three distinct components surrounding the dry whey in the Class 4b formula.

First, the proposed dry whey credit.

Second, a snubber on the dry whey component.

And third, an alternative approach to setting the dry whey make allowance.

Proposal component number one, the dry whey credit. Recognizing importance of maintaining a value for the whey stream in the Class 4b formula, we undertook a rigorous process of identifying the major issues and contemplating potential solutions. The Boards of Directors of the Alliance, Milk Producers' Council, and Western United Dairymen provided staff the opportunity to work together to file a united, well-reasoned alternative to the much-too-drastic request of the petitioners. Several ideas were floated by the group and all participants had the opportunity to provide input. The process resulted in what we believe to be the most reasonable compromise for cheese manufacturers and dairy producers alike.

Our proposal rests on the following conclusions:

Number one, there is a value to the whey stream that should be reflected in the Class 4b formula. Doing otherwise would undervalue the milk used for cheesemaking in the state and conflict with the directives outlined in the Food and Agricultural Code.

Number two, dry whey provides a reasonable basis for establishing a value for the whey stream in the Class 4b formula. While we recognize other whey products are manufactured in California, specifics on products such as whey protein concentrates are not readily available, i.e. yields, manufacturing costs, et cetera. If cheese manufacturers would rather incorporate these products into the formula, then they would need them to offer the guidance and data to do so. It is illogical to simply conclude that the entire value on whey should be discarded because this proprietary data is not shared by those privy to the data.

Number three, smaller cheese manufacturers allege they do not have the ability to process their waste stream and capture value from the marketplace. However, mid-size to larger manufacturers likely enjoy the economies of scale necessary to incorporate drying capabilities even if they decided not to.

Deal directly with the issue at hand. Our proposal aims to provide relief for cheesemakers who assert they cannot process whey, while retaining the value of the remainder of the milk used for manufacturing cheese. Specifically, our proposal:

First, provides a credit up to 100,000 pounds of daily milk used to manufacture cheese. Using an 30.4 days per month, this equates to 3,040,000 pounds per month. The credit is to be paid on solids-nonfat-basis up to 264,480 pounds of solids nonfat per month.

The credit is available to all cheese manufacturers on the qualified pounds.

The credit is valued on the applicable month's dry whey component value. Or, specifically, the value determined by the formula.

Implementation of our proposal. We attempted to find the appropriate section of the Stabilization Plan to establish the credit as well as the appropriate section of the Pooling Plan for implementation.

The underlying goal was to establish a credit for plants that process milk into cheese, up to the qualified pounds. According to CDFA data, there are currently 60 cheese plants in the state. It is our understanding 25 out of the 60 are pool plants. A significant portion of the remaining 35 non-pool plants purchase their milk from pool plants and therefore the quantities and value of that milk is reported to CDFA and captured in the monthly pool.

It is our intention that:

Non-pooled plants that purchase milk from pool plants should be eligible for the credit insomuch as the value of that milk used for cheese is captured in the pool.

Any non-pool plant that purchases milk directly from the producer would not be eligible for the credit. If the non-pool plant decide to pool their milk, then the credit would apply.

Any non-pool plant purchasing manufacturing Grade B milk from a producer would not be eligible. This plant would have the luxury of paying their producers whatever price they decide and could simply eliminate the dry whey value on their own accord.

If our proposed language does not accomplish our intent as outlined above, we recognize CDFA has the jurisdiction to develop the specific language to achieve our intention.

We see the dry whey credit to work just as a fortification allowance or transportation credit. And Mr.

Vlahos will expand on this at the conclusion of our testimony.

The outcome of our proposal. Small to mid-size cheese manufacturers will essentially be exempt from paying the dry whey component as their pool credit will offset their obligation on that portion of the Class 4b price. The large manufacturers will enjoy the credit even if they do process significant volumes of whey and do in fact capture the value from the marketplace. The credit will act as an added incentive.

Data from the Department on the pounds of milk processed into cheese for May, June, and July of '07 revealed the natural break in the data at 100,000 pounds daily. In fact, 35 out of the 60 cheese manufacturers in the state, or 58 percent, of the plants would be eligible for the proposed credit on 100 percent of their volume. In effect, these plants would essentially have the dry whey component eliminated from their regulated price. An additional six plants would enjoy a credit on nearly half their milk. This brings the total of plants to 41 out of 60, or 68 percent, that would substantially enjoy the credit. The next six plants on the list would be eligible for a credit on 15 percent of their milk processed into cheese, still a significant savings.

The remaining 13 plants, with the smaller share of milk eligible for a credit, presumably do something with their waste stream. What we can gather from the Department data, 13 plants in California will manufacture dry whey or low percentage, higher percentage, and isolate-type whey protein concentrates for human consumption in 2008. Whether or not these 13 plants happen to be the 13 higher volume plants, we don't know. If they are lower volume plants, they will not only enjoy a substantial credit, but also reap the returns from the marketplace. In these 13 plants are among the larger volume plants, the credit would be insignificant. However, an exemption from paying the dry whey component is not needed as they will recoup the value from the marketplace.

Updated data which includes August '07 released by the Department yesterday afternoon is even more convincing. The breakdown of plants show for 42 out of the 61 plants 100 percent of their milk processed into cheese would be covered under the proposed credit. The next six plants would enjoy 63 percent coverage. The following five would enjoy 28 percent coverage. And the next three would enjoy 14 percent coverage. For the remaining five large plants with six percent coverage, our arguments above would apply.

Proposal component number two, to implement a snubber. We support the implementation of a snubber on the dry whey price so that the dry whey component is never less than zero. The Class 4b formula is decide to capture the value of the milk used to manufacture cheddar cheese. If there is no value to the dry whey in any given month, then its contribution should be zero, not negative. For the instances in which there is whey that cannot be further processed, the Department indicates that disposal costs for any non-viable whey are included as a direct disposal cost in the manufacturing cost data for cheese.

Finally, the snubber is a necessary component of our proposed dry whey credit. Otherwise, given a negative dry whey value, a credit would essentially be a charge. This outcome is not our intent. Given the willingness of dairy families to provide a credit to alleviate the financial stress of small cheese manufacturers who do not process whey, this downside protection for dairy producers is fair.

Proposal component number three, the alternative method for setting the dry whey make allowance. With the eventual loss of the dry whey cost study in California, a new method of establishing the make allowance must be employed. We suggest the addition of $.03 per pound to the nonfat dry milk manufacturing cost allowance.

As we have testified at previous hearings, we have concerns with the sole use of the CDFA cost study and setting the dry whey make allowance. Some of our concerns include:

First, the 2006 weighted average dry whey manufacturing costs in California exceed dry whey costs detailed in the Cornell cost study for plants outside of California by $.1123 per pound. Using the 2005 figures for California, the deviation is still $.0875 per pound. No other California product manufacturing cost exhibits such a large deviation from plants outside the state. The extreme difference is difficult to reconcile.

2. In USDA's January 2007 federal order hearing interim ruling, CDFA's cost data was used for every commodity except dry whey in determining make allowances. For butter, nonfat dry milk and cheese, California data was combined with the Cornell data on a weighted average basis with the addition of $.0015 per pound marketing allowance. For dry whey, USDA did not use a CDFA data citing, "Three of CDFA's dry whey plants have a manufacturing cost variance so large it would be unreasonable to combine the total weighted CDFA value with a twelve plant Cornell sample." USDA's decision to omit only the CDFA dry whey cost study from consideration can be taking as a failed vote of confidence in its validity by USDA.

3. Only one plant in the CDFA cost study is a cheddar cheese plant. Prior evidence and testimony suggests a difference between processing whey streams generated in the production of mozzarella cheese versus other types of cheese, such as cheddar. Clear evidence suggests that due to the desire to capture whey in the curd for added moisture, there is less extraction of skim whey powder for the same amount of milk going into mozzarella production as there is going into cheddar cheese production. A lower volume of skim whey produced by mozzarella plants would increased the fixed and semi-variable cost components in the cost study.

Justification for the proposed three cent per pound addition to the dry make allowance includes:

First, as a result of the January 2003 hearing, the Department implemented a dry whey manufacturing cost allowance of 17 cents per pound, which was two cents higher than the nonfat dry milk.

The panel report affirmed widespread industry support for this approach, citing, "Notwithstanding the lack of cost data, there was general agreement among producers and processors that the processing costs for nonfat powder should be used as a basis for determining the make allowance on dry whey. Processors testified that whey processing costs are up to three cents per pound higher than those of nonfat powder."

2. The difference between the processing costs for the seven nonfat dry milk plants and the seven dry whey plants in the Cornell study for the calendar year 2006 was $.0314 cents per pound.

And finally, substantial testimony and evidence provided at the January 2006 federal order hearing by national cheese manufacturers supported the addition of approximately and two and a half cent to the nonfat dry milk manufacturing cost to capture the incremental costs associated with dry whey. We understand this approach was suggested prior to the release of the Cornell cost study; however, the results of the Cornell study verified the approach.

Whether or not the three cent per pound addition to the nonfat dry milk make allowance is the correct level, we propose a lower dry whey make allowance in any case. Different approaches could be taken to establish the correct allowance. Even using the most generous figure we can calculate, which is using the method adopted by USDA, explained above a maximum allowance would be established at 21 cents per pound. This is determined with the use of the 2006 studies in which the California cost is inflated due to a reduction in participating volume. We are not proposing this as a method to implement, merely using it as evidence that the $.267 per pound cost allowance is too generous, especially in light of the proposed dry whey credit.

And now I'll move on to just Western United's testimony on the other alternative proposals.

Given the new cost structure imposed on California dairy families, we simply cannot support any of the alternative proposals seeking to increase manufacturing costs allowances or FOB adjusters. California dairy families can ill afford additional permanent reductions in their minimum prices as they struggle to adjust to rapidly escalating production costs.

Just less than a year has passed since the implementation of the last reduction to the minimum prices that shaved an estimate $.20 per hundredweight off pool prices in California. The six to seven months following implementation brought severe economic conditions to dairy families. Production costs far outweighed producer prices. Producers were forced to acquire debt or go out of business. Just in the last several months, producers have been able to recoup at least a portion of their losses. And as we are all too aware, these current prices will not last forever.

A comparison of California mailbox prices to average cost of production in California since 2001 reveals that conundrum faced by producers. Production costs are on a steady upward trend. And at the same time, prices have not only been volatile but far below costs in many months.

The upward trend in production costs shows no sign of relief in the near future. To make matters worse, production costs do not reflect environmental mitigation or environmental regulatory costs.

Too often we hear increased milk production in the state is a signal of economic health for dairymen. A review of the elements that determine producer profitability shows milk production is the only element is a producer is able to entirely control to influence the bottom line.

Assuming the basic formula holds: net profits or losses equal milk production time, regulated minimum premiums less the cost of production.

We know that, number one, producer's can effectively influence milk production.

Producers cannot set minimum regulated prices at the same time. This is the only price they are guaranteed to receive.

Premiums are provided at the processors' discretion. Producers may have some control over quality premiums.

And finally, producers have limited ability to dramatically lower the cost of production given escalating costs of doing business in California, skyrocketing fee costs, increasing transportation costs, and growing environmental regulation.

Unfortunately, given the environmental climate in the state, expanding milk production may not be as easy as in the past.

Just a few examples to illustrate the point. The waste discharge requirement will impact milk production in several ways. First, it will impose hefty compliance costs as it relates to monitoring. Additionally, the cost of compliance for improvements required to the dairy infrastructure will be steep. For some dairies, the required changes will not allow the dairy to be economically viable and they will shut down.

Finally, under the WDR requirements, expansions of existing dairies will be more difficult and costly than in the past.

On the air quality side, an authority to construct is required for permitted dairies to expand or construct almost anything on their facilities. This currently applies to dairies with more than 1,000 milking cows, but that number will fall to 500 cows in the near future. This makes expansion more costly in the past but can also limit growth as some producers will be granted permits for far fewer animals than requested.

Given the new cost structure and the real cost of complying with environmental regulations in the state, producer prices of the past will no longer be sufficient to cover production costs. Permanent reductions in California's minimal producer prices only compound these problems given that the bulk of the aforementioned regulatory costs are discrete to California producers. Though a product's cost of production has not been weighed heavily by CDFA in the past, we ask the that the Department recognize these new challenges as they effect the economic viability of dairies in the state.

Plant capacity. We recognize plant capacity will be a focus at this hearing. Our members are well aware of the growing pressures on current capacity in the state. However, we re-affirm that lowering Class 4a or b prices to address plant capacity concerns is inadequate and inappropriate. The issue needs to be handled directly, not through a transfer of assets from dairy families to processors who may or may not expand capacity in the state. To this point, we are intrigued by the concept proposed by CDI. However, given the time frames involved with the hearing, it was impossible for us to vet the concept with our membership. As explained previously, WUD follows a diligent process of setting policy, beginning with committee meetings and ending with recommendations to the Board of Directors for final approval. There simply was no time to follow this important procedure and to clearly identify producer support or opposition to the idea.

WUD has recognized the need for discussion on the issue of plant capacity. We began discussions at a task force meeting held July 17th, 2007. Recognizing that additional work was needed and to allow for better producer and processor input, on August 28th, 2007, we invited the Dairy Institute to work with us to establish an industry committee to deal directly with plant capacity and develop a strategic plan for the industry. We recognize the task won't be easy and will require wide participation by all sectors of the industry. The Dairy Institute has agreed to participate with us, and we will kick off efforts immediately.

Through the proposed committee, different issues and concepts such as that proposed by CDI could be fully detailed, examined, and understood by a wide range of industry participants. Clearly, there are a range of issues and concerns at the processor level in terms of dealing with capacity. Our producer members also continue to raise a list of questions and concerns regarding plant capacity that should be addressed in order to fully educate all sectors of the industry. Some of the concerns questions and concerns we've heard from our members include:

Number one, the possible chilling effect on milk production increases fostered by environmental regulation as explained above.

2. The continued consolidation of dairy farms which will be escalated by current cost structures and further hastened by another inevitable downturn in milk prices.

3. The business climate in California and its role in discouraging expansion in the state. What hurdles beyond regulated prices to doing business in the state need to be overcome?

And finally, the conflicting messages in regard to plant capacity expansions in the state are hard to interpret. For instance, at the June 2006 hearing, Leprino Foods made a statement that, "The current construction at the LeMoore West facility referenced by the CDC witness at this hearing will increase our line flexibility and will not result in expanded milk throughput capacity." However, according to sources such as Cheese Market News, expansion is underway that will allow the facility to process an additional four million pounds of milk per day. We understand that several stages of expansion may have been planned and circumstances may have changed since the last hearing. Our main point is that to bring producers to the table, and especially to ask them to help fund new capacity, they need to be fully apprised of the intention of processing plants in the state.

These are some of the issues on the minds of producers. We recognize that things may be discussed internally by management of processing plants, but to truly involve producers and other industry stakeholders, forming a Committee such as we are suggesting would be prudent. For this reason, we ask that CDFA allow this effort to unfold before implementing the approach suggested by CDI.

At this time, I'll ask Mr. Vlahos to address one point.

MR. VLAHOS: Yes. I've been asked to address one point, which is a possible -- any possible concern that by allowing the credits proposed by the alternative suggested by Western United Dairymen, the Alliance, Milk Producers' Council might set a precedent and might open the door to third parties to raid the pool in order to fund various other objectives. I just want to state that in our view that those concerns are really not well founded, if they do in fact exist.

First, the notion of providing a credit for handlers and processors is neither unique nor precedential. We cite, for example, as was mentioned by Ms. La Mendola that already existing in the Stabilization Marketing Plan are similar structures. For example, fortification credits under the pooling plan section 900 C which permits the deduction of solid nonfat or consolidated skim milk equivalent used for fortification the amount specified in the Stabilization and Marketing plan and allowed -- is implemented by allowing the credit against pool obligations under the pooling plan.

And a similar example might be the plant-to-plant transfers where transportation credits are specified in the Stabilization and Market Plans for transfers from plants and surplus areas to deficit areas are implemented through a credit and the pooling plants. So there's nothing new in the type of concept that's being proposed on the alternative. And indeed, the alternative was drafted carefully to follow these already established precedent, not to set any new one.

Secondly, in our examination of the Stabilization and Marketing Act, the Pooling Act, and the various plans promulgated under those statute, we don't see anything there that would permit, if you will, the rating of the pool for other objectives by third parties. So to the extent there is any concern that the alternative being proposed would in fact set such a precedent and allow such a rating we believe to be unfounded. Thank you.

MS. LAMENDOLA: We thank you for the opportunity to testify and respectfully request the opportunity to file a post-hearing brief.

HEARING OFFICER LOYER: Motion granted.

Are there any questions from panel?

PANEL MEMBER IKARI: Mr. Vlahos, you said you don't see anything in terms of rating. What do you see in terms of chapter two that authorizes -- well, both the milk stabilization statutes chapter two and the milk pooling there is specific enabling statute that would authorize what the Western United, MPC, and the Alliance has proposed.

MR. VLAHOS: I can't cite you any specific provision of the plan, but I think it's fully authorized and we'd be willing to address that in a post-hearing brief, Mr. Ikari.

PANEL MEMBER IKARI: Isn't it true that the fortification allowance and the transportation credit were already existing in the State plan prior to the adoption of the following plan?

MR. VLAHOS: Prior to 1969?

PANEL MEMBER IKARI: Yes.

MR. VLAHOS: I'd have to go back and check. I don't know whether they existed prior to 1999, although I'm not sure of the relevance of that.

PANEL MEMBER IKARI: Well, when the adoption of the pooling plan was made effective, they were merely incorporating prior existing conditions that were already in effect in the Stabilization Plans.

MR. VLAHOS: You're talking about the adoption of the pooling plans in 1969?

PANEL MEMBER IKARI: Yes.

MR. VLAHOS: I would respectfully disagree somewhat with that statement. Because prior to 1969 and the implementation of the pooling plan in July of 1969, I'm not aware of any pooling plan statute that was carried over into the gone all Milk Pooling Act. As I said, my memory of history is far from perfect and becomes less perfect as each year goes by. But I don't recall any such thing. And perhaps if you could -- if you could elucidate that, I'd be happy to consider it.

PANEL MEMBER IKARI: Finally, Mr. Vlahos, you indicated there's adequate protection against rates. What criteria would the Department use to evaluate if there's a so-called do good proposal? For example, suppose small dairy farmers on the coast are having difficulty with environmental regulations. Why couldn't they ask for a pool credit so they could survive and meet the environmental challenges?

MR. VLAHOS: I would think that nothing would stop anybody from proposing a credit. And it is up to the sound discretion of the Secretary as to whether that credit and the proposed amendment to either the stabilization or marketing plan or the pooling plan was consistent with the purposes of the two statutes under which those plans are adopted.

So I think the protection you have here is that these statutes -- these plans are carefully designed to promote the purposes -- the public purposes of the exercise of the State's police power that are embodied in the language -- the introductory language of both of those statutes. I would rely on whatever proposal was made -- it was simply a raid on the pooling plan, the Department would see that and not allow the credits.

PANEL MEMBER GATES: Ms. LaMendola, I have a question on page 3 of your testimony. In regards to the implementation of your proposal, the third paragraph, you're stating that if your proposed language does not accomplish the intent of the outlined above, we recognize the Department has the jurisdiction to develop the specific language to achieve the intention. Could you explain that a little bit what you meant by that?

MS. LAMENDOLA: We've tried to outline for you how we see this credit working as far as how all the plans would -- how the plan would be handled. If we've missed some important part there, we recognize you have the ability to adjust the language to achieve our intent.

I think there's been hearings in the past such as the de-pooling hearing and such where proposals were put forth but the Department actually settled on the exact stabilization or pooling language to implement that proposal. So that's what we were trying to say.

PANEL MEMBER GATES: Okay. And then on page 4, the next page, the outcome of your proposal when you're talking about the eligibility of the credits, were you speaking to two minimum prices? Is that kind of like the bottom line of that there's --

MS. LAMENDOLA: Well, no. We didn't want to impact the minimum 4b price. Is that what you mean? We've suggested it be a handler credit out of the pool. So you wouldn't want to have to announce two different Class 4b prices, I don't think. So we tried to structure it in a whey it would be a credit similar to other credits that exist. Of course, a credit would essentially act as an equal reduction in that component of the 4b price. But it would just act as a credit.

PANEL MEMBER GATES: Thank you.

PANEL MEMBER REED: Ms. LaMendola, on page 5 towards the bottom, number one, where you're referring to the Cornell study and the difference in the whey costs from California to theirs, I'm just wondering if you looked at the comparison of costs from their lower production plants and compared that to what California costs were to see if there was a closer range there.

Also, another question I wondered is if California had more cheese plants that were producing a higher volume and then mixing them with those plants that we have, do you still feel that that range would be so large?

MS. LAMENDOLA: Unfortunately, the Cornell costs were not broken out in volume groups. So I have a weighted average, but I can't tell if there's some that are lower -- you know, much lower than that, much bigger than that. So I don't know if I can do a real close comparison in that case. All I could use was the weighted average, at least from what I can tell.

PANEL MEMBER REED: I think that they did separate them.

Tom, do you know?

PANEL MEMBER GOSSARD: When you were reciting the Cornell study? Are you citing the most recent one for the

plant for 2006 or the prior study that covered plant costs
2004 and 2005?

MS. LAMENDOLA: 2006 is what I'm looking at. And it was the testimony on cost of processing and cheese, whey, butter, and nonfat dry milk plants by Mark Stevenson, July 9th, 2007. And all they have is a weighted average on the pounds of whey. I don't see a breakout on volume. But if there's another document, I'd be happy to look at that.

PANEL MEMBER GOSSARD: In reference to Ms. Reed's question, could you please refer to the details of the cost studies done by Cornell for the 2004-2005 data? I believe they had breakouts.

MS. LAMENDOLA: So you want me to go back and look at CDFA's 2004-2005 cost studies and compare it to Cornell's?

PANEL MEMBER REED: I would like to know if you would still be able to make that statement if you were to compare apples to apples basically.

MS. LAMENDOLA: I'm just looking at the most recent, but I'd be happy to do that in a post-hearing brief.

PANEL MEMBER REED: Thank you.

PANEL MEMBER LEE: I have a question, Ms. LaMendola.

Regarding any amendments to the pool plan, one consideration that the Food and Agriculture Code requires the Department to do is to see if the amendment is substantive or non-substantive. And if it is substantive, it would require the Department to hold a referendum of producers. In your proposal of this credit, do you feel that -- do you feel this proposal would be substantive or non-substantive?

MS. LAMENDOLA: I'm going suggest non-substantive. I mean, given that what we propose is far less drastic than what the petitioners are proposing as far as impact on producer prices. We're coming forth with a view on a great proportion of dairy producers in the state, being this represents the views of Western United Dairymen members and Milk Producer Counsel members.

PANEL MEMBER LEE: Thank you.

I do have another question also. In most of the Food and Agriculture code regarding the Milk Stabilization Act talks about encouragement of removing availability of milk for usages for milk predominantly on Class I and Class II products. It's stated pretty clearly throughout that that's one area that the Department is given authority to do this. This proposal is regarding another class of product that's not indicated in this code itself. Did you see this may be a conflict in what you're asking the Department to do?

MS. LAMENDOLA: I think Mr. Vlahos kind of addressed that before. But I might ask him.

MR. VLAHOS: I don't see it as a conflict, Mr. Lee.

PANEL MEMBER LEE: Thank you.

PANEL MEMBER SHIPPLEHOUTE: A question regarding the application of your credit specifically regarding pool plants versus non-pool plants. On page 3 of your testimony, you indicate directly from a producer would not be eligible for the credit. Could you elaborate how you arrived at that decision?

MS. LAMENDOLA: So we assume that would be a plant whose milk is the milk they purchase is not pooled in any fashion. Therefore I don't know how the credit could be applied to that plant.

PANEL MEMBER SHIPPLEHOUTE: But your credit as you've written it would be a credit to the class price and you're simply using the pool to account for that class price credit, is that --

MS. LAMENDOLA: I don't think we've adjusted the class price in our proposed language. We certainly did not mean to. We've tried to establish as a credit when you determine the handler's obligation for each plant. If our language doesn't reflect that intent, that was our intent.

PANEL MEMBER SHIPPLEHOUTE: If I recall, your petition you had put the change in the Stabilization Plan.

MS. LAMENDOLA: We put in the Stabilization Plan the way the credit would be valued or the value of the credit. But to implement the credit, we propose language to the pooling plan.

PANEL MEMBER SHIPPLEHOUTE: So using the pooling plan to do the accounting for that credit?

MS. LAMENDOLA: Yeah. That was our intent.

PANEL MEMBER SHIPPLEHOUTE: Does that essentially establish two separate Class 4b prices, one for larger plants and one for smaller plants?

MS. LAMENDOLA: I don't think so. I don't think we tried to change the Class 4b price at all. We've just provided for a credit to plants on their pool obligation. Just as transportation credits and fortification allowance work.

PANEL MEMBER SHIPPLEHOUTE: Okay. The Food and Agriculture Code I believe it's Section 62720 prohibits the pool plan from resulting in unequal raw product costs. How does that fit into your proposal? Can you may be reconcile those two?

MS. LAMENDOLA: We haven't looked at that at all, but I can get with our co-petitioners and address that in a post-hearing brief. You said 62720?

PANEL MEMBER SHIPPLEHOUTE: Yes.

HEARING OFFICER LOYER: Are there any further questions from the panel?

PANEL MEMBER GOSSARD: Mr. Vlahos, at the beginning of the hearing, you made a formal objection to the completeness of the record. In making that objection, did you consider what statute of authority and under what conditions the Department has to release confidential data?

MR. VLAHOS: I think the request was carefully tailored to avoid that issue, Mr. Gossard, because no data with respect to a particular processor was being requested. Rather, it was sort of a cumulative or combined so you wouldn't tell from that what any particular processors numbers were. And it's no different than the Department releasing cumulative statistics about anything. So that's how that was addressed.

Actually, I'm glad you brought that up, Mr. Gossard, because I forgot to mention that when I made the objection in fact the way the request was formulated was specifically to avoid the invasion of proprietary protection.

PANEL MEMBER GOSSARD: My next question in establishing the solids nonfat price for Class 4b, the dry whey factor is divided by 8.8. And in establishing the small plant credit in your proposal, the whey factor is divided by 8.7. Why did you divide by 8.7 rather than 8.8?

MS. LAMENDOLA: That came up briefly in our discussion that wouldn't -- it didn't really make much of a difference. And we didn't discuss it any further. But I could check with the rest of our group and get back to you on that.

PANEL MEMBER GOSSARD: It was your intent to draft your proposal so that it would exactly cancel out the whey factor for plants under a certain size; is that correct?

MS. LAMENDOLA: Yes.

PANEL MEMBER GOSSARD: Did you realize dividing by 8.7 does not do that?

MS. LAMENDOLA: Yeah. We may need to address that.

PANEL MEMBER GOSSARD: Your proposal uses a credit to 100,000 pounds of milk. Prior testimony indicates that you have to get to a million pounds of milk before it's profitable to process the dry whey stream. Would you consider a figure higher than 100,000 pounds?

MS. LAMENDOLA: Looking at the breakdown in volume that was provided by the Department, we tried to find a natural cutoff that would capture a significant amount of the plants. I'm not sure from the testimony this morning whether it was a million pounds of milk or million pounds of whey. So I'm confused.

I've actually asked that question myself what are the economies of scale needed. So I don't know if I can answer that directly until I do a little more research. But our intent was to capture most of the small to mid-size plants as we could.

PANEL MEMBER GOSSARD: So your intent was to capture small plants -- not necessarily all plants that would not be feasible to process whey?

MS. LAMENDOLA: Again, I'm not sure what that level is. I may find out today.

PANEL MEMBER IKARI: Tom, can I ask a question? When you set that number in terms of the 100,000, you didn't rely on a study that says the economies of scale to process whey is this and that's how we're going to set our number? It appears based on your testimony that you looked at the volume of plants and tried to cover the volume of plants rather than going to what's the economies of scale for whey.

MS. LAMENDOLA: Yeah. I wish we could access the data on the individual volumes of each cheese plant and what type of whey processing capabilities they have.

We're not privy to that data, so we have no way of knowing that.

PANEL MEMBER IKARI: Did you research any academic information? Is there any kind of academic information about economies of scale of plants?

MS. LAMENDOLA: I have not been able to find any. But if there is some available, that would be great. So we took a different approach of just trying to cover as many smaller to mid-size plants as we could to offer a compromise.

PANEL MEMBER IKARI: But if a plant grew beyond where you drew the line, they would have the same problem.

MS. LAMENDOLA: They would receive the same credit. And we assume they do something with that whey. They could recapture that out of the marketplace. But you know, we're just not -- we don't have availability to that data to know what each plant does.

PANEL MEMBER IKARI: Tom, I'm going to go ahead and ask a few other questions.

You heard me ask the questions of the small cheese processors. I'm going to ask the question of the petitioner. What did the producers do to encourage the cooperation and input of processors in developing your proposal?

MS. LAMENDOLA: I think we've taken the biggest effort we've ever taken to try to find some consensus in industry. We've asked groups outside the three co-petitioners to join in our brainstorming sessions. Some of them were unable to agree with our proposal. But in any case, we have two major producer groups in the state as well as the Alliance represents three large processors in the state. So I think that's probably the most consensus you've seen in a long time.

PANEL MEMBER IKARI: So you asked the producers. Did you in any procedure ask the processors to participate in the development of the proposal?

MS. LAMENDOLA: We contacted -- it was clear of their position on the hearing. And I don't know that would have been possible at this time. But I think we made the largest leap we could.

PANEL MEMBER IKARI: If you -- during the hearing you heard me ask the question of Mr. Maldonado where he indicated the current formula had no risk. But your proposal would eliminate the risk by introducing a snubber. The only thing that would provide is a positive when it comes to the whey factor; is that correct?

MS. LAMENDOLA: The snubber combined with the dry whey credit that reduces the risk significantly for the processors. So we're saying first of all you have to do that or why is our proposed credit -- if it was a negative would actually become an additional charge to the cheese manufacturers, which was not our intent. And we're saying we're providing you some risk on the upside when whey prices escalate, so we would like some protection on the downside. We've just asked for that compromise.

PANEL MEMBER IKARI: What about a -- did you consider a concept of the -- if you're going to protect the low that you protect the high?

MS. LAMENDOLA: We feel we've done that. Our credit moves with that dry whey component. So if dry whey is three dollars a hundredweight to the 4b, then the credit is three dollars a hundredweight. So it does protect it. It moves up right along with it.

PANEL MEMBER IKARI: As I indicated to the small cheese processors, we have the producer proposal and the processor proposal. I want to explore anything in the middle.

Have the producers -- did you in developing a proposal consider any options whereby given a certain level of whey prices that we provide a range of values that could be incorporated for whey factor instead of the complicated formula we currently have?

MS. LAMENDOLA: I think we had about six to eight different ideas we floated. And this was the one that the group felt was the best compromise.

PANEL MEMBER IKARI: Would the producers be supportive of some -- and I'll use the word reasonable value added for whey that would not cause small cheese processors to face financial difficulty?

MS. LAMENDOLA: David, right now we have policy to support this proposal. And I could not comment on -- first of all, I'm not quite sure what you're proposing and I would have no policy to say whether or not they would support that.

PANEL MEMBER IKARI: So you're going to leave us with a choice of either one or the other, and that's it?

MS. LAMENDOLA: Again, we really feel like we've come up with a compromise. In the past, we've just came and argued, no, the dry whey factor needs to stay as is. Keep it as it is. Lower the make allowance. And I think we got together, formed some consensus, and have tried to provide the Department with a compromise. So we really feel like we've already taken that step. And we hope you think the same.

PANEL MEMBER IKARI: Tom, did you have any other questions?

HEARING OFFICER LOYER: No further questions.

PANEL MEMBER SHIPPLEHOUTE: I do. Following the questions of Mr. Ikari on the snubber on the whey price, he asked about basically a ceiling on the whey price and

4b formula as well. And you thought that you already captured that or are doing that by including it in that credit. That credit would apply to a small percentage of the 4b milk in the state. Yet, on the upside, 100 percent of the 4b milk would pay value to the pool for the higher price of whey. So are you still -- is it your opinion that you still have that up side protection?

MS. LAMENDOLA: In our proposal we tried to capture the plants that do not manufacture whey and do not get the value from the marketplace. If dry whey prices escalate, we've provided a credit at this price to the plants that we think process whey. Those that do, the price is reflective of the value they've recouped from the marketplace. So I don't know why for those plants they would need upside protection. They've manufactured, whether or not it be dry whey, some other product that that price is reflective of the value they've received. So I guess that would be at least Western's position. If our co-petitioners think otherwise, they can say so.

PANEL MEMBER SHIPPLEHOUTE: Thank you.

HEARING OFFICER LOYER: If there are no further questions from the panel, I will now call up the organizations who submitted alternative proposals. Each of these will be granted 30 minutes period to testify. First, I would like to call the Dairy Institute.

Q We're going to give our slot to Humboldt Creamery because he has a plane to catch. We'll just take his spot.

HEARING OFFICER LOYER: I'm going to mark this as Exhibit 52.

(Exhibit marked)

MR. GHILARDUCCI: My name is Rich Ghilarducci, R-i-c-h, G-h-i-l-a-r-d-u-c-c-i.

HEARING OFFICER LOYER: And do you swear or affirm to tell the truth and nothing but the truth today?

MR. GHILARDUCCI: I do.

HEARING OFFICER LOYER: Are you testifying for the record just on behalf of an organization?

MR. GHILARDUCCI: Humboldt Creamery Association.

HEARING OFFICER LOYER: And you may proceed.

MR. GHILARDUCCI: My name is Rich Ghilarducci. And I'm the Chief Executive Officer of Humboldt Creamery Association. Our membership consists of approximately 50 dairyman located in northern California. My appearance today is on behalf of our Board of Directors and the 50 families that own our cooperative.

Humboldt Creamery processes and markets powdered milk, ice cream, and fluid milk products. Our dairymen have made substantial investments during the past ten years in their facilities and in developing markets for California ice cream and powdered milk. In addition, our facilities are used to balance the raw product requirement of fluid milk and cheese processors in northern California similar to other butter/powder facilities throughout the state of California.

The California Department of Food and Agriculture have granted F&A a public hearing to consider amendments to the Class 4b pricing formula because of the impact the current formula is having on small cheese manufacturers. Also the Secretary of Agriculture broadened the hearing to include all aspects of the Class 4a and 4b pricing formulas.

We recognize that owners of California manufacturing facilities, which include our dairymen, are experiencing high raw product prices and cost of production increases in all aspects of their business. As a result, manufacturers are looking towards this hearing of the Department to solve the inequity of their revenue to expenses. Sound policy, not temporary economic conditions, should be the basis for the Department's decisions. Current raw product prices are a reflection of supply and demand and not the state of California's milk pricing system.

Listed below is our position on the Humboldt Creamery alternative proposal, manufacturing allowances, and the Class 4b price structure.

Humboldt Creamery alternative proposal. Our proposal recognizes the plight faced by small processors faced in the state of California with minimal impact to pool revenues. It maintains parity between the California classes of milk, as well as maintaining a reasonable relationship with surrounding federal orders. Also, our proposal allows for the California dairy industry to remain regionally diversion.

For example, our powdered milk facility is located in a region which has minimal annual growth in milk supply. In the most recent cost studies published by the Department of Food and Agriculture, the four low cost power plants produced on average approximately 110 million pound of powder annually, compared to the four high cost plants which on average produced 25 million pounds of powder annually. Due to our limited regional milk supply, there will be a powder manufacturing facility located in our region that produces 110 million pounds of powder per year. However, based on the current state of California pricing system, the California dairy industry will eventually be consolidated to a few counties since milk volume dictates a manufacturing plant's ability to achieve efficiency. If an individual looks at historical trends, they would see that the previous statement has already become reality.

Another aspect of our proposal is that it uses the same milk volume thresholds for Class 4a and 4b processors and incorporates the State of California audited costs to calculate the difference in manufacturing allowances between small and large manufacturers. We used the difference between the low cost group and the high cost group to establish the make allowance variances for small manufacturers. By using the equivalent butterfat and solids-nonfat for Class 4a as compared to the pounds of milk in Class 4b, our proposal ensures parody between classes.

Manufacturing allowance. The State of California audited weighted average manufacturing costs for the 2006 year was $.1664 cents per pound for nonfat powder. Based on this study, there are four of eight plants which are classified in the high cost group which are losing four cents per pound on the hundred million pounds of powder they process annually, or approximately four million dollars. The Humboldt Creamery alternative proposal addresses this inequity.

In the past, Humboldt Creamery has always supported cost justified changes in all make allowances. Although our alternative proposal used existing make allowances to demonstrate a structural concept, we believe that make allowances should be adjusted to the published cost studies, while also addressing the difference between small and large manufacturers.

The State of California has received an alternative proposal to expand production capacity within California by establishing a pool credit for manufacturers adding new capacity. We believe as an alternative the State of California needs to alter the return on investment calculation and ensure we maintain the facilities already established within the state. We believe the return on investment calculation used by the Department in establishing make allowances does not reflect the true cost of capital to maintain or build new processing facilities within the state. Let's not discourage investment that would keep our facilities efficient, cost effective, and competitive.

Currently, the formula uses the depreciated value of plant assets multiplied by Moody's corporate bond index. This calculation does not truly recognize the cost to maintain or replace an existing facility within the state of California. The return on investment calculation should be calculated using the replacement value of the plant assets multiplied by the rate on a ten year note which would be a closer reflection of the value required to maintain or build new facilities.

Class 4b price structure. We support maintaining the whey component in the 4b pricing structure. The current structure recognizes the raw product value for whey solids.

The processing and marketing of whey solids has become a profit center for many cheese manufacturers. California manufacturers should have an adequate manufacturing allowance and should be rewarded for innovative marketing and developing and selling above the CME cheese price, or the western mostly dry whey value, or efficiencies recognized by processing below the manufacturing allowance. Processors should not be allowed to prosper by not paying the true value of the milk they are processing.

With over 40 percent of the milk produced in California being processed in Class 4b, it's imperative our pricing system recognizes the value of whey in the manufacturing of cheese. California dairymen should recognize the raw product benefit of these component values. The current 4b structure recognizes the raw product value of whey solids and allows our 4b pricing to be in reasonable relationship on a month-to-month basis with the federal order Class III pricing. The Humboldt Creamery alternative proposal addresses the inequity in the current 4b pricing structure which is the difference in plant size, not whether there is a value in whey.

In conclusion, the 50 family farms and the Board of Directors of Humboldt Creamery Association encourage the members of the panel to recommend, and the Secretary of Agriculture to adopt, the alternative proposal submitted by Humboldt Creamery which addresses he inequities within the California Milk Stabilization Plans related to small manufacturers as well as maintaining parity between Class 4a and 4b pricing structure. We also support the adjustment in make allowance as proposed by California Dairies.

This concludes my testimony on behalf of Humboldt Creamery Association. We appreciate the opportunity to testify at this hearing. And I'd be happy to respond to any questions the hearing panel may have.

HEARING OFFICER LOYER: Does the panel of any questions?

PANEL MEMBER IKARI: I do. Mr. Ghilarducci, you seem to be saying that because of the proposals at the hearing for small cheese plants for A or butter powder needs the same type of treatment.

MR. GHILARDUCCI: Yes.

PANEL MEMBER IKARI: Why not then propose a credit out of the pool for small butter powder plants? Why go through the exercise of creating two distinct prices on 4a and 4b?

MR. GHILARDUCCI: Well, one of the things -- and as you questioned earlier in the pool to change the pooling provisions which may have to go back to referendum of the members. As an alternative, I think what you asked for is some different alternatives. I tried to address it through the make allowances in the stabilization plan in 4a and 4b. That was our intent.

PANEL MEMBER IKARI: So you prefer what you propose versus what the Alliance proposed?

MR. GHILARDUCCI: Yes.

PANEL MEMBER IKARI: In your view, you mentioned vote. In your opinion does the Alliance Western require a vote?

MR. GHILARDUCCI: I wouldn't have a position on that. But I know certain changes in pooling provisions require that. So our focus was on the milk stabilization plans.

PANEL MEMBER IKARI: Let me ask it differently. Would the credit as proposed by the producer organizations have a material effect on the pool prices your members receive?

MR. GHILARDUCCI: I don't think I would be in a position to answer that today.

PANEL MEMBER IKARI: Is that something you can look at and address in your post-hearing brief?

MR. GHILARDUCCI: We can look at that, Dave.

PANEL MEMBER GOSSARD: Mr. Ghilarducci, under your proposal, what if one side has more than one plant? Would both plants get the one credit? For example, both Hillmar and Land O'Lakes have more than one plant on the same property. How would your proposal work under these conditions?

MR. GHILARDUCCI: If they have separate pooling ID numbers, that they're processed under they would both separately get that credit.

PANEL MEMBER GOSSARD: Okay. I had two other questions. At the bottom the second page of your testimony, you note that you want to use a ten-year note. The ten-year note is referring back to the same, the Moody corporate bond interest rate that's currently used, or are you referring to a different interest rate?

MR. GHILARDUCCI: It could be the Moody's current one.

PANEL MEMBER GOSSARD: And then my other question, you state that should be based on the replacement value and rather than the depreciated as set value. How do you propose as the Department calculate replacement values for all the facilities under costs?

MR. GHILARDUCCI: That obviously would be a challenge for the Department to work through. However, it's not insurmountable. And it's a true reflection of what the value is of the assets. It's definitely a closer reflection of what is there today. One of the things I know many of us have a praise else for replacement value on insurance. So if that information was made available to the Department in the cost studies, I know for our facilities we do have that information. So that is one whey that the Department could source that information.

PANEL MEMBER GOSSARD: Thank you.

PANEL MEMBER IKARI: I had one final question to question to ask you. When you made the proposal, did you consider anything about the equal raw product cost doctrine. We're going to have processors, if we adopt your proposal, with different raw product costs.

MR. GHILARDUCCI: No.

PANEL MEMBER IKARI: Thank you.

HEARING OFFICER LOYER: Just to clarify, you are requesting to file a post-hearing brief?

MR. GHILARDUCCI: Yes.

HEARING OFFICER LOYER: Okay. Thank you.

PANEL MEMBER DOEGEY: I have one simple question. Your position hasn't changed from your alternative proposal; correct?

MR. GHILARDUCCI: No.

And I think back to Mr. Ikari's question there. You know, our proposal is a concept with thing that we've tried to put out to address the inequities within the milk stabilization plan. And I think the technical aspects of that we would hope that the Department can work through with us as an industry to try to address that if there's a concept that meets the practical needs of all the processors and producers within the industry. That's what we're trying to put forward. But we did not look at that provision to address that within the proposal.

PANEL MEMBER IKARI: Are you saying that the there's inequity in the system if we -- let's ignore the fact that the producers propose the pool credit. Would you come and would you propose that we amend the state pricing plans to have two price levels one for small processors and a second one for large processors?

MR. GHILARDUCCI: Well, there would be a different under our proposal. Dave, is what you're talking about?

PANEL MEMBER IKARI: I'm trying to --

MR. GHILARDUCCI: Yes.

PANEL MEMBER IKARI: -- determine whether or not your proposals is a response to the Western United Alliance or that you see an inequity in the pricing system you're trying to bring up fresh that there needs to be two prices, one for small plants and one for large plants.

MR. GHILARDUCCI: Let's go back. My proposal, number one, is not a response to MPC's Alliance or their proposal. Our proposal is based on the original petition from F&A cheese, which was put out by small cheese manufacturers. And once the Secretary --

PANEL MEMBER IKARI: But their proposal would eliminate the whey factor for all processors.

MR. GHILARDUCCI: But what they came in with is they said there's an inequity in the pricing systems as a small manufacturer in the state of California. Their whey the address it is elimination of the whey. We've come up with -- we've said okay, we agree that there's an inequity with small manufacturers within the state. We recognize that. We came up with a different method to address that besides eliminating whey. That's our intent with things.

PANEL MEMBER IKARI: Okay. But one of the things you could have done is simply said the Department increase the make allowance for 4a and 4b and therefore the small processor would have had a greater margin.

MR. GHILARDUCCI: However, that also doesn't address for the producer side of it because then you're going to take up everything to the lowest levels what you're saying. You're basically saying if the high costs group let's adjust the make allowance up to the high cost group so all the small manufacturers or people that are not in a milk shed that are going to run with those volumes then what you're saying is you're going the change the whole pooling system up that's not what we tried to do because we don't believe that would be fair overall to producers within the state to the pool revenues. So we tried to break that out into different than the Secretary recognized that the small manufacturers in granting the hearing have an issue within the state pricing system. So we tried to address that portion of it.

PANEL MEMBER IKARI: Thank you.

PANEL MEMBER SHIPPLEHOUTE: You indicated in your testimony in your answer to Tom's question that you thought any plant that had a separate pool number issued the -- it would be eligible to receive that credit. Do you have any suggestions for us as to how we would determine when to assign a pool handler number to a plant?

And the reason I ask there's a number of around the state that have multiple milk and dairy food safety permits issued to those operations. So they may have three or four different plant permits within that facility, yet we've only issued one milk pooling number for that operation. How would you propose we would handle a situation where those entities came before us and said we would now like three or four milk pooling numbers for

this operation, even though it's one piece of property one
building. Any thoughts there?
MR. GHILARDUCCI: I wouldn't have any answers on
that with this.
PANEL MEMBER SHIPPLEHOUTE: Maybe think about
that and address that in your post-hearing brief. Thank
you.
HEARING OFFICER LOYER: Well, hearing no further
questions from the panel, we're going to go ahead and
adjourn for lunch. See everybody back here at 12:30. And
so we are off the record.
(Thereupon a lunch recess was taken.)
HEARING OFFICER LOYER: The hearing will now come
to order.
Once again, please turn off your cell phones or
set them to vibrate. And we are going back on the record.
The next to testify is Land O'Lakes.
I'm marking the Land O'Lakes exhibit Tom Wegner
as Exhibit 53.
(Exhibit marked.)
HEARING OFFICER LOYER: Okay. Mr. Wegner, would
you please state and spell your name for the record.
MR. WEGNER: I'm Tom Wegner, T-o-m, W-e-g-n-e-r.
HEARING OFFICER LOYER: Okay. And, sir, do you
promise to tell the truth, the whole truth, and nothing

but the truth today?

MR. WEGNER: I do.

HEARING OFFICER LOYER: And are you testifying today on behalf of an organization, just for the record?

MR. WEGNER: Yes, I'm testifying on behalf of Land O'Lakes, Inc. And our directors have -- western directors have reviewed our position and support it.

HEARING OFFICER LOYER: Okay. Thank you.

You may proceed.

MR. WEGNER: Ms. Hearing Officer and members of the panel. My name is Tom Wegner and I'm here to testify on behalf of Land O'Lakes. My business address is 4001 Lexington Avenue North, Arden Hills, Minnesota. My current title is Director of Economics and Dairy Policy. We thank the Department for promptly calling this hearing to address these issues of critical importance to all of our dairy producer members.

Land O'Lakes is a dairy cooperative with 3,100 dairy farmer member-owners. The cooperative has a national membership base, whose members are pooled on the California State Program and six different federal orders.

Land O'Lakes members own and operate several cheese, butter powder, and value-added plants in the upper Midwest, East, and California. Currently, our 275 California member-owners supply us with over 16 million pounds of milk per day that are processed at our Tulare and Orland plants.

Land O'Lakes is very concerned about the apparent lack of manufacturing capacity in California and believes that the Department needs to make changes to the Class 4a and 4b formulas to encourage investment in the development of additional manufacturing capacity in the state.

I'm here to testify in support of our alternative proposal filed with the Department on September 25th, 2007, involving the make allowances and/or prize adjusters for butter, nonfat dry milk, cheese, whey based upon the weighted average of cost information and other data supplied by the Department.

Proposal summary. Regarding the 4a formula, LOL recommends that the Department maintain the current butter make allowance of 15.6 cents per pound. Concerning the price adjuster on butter, we recommend that the Department use the simple difference between the Chicago Mercantile Exchange butter price and the prices received by California processors for twelve months ending August 2007. We recommend increasing the f.o.b. price adjuster for butter from the current level of 1.68 cents to 2.8 cents.

For nonfat dry milk, Land O'Lakes recommends that the make allowance be increased from the current 16 cents per pound to 16.64 cents per pound, which matches the weighted average manufacturing costs for nonfat dry milk in the most recent CDFA cost survey.

Regarding the 4b formula, LOL recommends the Department increase the cheese make allowance from 17.8 cents to 19.88 cents, reflecting the weighted average manufacturing cost for cheese from the most recent CDFA cost survey. We recommend no changes in the f.o.b. price adjuster for cheese since the f.o.b. price adjuster matches the most current 24-month difference between the CME price and the price that's received by California cheese plants.

We recommend that the dry whey make allowance be based upon the difference between the current dry whey make allowance and the current make allowance for nonfat dry milk. The current difference between the two make allowances is 10.7 cents (26.7 cents whey make allowance minus 16 cents nonfat dry make allowance equals 10.7 cents). We recommend that this 10.7 cent difference get added directly to the weighted average manufacturing cost for nonfat dry milk of 16.64 cents to arrive at the recommended whey make allowance of 27.34 cents per pound.

We have observed that the costs of manufacturing nonfat dry milk and dry whey have increased as costs common to both processes have risen. Some of these common costs include energy, bagging, labor, et cetera. As stated earlier, we recommend increasing the nonfat dry make allowance to 16.64 cents per pound, matching the weighted average manufacturing costs for nonfat dry milk in the host recent CDFA survey. We further recommend that the Department use the difference that currently exists between the make allowances for dry whey and nonfat dry milk, amounting to 10.7 cent per pound, and apply that difference to the recommended make allowance for nonfat dry milk of 16.64 cents, to arrive at the recommended whey make allowance of 27.34 cents per pound, an increase of .64 cents per pound.

And the specific changes and proposed language, I will not read through. There they are for the record.

Justification for the proposal. According to departmental data, the current make allowance for butter of 15.6 cents covered the total operating costs, including a 6.48 percent ROI, of nearly two-thirds of the butter manufactured in California during 2006. Specifically, a make allowance of 15 cents covered 58 percent and a make allowance of 16 cents would cover 61 percent of the butter manufactured. Land O'Lakes feels that covering roughly 60 percent of butter processed with the current make allowance of 15.6 cents is adequate and consistent with previous departmental decisions.

By way of contrast, the current make allowance for nonfat dry milk of 16 cents covered only 28 percent of the nonfat dry milk processed in California during 2006. Increasing the nonfat dry milk make allowance to 16.64 cents matches the weighted average cost for nonfat dry milk in the most recent CDFA cost survey and will increase the volume coverage to a more acceptable level that is consistent with previous departmental decisions.

According to the Department's data, the current cheese make allowance of 17.8 cents did not cover the total costs of any cheese plants in California during 2006. Increasing the cheese make allowance to 19.88 cents would have covered just under two-thirds of the cheese processed in California. This level of coverage is consistent with previous decisions of the Department.

The Department also provided information about the approximate return on investment to cheese plants under various possible cheese make allowances. Under the current cheese make allowance of 17.8 cents, cheese plants earn a return on investment of a negative 8.64 percent. Clearly, the current levels of the cheese make allowance do not provide adequate financial incentives for cooperative cheese processors and their member investors or proprietary operators to continue running their plants, much less invest in new or expanded ones. Land O'Lakes recommends that the Department set the cheese make allowance at 19.88 cents to improve the return on investment from operating a cheese plant.

The department could not provide estimates of the volume covered under different cost allowances of manufacturing dry way due to confidentiality constraints. They did provide data revealing that under the current dry whey make allowance of 26.7 cents, the approximate return on investment for dry whey powder plants was less than 4.05. Increasing the whey make allowance to 27.34 cents per pound would have only increased the ROI to dry whey plants to 5.41 percent.

Neither the ROI from the processing of dry whey powder, nor the ROI on the processing of cheese resulting from adoption of our two proposals will guarantee future investments in cheese plants or whey processing facilities. But the updated make allowance should provide some immediate and much needed financial relief to all cheese plants regardless of size.

As stated previously, we observed that the costs of manufacturing nonfat dry milk and dry whey both increase as costs common to both processes rise. Some of these common costs include energy, bagging, labor, et cetera. We propose that the Department use the established difference between the make allowances for dry way and nonfat dry milk that currently exist, amounting to 10.7 cents per pound, and apply that difference to the recommended make allowance for nonfat dry milk of 16.64 cents to arrive at the proposed whey make allowance of 27.34 cents per pound.

LOL understands that the Department will no longer have the ability to report a weighted average cost for dry whey powder since the number of plants reporting will drop to two, thereby preventing the Department from releasing any cost data publicly. We propose this method of calculating the dry whey make allowance to allow the Department some additional time to analyze how to estimate the cost of processing dry whey since the number of plants participating in the survey may prevent them from publishing a cost of production figure. Perhaps the Department may want to consider using the percentage increase in nonfat dry milk processing costs or a form of indexing to update the whey make allowance.

To clarify, our current proposal would add 10.7 cents to the powder make allowance to arrive at a make allowance for whey. Assuming that the Department adopted our proposed increase in the make allowance for powder and for whey as a result of this hearing, then with an indexing approach we would expect, as a result of future hearings, that the absolute difference between the powder make allowance and the whey make allowance of 10.7 cents would become larger as time goes on. Such a result would make economic sense because of the fact that more water has to be removed from whey than from skim to make powder. We are confident that the Department will develop an alternative method of calculating an appropriate value for dry whey in the 4b formula.

Capacity issue. As you know, California milk production has been increasing rapidly in 2007. Through August 2007, milk production has increased 4.7 percent over 2006. If we project that milk growth for the entire 2007 calendar year, we'll have added roughly four billion pounds of additional milk. On a daily basis, this increase amounts to about five million pounds per day, which nearly equals the initial capacity of the new CDI plant.

With this volume increase, it is not surprising to find that the state's plant capacity is being pressured. We have heard reports of distressed milk getting dumped because of plants being too full to process the additional milk.

Loss of cheese plant capacity. Meanwhile, there has been a loss of cheese plant capacity in California. The list of plant closings and recently announced plans for closing include:

In 2002, the Suprema plant, that handled 26 loads per day, closed.

In 2003, the Sorrento plant, that handled 32 loads per day, closed.

In 2005, the Gustine plant, that handled 30 loads per day, closed.

The DFA plant, that handles 80 loads per day, is scheduled to close by early 2008.

The total plant capacity lost amounts to 168 loads per day or about 8.5 million pounds of milk per day. This is roughly equal to the capacity of two plants the size of the CPI plant in Tulare. This volume of lost cheese plant capacity is significant in light of the continued growth of California's milk supply. Any additional loss in plant capacity would put even more stress on the milk processing sector. The loss of additional cheese plant capacity is very possible in light of the recent default of the F&A cheese plant that receives approximately 30 loads per day.

The impact of the inadequacy of the cheese make allowance has already been realized in the decisions by both Glanbia and Hilmar to build new cheese plants outside of California. These two plants, in New Mexico and Texas, would have provided California with badly needed manufacturing capacity. The industry needs a change in policy to encourage new cheese construction in California rather than in neighboring states.

Other proposals. We agree with the Dairy Institute proposals to increase the cheese make allowance to the cost-justified level of 19.88 cents, to increase the nonfat dry milk make allowance to the cost-justified level of 16.64 cents, and to increase the f.o.b. butter price adjuster to 2.8 cents per pound.

We do not support the proposal of the petitioners or the Dairy Institute to completely remove the dry whey cost factor from the 4b formula. Although we understand the detrimental effect that the current dry whey cost factor has had on cheese plants, we strongly urge the Department to consider the need to balance the producer benefits from rising whey prices against the costs of rising whey prices to cheese processors. Whey clearly has value in the market, but we need a realistic and balanced approach to approximating that value in the 4b pricing formula.

We oppose setting the dry whey make allowance on the nonfat dry milk make allowance plus three cents as proposed by the Alliance, the MPC, and Western United. There's no cost justification for lowering the whey make allowance to 19 cents. The resultant increase in the 4b price of 48 cents as estimated by the CDFA over the past five years makes no sense in light of the current financial situation of California cheese plants. We need changes to increase the cheese manufacturing capacity in the state, not to discourage it.

As shown above, milk production trends point to the dramatic need for additional manufacturing capacity. The Alliance, et al., proposal would strongly discourage any additional investment in new plant capacity for cheese and would seriously threaten the existing cheese manufacturing capacity. Their proposal to maintain the current make allowance for cheddar at 17.8 cents per pound and the information provided by the Department clearly shows that zero percent of the volume is covered by the current make allowance, thereby guaranteeing a loss for cheddar operations in the state.

The Department's information also shows an inadequate return on investment in whey operations with the current make allowance of 26.7 cents per pound. Yet the Alliance recommends a reduction in the make allowance for whey to 19 cents per pound. Based upon the cost analysis of whey operations in California for 2005 and for 2006, there's no cost justification for the reduction of the whey make allowance to 19 cents. Lowering the whey make to the levels recommended by the Alliance, et al., would make a bad situation even worse for small cheese plants that do not have facilities to process their whey. We do not support the dry whey credit or the implementation of a snubber on the dry whey component of the 4b formula as proposed by the Alliance, et al.

The Department's cost data shows that the whey make allowance should be raised. LOL feels that updating the cheese make allowance and the dry whey make allowance will more effectively address the needs of both small and large cheese plants. The Alliance, et al., approach of giving cost relief to just the very smallest cheese plants falls far short of what is needed to address the capacity issue in California. We need the development of additional large cheese and other manufacturing facilities to be able to handle the growing milk supply in the state.

We do not support the CDI proposal to implement a plant processing capacity credit. While this idea conceptually has some merit, it lacks the detail and definition necessary to fully evaluate its impact. If this proposal is implemented, we strongly recommend that the credit not apply to plants currently under construction but only to new plants.

The issue of inadequate plant capacity to process our state's growing milk supply continues to challenge the dairy industry. We feel that using the market-wide pool to finance the expansion or construction of an individual cooperative's or proprietor's plant is not equitable, especially to those producers who would not have access to the expanded or new plant. Additional questions need to be addressed. For example, how would a processor prove that they have added new processing capacity? How should the Department determine what is the appropriate level of credit? How long should the credit be in effect? Should producers who have not increased their production or plan to increase their production contribute?

We do not support the DI proposal to increase the f.o.b. cheese price adjuster to 2.7 cents.

We do not support the Humboldt Creamery alternative proposals to increase the make allowances above levels that are cost justified by the weighted average costs collected by the Department. We oppose their two-tiered approach to the make allowance issue. For the second tier, they advocate a 17.8 cents make allowance for cheese even though departmental evidence clearly shows that zero volume is covered by the 17.8 cents make allowance. Furthermore, a two-tiered approach would tend to discourage the development of the more efficient plant operations in California.

Additionally, the Humboldt and CDI proposals may violate the Food and Agricultural Code Section 61805(b), which states, "In determining minimum prices to be paid by handlers, the Director shall endeavor under like conditions to achieve uniformity of cost to handlers for market milk within any marketing area."

We advocate the adoption of the Land O'Lakes proposal for make allowance and price adjusters for butter and powder. We do not support the make allowance nor the price adjusters recommended by CDI.

Conclusion. Land O'Lakes manufactures butter, powder and cheese. Our recent experience within the California State Program is that the net returns for butter and powder are significantly higher than for cheese. Land O'Lakes is urging the Department to reflect a balanced approach. The returns on investment for cheese and for butter-powder operations should be very similar, and both need to be adequate based on economic factors within the marketplace. Based upon our experience at Land O'Lakes, that is not the case today. Returns on butter-powder operations are clearly superior to returns on cheese.

Land O'Lakes has deep concerns about inadequate manufacturing capacity in the state. The evidences clearly shows that milk production in California is growing rapidly. We urge the Department to take steps to encourage additional manufacturing capacity in butter, powder and cheese. The current make allowances for cheese, nonfat dry milk and whey and the price adjuster for butter are inadequate to maintain, much less increase, manufacturing capacity in the state. The proposal by Land O'Lakes is a reasonable one for producers and for manufacturing plants.

Currently, California's manufacturing plants are operating at full capacity to process the continued growth in milk production. If long-term returns to producers' investments in cheese plants do not improve, more cheese plants may cease operations, putting even more stress on the remaining plants.

This concludes my testimony. And I would like the opportunity to file a post-hearing brief.

Thank you.

HEARING OFFICER LOYER: Granted.

Are there any questions from the panel?

PANEL MEMBER GOSSARD: On page 4 of your testimony, you state you don't support the DI proposal for increasing the f.o.b. adjuster to the difference between -- the 24-month difference between the CME and the California prices.

Why did you not support -- why do you not support their proposal?

MR. WEGNER: We felt that the current f.o.b. adjuster was adequate.

PANEL MEMBER GOSSARD: In top of page 7, you say whey clearly has value in the market but we need a realistic and balanced approach to approximating that value in the 4b pricing formula.

Could you expand on what might be a realistic and balanced approach?

MR. WEGNER: Well, we haven't given a significant amount of thought to that, to be honest with you. It's a problem that we proposed an opportunity to spend a little more time on coming up with another idea, because we sense that what you currently got is not going to be able to continue it with a survey shrinking down to two plants.

So I don't have any silver bullet right now, Tom.

PANEL MEMBER GOSSARD: So basically your statement is, as I understand it, the current formula is not going to work into the future but you don't have a specific recommendation for replacement?

MR. WEGNER: We don't.

PANEL MEMBER GOSSARD: Okay. On page 4 you talk about the volume covered for the various manufacturing cost allowances that you're recommending. And the volumes range between 60 and 80 percent.

Do you feel in general that a range of plant volumes between 60 and 80 percent give adequate coverage for processing?

MR. WEGNER: We do.

PANEL MEMBER GOSSARD: Do you have any specific recommendations on what sort of range in ROIs would be appropriate?

MR. WEGNER: We don't at this point. We do know it needs to be positive.

PANEL MEMBER GOSSARD: The third paragraph on Page 2 you mention a lack of manufacturing capacity.

Do you have any quantitative information that you could supply either now or in your post-hearing brief that is -- is there distressed milk being left on the farm, used as animal food, going to other plants outside of California, what sort of prices they're getting for that milk?

MR. WEGNER: I don't have any specific insights beyond what I've picked up in conversations. Within our system, within Land O'Lakes, we're managing our supply with our customers and our available capacity.

So I can't offer any more specifics in terms of distressed loads or their price, Tom.

PANEL MEMBER GOSSARD: Thank you.

PANEL MEMBER IKARI: One question.

Have you been offered milk that is distressed as Land O'Lakes in California?

MR. WEGNER: I'll need to follow up on that, David. I don't have anything on my fingertips about that. If you'd like, I could follow up to see if we do have any reports and what that might be.

You'd be interested in volumes and prices?

PANEL MEMBER IKARI: Well, anything that you can cite. You don't have to -- perhaps don't have the specifics. But rather than just a vague statement that "we understand milk is leaving the state," any kind of citations of when it occurred and by whom it occurred, that would be helpful.

MR. WEGNER: But as I understood your question, you were also interested if we were offered distressed milk?

PANEL MEMBER IKARI: Right, yes.

MR. WEGNER: I will follow up with that.

PANEL MEMBER IKARI: In listening to your testimony, I was struck by -- and Tom kind of touched on it. You clearly indicated what you're not in favor of, what you don't support. You're not ready to talk about what we should do long term. But in terms of that question about a fair -- no, a realistic and balanced approach to approximate the value of 4b pricing formulas, it sounds like -- and correct me if I'm wrong -- but it sounds like you oppose the concepts that the small cheese processors eliminate whey, you oppose the concept that producers have offered about the credit.

So as a hearing panel, what are you in favor of that we should do with the issue of dry whey today?

MR. WEGNER: Well, I guess the way we're looking at it is we're proposing to buy some time with the way that we come up with the make allowance for whey of the 10.7 cent fixed margin to the updated nonfat dry milk make allowance. What to do with whey. Like I mentioned before, I don't have any silver bullet necessarily. But it seems to me there needs to be some types of -- way of providing incentive to the processor to market the whey, while also returning some value to the producer.

We don't have a proposal that we put forth a year ago that would have shared the contribution of whey to the 4b formula. We don't have that. I know we're not at the point of being able to say we'd support that. But I think those types of opportunities where you're doing some sharing of the value might be something for the Department to take a harder look at.

PANEL MEMBER IKARI: Do you think that there's a possibility that there's another approach, another alternative where some value for dry whey could be reflected, and it's a more steady constant range than the current formula where producers will get some value but yet it would not create financial, you know, ruin for small cheese processors? Is that a possibility?

MR. WEGNER: Well, I guess you have to look at what we're dealing with in terms of the end-product pricing box that we find ourselves in here, that the Federal Order's in as well. When you have run-ups like we've seen in whey pricing and comparable run-downs, that's a variability that gets transmitted to the pay price, as you guys well know.

So I'm not quite sure -- I guess I'd need to see more detail behind your question about what would stabilize, if I hear what you're saying, sort of that return from whey? The markets are what the markets are. But I think those have much -- there's other factors that are entering into why the markets are where they are. How you connect that volatility to the producer pay price formula is another issue. But if you go with product pricing, you're going to have that volatility.

PANEL MEMBER IKARI: Am I incorrect in interpreting your testimony as meaning, if the Department -- if the current formula stayed intact and Land O'Lakes increased its production, are you kind of indicating to us that you're going to make investments in butter and powder and not cheese?

MR. WEGNER: At this point, that's what looks the best, if the numbers are what the numbers are in terms of return on investment. And I'm not speaking out of school here, but that's what the numbers would lead a rational plant decision maker to do I think.

PANEL MEMBER IKARI: Hiram, do you have a question?

PANEL MEMBER DOEGEY: No. Thanks for asking them all for us.

(Laughter.)

PANEL MEMBER SHIPPLEHOUTE: I do.

On page 6 you have a list of plants that have closed. Was that meant to be an all-inconclusive list of cheese plants that have closed in the last few years?

MR. WEGNER: Not meant to be all-inconclusive as much as to point out the rough magnitude of the losses in terms of capacity.

PANEL MEMBER SHIPPLEHOUTE: And page 9 you talked about the California manufacturing plants operating at full capacity currently. We had some testimony from cheese operators earlier that indicated they are not running at full capacity.

Do you have any comment on that?

MR. WEGNER: I was not aware of that actually.

PANEL MEMBER SHIPPLEHOUTE: No other questions.

PANEL MEMBER IKARI: I have a follow-up question there.

On Page 2 of your testimony you -- when you're talking about the price adjuster for butter, you're using a period of twelve months. Yet on the price adjuster for cheese you're using a period of 24 months.

Can you justify the difference in approaches?

MR. WEGNER: Well, I think that we looked at that twelve month and thought it was the most current and felt that that was more appropriate for right now.

What I said previously on the 24 month is we felt that was adequate.

The difference between the two periods I can't speak to any more detail than just this is how it mapped out in our thinking in terms of the resultant impact on the 4b and 4a prices.

PANEL MEMBER IKARI: Should the Department try to follow the same process or procedure in establishing the price adjuster? Or do you think it's appropriate to go ahead and have different time periods?

MR. WEGNER: Well, I think consistency is important from your perspective. We had to look at the sum total of the impacts of our proposals and this is where we came up.

PANEL MEMBER IKARI: If I can ask one other question.

In terms of the make allowance covering volume of product process, how narrow or how wide a range do you think that, say, the butter make allowance, the cheese make allowance, and the powder make allowance should be in covering the volume? How much discretion should there be or how much difference should there be between those individual commodities?

MR. WEGNER: Between each individual commodity. I think what I spoke in response to Mr. Gossard's question was that 60 to 80 percent seemed like a range that was consistent with how you guys -- how the department had made decisions previously in terms of volume coverage.

PANEL MEMBER IKARI: What I'm trying to do is take that comment and then say, you know, your other comment where you indicated you would make investment.

So I guess my question is, if we covered 60 percent of the volume in cheese and covered 80 percent of the volume in butter, would Land O'Lakes still say, "Well, we're going to make the investment in butter"?

MR. WEGNER: It depends on what the makes would be, David, in part. I mean realize there's many more factors that come into play rather than the regulatory price. Milk supply and actual cost of milk. But whether 60 or 80 percent of the volume, I don't think is as important as the level of make allowance relative to our own costs. So that would be the factor that would be more important to us, more key.

PANEL MEMBER IKARI: Thank you.

HEARING OFFICER LOYER: Any further questions from the panel?

PANEL MEMBER SHIPPLEHOUTE: Yes, I have a question.

On page 8 you make reference to Code Section 61805(b) and you indicate that the proposal may violate that code section.

If I read the rest of that code section, it says, "However, no minimum price is established or determined under this chapter may be invalid because the informative cost to handlers for market milk in an area is not achieved."

With the rest of that section -- and I truncated a little bit more. But with the rest of that code section in context there, do you still think that those proposals may violate that code section?

MR. WEGNER: That's why we put the word "may" in there, Don. We're sort of looking to you guys -- to the Department again to provide some guidance. We offered that more as a reminder to take a look at that. I'm not here to make a judgment on that.

PANEL MEMBER SHIPPLEHOUTE: Thank you.

HEARING OFFICER LOYER: Anything further from the panel?

Thank you very much.

And the next witness will be Dairy Institute.

Marking the exhibit of Dairy Institute as 54.

(Exhibit marked.)

HEARING OFFICER LOYER: Good afternoon.

DR. SCHIEK: Good afternoon.

HEARING OFFICER LOYER: Could you please state and spell your name for the record, sir.

DR. SCHIEK: Yes, it's William Schiek. That's S-c-h-i-e-k.

HEARING OFFICER LOYER: And for the record, are you testifying on behalf of on organization today?

DR. SCHIEK: Yes, I'm testifying on behalf of the Dairy Institute of California. I'm their economist. And we represent about 35 dairy -- 34 dairy processors in the State of California.

HEARING OFFICER LOYER: Okay. Thank you.

You may proceed.

DR. SCHIEK: Ms. Hearing Officer and members of the Hearing Panel. Dairy Institute is grateful for the opportunity to testify at this hearing and we thank the Secretary for recognizing that the current situation facing our dairy industry is one that needs scrutiny. To state the problem quite simply, the regulated price for milk used in manufactured products, particularly cheese, is too high. Milk output growth is accelerating and not all of California's production can be marketed in the state. Increasing volumes of milk have been sent outside the state to be processed, often at considerable discount to the current price. There have been instances of milk not being marketed.

On the other side of the coin, dairy manufacturing plant capacity has not been keeping up. Dairy cooperatives have been exiting the cheese business in California and plants have closed. More cheese plant capacity is at risk for loss due to the milk cost/cheese revenue squeeze that has been induced by the whey factor in the Class 4b formula.

It is the duty of the Secretary to address this situation. The regulated price must be lowered.

In authorizing the state's dairy regulatory programs, the Legislature declares: "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 produced from producers." Indeed, orderly marketing is the stated purpose of most dairy regulation. The level of regulated price plays a key role in maintaining an orderly market.

Minimum milk price regulation must be based on market-oriented economic principles and analysis. The greatest risk in any minimum milk price regulation decision is setting prices too high, which might lead to enhanced producer income in the short run, but will definitely lead to loss of product sales and manufacturing capacity in the longer run. When regulated prices are set too high -- or more specifically, when there is not enough of a wedge between the manufactured product price and the milk price -- manufacturing plants have no ability to created the margin they need to operate successfully. If they increase finished product prices to customers, these are in turn reflected in higher commodity prices that are then translated through the markets and the product formula into even higher raw milk prices.

The circuitousness of the pricing formula means that there is no escape for plants from regulatory pricing mistakes. Regulated prices that are too high also artificially stimulate milk production, while at the same time the formula's inadequate plant margins reduce the incentive for plants to procure milk. The result is more milk looking for a home in plants that have a reduced incentive to buy it. The milk then becomes distressed and must seek homes in venues outside the state, often at a severe discount to prevailing regulated prices, or it won't be marketed at all, which returns to value to the producer. These conditions cannot by any stretch of the imagination be described as intelligent production and orderly marketing.

The scenario just described is reflective of dairy marketing conditions in California in the spring of 2006 and in both the spring and summer of 2007 as chronicled in USDA's Dairy Market News. When regulated prices are maintained at a level that is too high or too intrusive on the market and when plants do not have sufficient margin to operate profitably, the dairy price regulation can actually create the kind of disorderly market situations that it was enacted to prevent. This is the case in California today.

Milk supply growth in California has been nothing short of astounding over the past few decades. In the last ten years, milk production trend has been for growth of about 4.2 percent per year, or an average daily milk production increase of about 4.5 million pounds. Some might argue that that kind of milk output growth that we saw, say, in 1999 could not be repeated in today's environment. So if we look at only 2000 through 2007, milk production growth year over year averaged 3.5 million pounds per day. So far in 2007, milk output in California is running at 5 million pounds per day more than the comparable period last year.

In 2006, peak California milk production was reached in March with an average of 110.5 million pounds per day, and numerous difficulties were reported in Dairy Market News concerning the handling of the milk supply. Milk was sent out of state for processing and according to testimony at last year's Class 4a/4b hearing, some milk was not marketed.

In 2007, peak milk production was reached in April at 115 million pounds per day. So far in 2007, only January had an average daily milk output that was below March 2006 -- the March 2006 peak. Based on 2007 reports in Dairy Market News of when milk was leaving the state to be disposed of or when plants were unable to handle all the milk, it would appear that the current processing capacity in the state under ideal conditions is no greater than 112 million pounds a day.

If the ten-year trend in growth milk output were applied to 2007 output of milk, 2008 milk output will exceed 112 million pounds per day during every month next year.

For those who do not believe such milk output is likely, we point out that the rate of growth in milk cow numbers in California is accelerating. According to USDA, during the first five months of the year California milk pound numbers grew at an average rate of 2600 cows per month. In the last three months, cow numbers have grown at an average rate of 4,000 per month. When we consider that the U.S./Canada border will be open soon to dairy cattle and heifer imports, a year-over-year growth rate of 4.2 percent for 2008 is not only possible, but well within the realm of the probable. Also, history has shown us that more often than not a major increase in California milk output occurs in the year following the one where prices spike.

Add to this projected 2008 scenario the prospect of two or three cheese plants who each use around a million pounds of milk a day exiting the industry, and the situation becomes even more brutal. The state can simply not afford a too high regulated price for Class 4b to force what would otherwise be healthy cheesemakers out of the business. The petitioners, some of which have testified already, collectively represent capacity in excess of 5 million pounds of milk per day. This is processing capacity that the industry cannot afford to lose.

Perhaps milk producer representatives will argue, as they have in the past, that producers are finished growing in California and that added environmental requirements will put a lid on milk output and make additional plant investments unnecessary. Such prognostications have proved to be incorrect and perhaps wishful thinking, but public policy decisions must be based on the stark reality of California's milk output growth.

Unfortunately, plant capacity growth has not kept pace with milk production. Testimony by Dairy Institute and Mike McCully of Kraft Foods at the 2006 hearing detailed plant investments made inside and outside California in previous years. The picture painted by this data is one that shows cheese plant investments bypassing California in favor of other states. What Mr. McCully's testimony did not show is the existing California capacity that has been placed at risk this year because of high regulated prices that do not provide adequate operating margins for many of the state's current cheese plant.

Much has been made of the new plant being built by California Dairies in Visalia, which will opened at the end of this year. While that plant will have a reported milk intake capacity of 5 million pounds per day, another plant with 5 million pounds per day capacity, Golden Cheese in Corona, will be closing. The net addition to the capacity to the state of these two developments is zero.

High milk and dairy product prices have led to the resurrection of some previously idle plant capacity to manufacture nonfat dry milk. It remains to be seen whether this new/old capacity will be a permanent addition to the state's plant stock or merely a temporary one that will disappear when nonfat dry milk prices retreat to more historic levels. There might be some room to process milk in existing plants, but such processing will only occur if plants can attain the margins necessary to make additional production possible.

The regulated milk price level must be lowered. Summing up the preceding arguments that we have made, there is a dramatically strong growth occurring in California milk production. Plant capacity is not only not keeping pace, but existing plant capacity is threatened. In assessing and defending his decision in the 2006 4a/4b hearing, the Secretary found in his August 2006 CEQA initial study: "The increase in the make allowance and corresponding decrease in milk prices will send two signals. It will signal producers to reduce production, but also signal processors to increase demand. It can be expected that as the markets change to reflect the new circumstances, producers, processors, and the Department as a regulating agency will make additional adjustments." The CDFA decision referenced in the preceding quote went into effect in November 2006. After initially growing strongly during the first part of the year, cheese output growth retreated as the run-up in dry whey markets drove milk costs to increase faster than revenue from the sales of cheese and other whey products. Now, another adjustment to the regulated price level is needed. Manufacturing costs for cheese and nonfat dry milk have increased, but it is the impact of the dry whey factor in the 4b formula that is especially troublesome.

When discussing last year's 4a/4b hearing decision, the Secretary made the following statement: "In ascertaining the appropriate formula and resulting prices, the Department considers costs for a reasonably efficient processor. The prices are not intended to encourage inefficient milk processing, nor are they intended to encourage inefficient production or production in excess of market needs. It is intended that by considering market efficiencies, production and prices will remain in balance to ensure an adequate supply of milk at prices which neither encourage nor discourage shipment of raw milk to or from California."

Today we have a regulated system that is encouraging production in excess of local market needs and is encouraging the shipment of California-produced raw milk to plants outside the state because adequate capacity inside the state is not being built. Compounding this problem, the excess milk is sometimes sold at a steep discount to cheese plants outside California, which compete directly with California cheese plants that are required to pay the higher California regulated price. This is clearly a self-defeating policy, which again cannot be construed as fostering intelligent production and orderly marketing. Rather than eliminating economic waste, the current 4b formula is creating economic waste. Milk that could be processed in California if plants were allowed adequate operating margins is being shipped many hundreds of miles out of state. Lowering the regulated price is the most efficient and correct way to send appropriate economic signals to the market. It sends the same uniform signal to all market participants and it does not create new economic distortions or encourage inefficiencies as do the other proposals, such as two-tier pricing schemes, pool credits, or de facto increases in the number of classes of milk, which are being considered at this hearing. A uniform reduction in the regulated price will also send a signal to all producers to reduce production. While this is a signal that producers might not wish to receive, it is an essential one nonetheless, and it is the most equitable way to deal with the overproduction and plant capacity problem. If the Department does not act in a significant way as a result of this hearing, the oversupply situation in California will only get worse.

At the past several 4b hearings we have argued either against the inclusion of the dry whey factor in the 4b formula or, since 2003, for its removal. We have testified at length of the problems associated with incorporating a dry whey factor into the regulated pricing formula and we repeat them here. The current formula assumes that cheese plants recover revenue from the whey side of their operations equal to the midpoint of the western dry whey mostly spot price range as reported in USDA's Dairy Market News. Unfortunately, most plants in the state don't earn revenues assumed in the formula.

Some plants produce whey protein concentrates and isolates from their whey stream. While these products often sell for more than dry whey on average, their yields are lower and their costs are higher. Other plants make lower-valued whey products that sell for less than dry whey. Examples include condensed whey and roller-ground dried popcorn whey for animal feed. For plants making whey products other than dry whey, revenues have often not kept pace with the dry-whey-driven increases in milk cost.

There are still other cheese plants that do not recover any revenue from their whey streams. These are typically smaller plants that make specialty cheeses. The size of investment needed to achieve the economies necessary to market whey products competitively is substantial and beyond the means of these cheesemakers. The added milk costs these plants have absorbed due to the dry whey price in the formula have threatened their viability. Given the recent unprecedented rise in dry whey prices, the cost of milk to cheesemakers increased by more than $3 a hundred weight this past summer. For plants that do not have whey revenue or for plants whose revenues do not increase commensurate with dry whey prices, margins are squeezed to the point where their ability to continue operations is in doubt and producer payments are put at risk.

While some might argue that the 80 cent per pound dry whey market was an aberration, the financial devastation wrought by these prices on the cheese industry is real. And now that are market prices are being driven by world supply and demand, it could happen again.

With regard to plants that cannot process whey or that process whey products which do not return the revenues assumed in the formula, producer representatives have often argued that cheesemakers need to increase the price they charge to customers for cheese as a means of making up for the lost whey revenue. Such arguments are naive. Plants that make commodity cheese are usually price takers and unable to influence the price they receive. In tight markets, if a cheesemaker is able to get a price concession from customers, the price increase will be followed by competitors and is soon reflected in the CME price. So ultimately the cheese plant sees no price relief.

In the case of specialty cheese, producers have argued that the higher retail prices for these products imply that plants must be earning margins that are great enough to accommodate the higher dry-whey-driven milk cost. What these arguments fail to recognize is the higher manufacturing cost, lower yields, and extremely high marketing and distribution costs that specialty cheesemakers face. They also fail to account for the fact that a large share of the retail cheese price is the retailer's margin for carrying the cheese. Unfortunately, increasing the price that they charge for cheese is not a workable solution to specialty cheesemakers' whey-related problems.

Whey is unlike other dairy products that are manufactured in the state in that there is no single product that can reasonably approximate the revenue stream that each individual cheesemaker receives from the whey side of its operations. Because of these complex factors, we believe that it is essential that the state's regulated pricing formulas be adjusted to account for differences in cheese plant operations. As there is no uniformity of whey operations, any attempt by the Department to select a whey product or combination of whey products to represent the entire California cheese industry's operations will virtually guarantee that some cheesemakers are unprofitable.

From a regulator's standpoint, achieving an economically appropriate formula construction for whey is an intractable problem. The lack of uniformity in both whey processing operations and whey revenue streams, which we testified to in the 2006 hearing, is a compelling reason to remove the whey factor from the 4b formula.

Whey revenue is not a producer entitlement. In recent months producer leaders have asserted that they are entitled to some share of the whey revenues being earned by cheesemakers. In the past several weeks, I have given considerable thought to the "entitlement" assertion, and I you have come to the conclusion that not only are producers not entitled to the whey revenues earned by cheesemakers, but they're not entitled to the cheese, butter and nonfat dry milk revenues received by dairy product manufacturers either. The producers' "entitlement" argument originates from a false premise that the value of milk is defined solely by the combined product prices of the various manufactured dairy products and byproducts that can be made from milk. To be sure, the demand for milk is a derived demand and the underlying market value of milk will be influenced by the price of finished dairy products. But other factors, such as marketing costs for finished products and manufacturing costs, are also important. Also, because milk is a bulky and perishable commodity that is expensive to transport, the availability of plant capacity -- local plant capacity will set an upper bound on the demand for milk in a given area and limit its market value even when finished product prices are escalating.

Milk is a commodity; and, as such, its producers are entitled to a market price that will bring forth an adequate supply to meet the demand for that commodity. The pricing formulas we employ in our regulated system are designed to approximate the underlying market value for milk. But they are not the definers of that value. If conditions are right and all the technical parameters of the formula construct are correct, they can do a reasonable job of reflecting that value. However, when the formulas are not reflective of the industry, they will incorrectly value milk. The good news is that if the formula undervalues milk, market forces will step in and correct the problem through competitive premiums that will be paid to dairymen on top of the regulated price. The bad news is is that when a formula overvalues milk, milk production's stimulated, but plants find their margins squeezed and their financial viability threatened. There is not a market-based correction to this latter situation. In this case the correction must be made directly to the pricing formula in hearings such as this one.

It is important to recall that the California dairy industry had no skim whey factor in its regulated pricing structure prior to 2003. Prior to that time, the industry not only survived, but by all objective measures it thrived. Milk production grew consistency and companies built plants at a rate that kept up with milk production growth.

In 2003, responding to a period of low market prices for milk, due to low commodity prices that had been brought about by strong milk output growth, the Department added a skim whey factor as a means of increasing revenue to producers. Quite Frankly, that decision was a mistake. After the 2003 decision, cheesemakers complained to the Secretary and were told to be patient and that the Department would watch to see how well or poorly the industry coped with the new formula construction. At two subsequent hearings, the Department's expert panel recognized the problems with the 2003 decision and recommended the elimination of the skim way factor. Unfortunately, the Secretary did not adopt the Panel's recommendations.

And while we appreciated the Secretary's and this current Secretary's efforts to mitigate the impact of the 2003 decision by twice increasing the dry whey make allowance, the inclusion of the skim whey factor has been a train wreck for the California cheese industry. Since 2003, there have been no new cheese plant investments that were significant enough to provide the capacity needed to accommodate the growth of the milk supply. Since 2003, dairy farmer cooperatives in the state have been backing away from their cheese plant investments. Cooperative are not abandoning the cheese business because it was too profit able for them; they are leaving because it was losing too much of their members' money.

The tornado that was the 2007 dry whey market has sheared off a good portion of the cheese industry's profits. If a similar event happens in the future, it will wipe out a number of financially weakened cheese plants and their associated plant capacity. All the while, milk production continues to grow.

This situation is neither intelligent, nor orderly. We urge the Department to remove the skim whey from the formula before the situation becomes irreparable. If cheese plants exit the industry due to the poor economics imposed on them by the 4b formula construction, it is unlikely that they will return even after the problematic portions of the formula are corrected.

HEARING OFFICER LOYER: Mr. Schiek, before you answer questions from the Panel --

DR. SCHIEK: No, I'm not done yet.

HEARING OFFICER LOYER: Oh, you're not?

DR. SCHIEK: I'm just checking time, and my eyesight's not very good.

HEARING OFFICER LOYER: I see.

DR. SCHIEK: Dairy Institute's other proposed changes:

Make allowance. The weighted average cost information for the January to December 2006 study period is as follows: Butter, thirteen seventy-three per pound; nonfat, sixteen sixty-four per pound; cheddar cheese, nineteen eighty-eight per pound; and skim whey powder, thirty ninety-nine per pound. In the summary of the 2006 cost study, CDFA notes that only 61 percent of the butter is processed at a cost less than the current make allowance of 15.6 cents per pound; 28 percent of the nonfat dry milk is processed at a cost of less than the current make of 16 cents per pound; and for cheese, zero percent is processed at a cost less than the current make allowance of 17.8 cents per pound. And one of the three whey plants in the study processed whey at a cost less than the current make allowance of 26.7 per pound.

It would seem that if plant capacity is short in the state, CDFA should be targeting a coverage rate of 70 to 80 percent of the volume processed. Based on this analysis, there's probably some justification for increasing the butter make allowance rather than reducing it, but we have no indication what the appropriate make allowance level might be. Also, the variance of costs among plants should be considered in setting make allowances. When one plant type shows some plants with a cost far below the weighted average, such as butter, it is safe to assume that there is a greater margin available for at least some plants to make investments in new plants than it is the case when a majority of plants' costs are clustered tightly around the weighted average, such as the case with cheese. The Department's ROI analysis illustrates this point, although we would prefer to see the analysis based on the original cost of the plant's assets, or the replacement cost, rather than the depreciated asset value.

Based on the available data, Dairy Institute recommends leaving the make allowance for butter at its current level. For cheese and nonfat dry milk, we recommend increasing the make allowance to a new weighted average manufacturing cost level, with the caveat that CDFA should set make allowances so that there's comparable volume coverage in both cheese and butter-powder.

f.o.b. adjusters. In recent years, CDFA has established the f.o.b. adjuster at a level equal to the 24-month simple average of the difference between the CME and California weighted average monthly prices for butter and cheddar cheese blocks. We have observed that the value calculated in this manner shows considerably less stability than would be expected for the underlying pricing basis. With regard to cheddar cheese, we postulate that day-of-make cheese pricing introduces a lag between the California weighted average cheese price and the CME that causes the 24-month average difference to overstate the pricing basis when the overall cheese market price is rising and understate this basis when the market price is falling. This assertion seems to be supported by graphical analysis of the data; and I'll refer you to the attached Appendix A. Therefore, we propose that CDFA abandon the 24-month average price difference and adopt the calculated average price difference from 2001 through the most current time period available as the basis for establishing the f.o.b. adjusters. This method would average out the biases introduced by rising and falling market prices and would result in an f.o.b. adjuster price of minus 2.7 cents per pound for cheese and minus 2.8 cents per pound for butter based on data through August 2007.

Our f.o.b. adjuster argument is based on our observation related to cheese markets, and we have extended our methodology to the butter f.o.b. calculation for consistency. However, we recognize that appropriate calculation of the f.o.b. adjuster for butter might require a different methodology.

While we continue to argue that product yields should be established based on California milk of average farm-level composition from milk, that has not been incentivized to alter its composition. As such, we continue to maintain that the current cheese yield of 10.2 is too high. But given that we have heretofore been unsuccessful making these arguments and given the magnitude and importance of the other formula issues that are under consideration, we are not proposing a change in the cheese yield at this hearing.

Other proposals. The proposal by Land O'Lakes, while it moves the regulated 4b price in the right direction, doesn't go far enough in providing an incentive for plant investment in the state. An appropriate question for the witness might be to ask if their proposal were adopted, would they build a new cheese plant in California. The LOL proposal also does little to address the problems for small and medium-sized cheesemakers that are caused by the runaway dry whey markets like we saw this year.

The Alliance, et al., proposal would provide potential relief to only the smallest plants and would raise the overall 4b price, which will exacerbate the supply/demand imbalance. Also, the Alliance proposal, by treating different sized processors differently, creates different raw product costs for the same class of milk users. The proposal would require the Secretary to take actions which contradict Section 61805(b) of the Food and Ag Code, which states that: "In determining minimum prices to be paid to producers by handlers, the director shall endeavor under like conditions to achieve uniformity of costs to handlers for market milk within any marketing area.

The two-tier pricing aspect of this proposal would also distort the economics of the industry in that small plants trying to achieve incremental growth would find themselves facing a rising cost curve as they expanded their business. This economic distortion could create a financial disincentive for plants to grow and would lead to a less efficient industry as scale economies would be trumped by the growth penalty that these plants would face due to the higher regulated price they would be required to pay as they expand.

Also, we believe the proposed pool credit would require a referendum of producers, which means that even if the department agrees with the Alliance's proposed solution to the problem, there is no guarantee that the solution would be adopted. The same applies to CDI's proposed new plant credit. A legal analysis of this issue by John M. Lemmon, Dairy Institute's attorney, is attached as Appendix B.

The Alliance proposes a new way to calculate the dry whey make allowance, which has no sound economic basis and is, not surprisingly, price enhancing. Therefore, this proposal will curtail plant capacity rather than expand it. The Hearing Panel has already twice rejected for valid reasons the idea of a dry whey snubber that prevents dry whey from having a negative impact on the Class 4b milk price. We urge you to do so again. The Alliance proposal and its crude attempts to force a new and different dry whey factor into the 4b formula illustrate precisely why the dry whey factor should be removed. It does not fit and it cannot be incorporated in a way that is consistent with the approach used for the other commodities.

CDI's proposed new plant credit plan is inequitable because it treats competitors making the same products or competing for the same inputs differently. It has many of the same drawbacks from an economic sense as the Alliance's proposal in that it complicates the pricing structure and is a contradiction to Section 61805(b) of the Code. It further exacerbates the economic distortions introduced by pooling by making all producers pay for the benefits that accrue to a few.

The proposal by Humboldt Creamery also creates different raw product costs for the same class of milk users, and its two-tier structure would distort industry economics much in the same way as the Alliance's proposal. We urge the Department to reject all of these two-tier proposals, which are essentially attempts by producers to expand price discrimination as a means of preserving revenue when the market requires a different solution.

In summary, the most efficient and effective way to address the current problems facing the industry is adoption of the petitioners' request to remove dry whey and adoption of our suggested changes to the make allowances and f.o.b. adjusters.

Thank you for the opportunity to testify. And

I'm willing to answer any questions you may have at this time. I also request a period for the filing of a post-hearing brief.

HEARING OFFICER LOYER: That's granted.

And, Mr. Schiek, before you answer the questions from the Panel, I just need to correct a minor procedural error for the record.

Do you solemnly swear or affirm that the testify that you have given and shall give today will be the truth and nothing but the truth?

DR. SCHIEK: I do.

HEARING OFFICER LOYER: Thank you.

PANEL MEMBER DOEGEY: I have a question.

We've asked sort of the similar question to other witnesses. On Page 2 you mention how there's distressed milk.

Do you have any data in terms of quantity or prices or some sort of concrete evidence that you could provide?

DR. SCHIEK: I actually did put together a table that was drawn from Dairy Market News descriptions of the fluid milk situation in California, weekly reports; and I can provide that in a post-hearing brief. Although I believe that one of our other witnesses, Mike McCully of Kraft Foods, will be introducing in evidence a listing of all those reports from Dairy Market News as well.

PANEL MEMBER DOEGEY: Okay. Great.

PANEL MEMBER GATES: Dr. Schiek, I do have one question.

When you're talking about make allowances and coverage between the three commodities, you talked about 70 to 80 percent of the volume in the state. Is that for all butter, powder and cheese? I just wasn't clear on what you meant on that.

DR. SCHIEK: I think you do have to look at butter and powder somewhat together because of the jointness of the nature of those product. So, you know, you could have a lower volume coverage on butter if your own volume coverage on powder was higher. But, you know, we need to find some consistency in that so that there's not overwhelming economic incentive one way or another for investment in one complex over the other.

Although we've argued in the past that, you know, the cheese industry has returned over time a higher value to producers over the long haul, obviously there's differences at different times; and that, you know, if anything, there could be a good policy argument to favor cheese over butter-powder. But we continue to support that they would be consistent.

PANEL MEMBER GATES: So just to clarify for me, one more time.

You're talking about cheese also being covered, currently at zero is what --

DR. SCHIEK: Right.

PANEL MEMBER GATES: -- is what is stated in here.

So you would be looking to move that to the 70 to 80 percent along --

DR. SCHIEK: Yes.

PANEL MEMBER GATES: Okay. I just wanted to make sure that that's what you meant.

Thanks.

PANEL MEMBER GOSSARD: On the bottom of page 8 in your testimony, in terms of the ROI, you stated the preference that rather using depreciated asset values, you would rather use original cost of the plants. And I think you added to your text "or replacement cost," is that correct?

DR. SCHIEK: Yeah, it really depends on what you're trying to represent there. But let's look at it from the example of someone who's investing money. You know, if I have $100 million to invest and I decide that in order to achieve, you know, proper return on that investment relative to my other alternatives, I need 5 percent. If the ROI is being calculated as 5 percent a few years down the road on 50 million pounds, I'm really not earning that 5 percent on the original investment. I'm earning something less -- well, nearly half that return in that particular year. So the idea of having the original cost would make some sense.

The idea of replacement value probably is more appropriate if you're thinking about incentive for new investment, because that's -- you know, that's the money people are going to be putting down today. There's been a high rapid escalation in plant construction costs, as I'm sure you're probably aware. You know, we had a building here in Sacramento that -- a big high-rise hotel project that, you know, I think when they penciled it out they had some assumptions about construction costs. But because of all the demand for materials and labor and construction cranes and everything else, the costs overran that project pretty substantially. And that's the kind of thing that plant construction cost has faced recently.

PANEL MEMBER GOSSARD: If one were to use the original cost, would that cost be adjusted by any sort of inflation factor?

DR. SCHIEK: Yeah, I think you could adjust it for inflation, if that's the -- that probably would be easier to do than to actually get at the replacement costs, in terms of a response to an earlier question.

PANEL MEMBER GOSSARD: In your proposal for the f.o.b. price adjuster, you used an 80-month period?

DR. SCHIEK: Uh-huh.

PANEL MEMBER GOSSARD: Any particular reason why you didn't use a multiple of twelve months for seasonality issues?

DR. SCHIEK: Well, I used all the data I had available. And, you know, in terms of looking at the visual inspection of the ups and downs in the market, it appeared to sort of encompass a relatively equal amount of both up and down cycles else, so that you would expect those biases that I talked about to kind of cancel each other out.

Obviously it's not getting at estimating directly in the underlying pricing basis. And, frankly, if we had weekly data, we might be able to do that. You know, if we had sort of California weighted average weekly data to compare with the CME weekly data, we might be able to somehow get at estimating that pricing basis more directly. But with the monthly data, you know, we felt like this was the best we could do.

PANEL MEMBER GOSSARD: Instead of having to keep -- to arguing about what's the best way to calculate the f.o.b. adjuster, wouldn't it just be simpler to come out with a monthly CWAP for California butter and cheese prices?

In a sense, we already collected those monthly numbers retroactively. Why not just do it like we do the powder.

DR. SCHIEK: Yeah. Well, this precedes me a little bit. But when I first arrived here ten years ago, the state plans actually did have the California weighted average price for those commodities in the plans at that time. And my understanding is that was never implemented. I know there were a lot of producer concerns about that. People worried about the data and whether the data was going to be accurate or whether it would be, you know, weighted too much or whether people would play games with the data. I don't know whether there was any real validity to those concerns, but I know those were some of it.

The other issue of course is the getting the market information as timely as possible. You know, the CME is where price discovery occurs. So if you're going to get the most timely information about market supply and demand, the CME price does get you that. The California price because of the structural factors that I was talking about would give you a lag price, much in the same way the NASS price lags the CME price. So it's a trade-off.

We've continued to support using the CME price.

PANEL MEMBER GOSSARD: Thank you.

PANEL MEMBER SHIPPLEHOUTE: Mr. Schiek, on page 10, the same question I asked of a prior witness. You cite part of Section 61805(b) and leave off the tail end of that section where it indicates that the lack of a uniform price does not take a minimum price invalid.

DR. SCHIEK: Right.

PANEL MEMBER SHIPPLEHOUTE: Any comments on that?

DR. SCHIEK: Well, I you believe that section was really put in to deal with Class 1 situation where the state enacted to give -- the State Legislature decided to give special consideration to a class of plants. And in that case they didn't want the whole thing being invalidated. But they made it clear that the Secretary in making his decisions is to endeavor to achieve equal raw product costs.

So it's kind of like, you know, they say, "This is the way it's going to be," and, you know, "We've made it so that in Class 1 you can't achieve equal raw product costs, but, you know, in subsequent decisions we want you to endeavor to achieve equal raw product costs."

So if you were to adopt these proposals that are being put forward that on their face do not create equal raw product cost, I think that would be violative of the intent and the letter of that code.

PANEL MEMBER SHIPPLEHOUTE: And in reading your interpretation of the Alliance proposal and Humboldt Creamery's proposal, those differ somewhat from CDI's in that the Alliance and Humboldt's are adjustments to class prices or a credit to class prices as opposed to CDI's, which is a straight pool credit for plant expansion.

Did you give any thought or any consideration to the section of the code that requires a pool plan to -- or prohibits a pool plan from creating unequal raw product cost between distributors in the same marketing area?

DR. SCHIEK: You know, I didn't. But I'd love to, you know, look into that and expound on how that fits in here too in my brief.

PANEL MEMBER SHIPPLEHOUTE: And the code also gives the Department authority to formulate stabilization or marketing plans subject to limitations.

Do you have any limitations that you can cite outside of the one that you already cited that you felt were violating any proposals where adopted?

DR. SCHIEK: Limitations? I guess I'm not clear what you're asking.

PANEL MEMBER SHIPPLEHOUTE: Well, the Code specifically says the Department can create destabilization and marketing plans subject to limitations within the Chapter 2 specifically.

DR. SCHIEK: Right.

PANEL MEMBER SHIPPLEHOUTE: And I'm curious if you have --

DR. SCHIEK: Yeah. And I would say that it's our view that the proposals that create new classes of milk or credits from the pool or non-equal raw product cost, any of these two-tier schemes, the pool credit, are all -- they're not authorized under Chapter 2. And we would argue that they are -- you know, therefore they're not really valid for the Department to consider.

And if you'd like, we can present some legal arguments to that effect.

PANEL MEMBER SHIPPLEHOUTE: And I'd appreciate that.

And to the topic of substantive change to pool plans. I see in the back you have attached Mr. Lemmon's analysis. I haven't had a chance to go through it in detail.

Does that differ in any way from any of your prior positions on what's a substantive change to the pool plan?

DR. SCHIEK: It doesn't in the time frame that I've been here. I can't speak for, you know, going farther back than that. But I don't believe it changes our position.

PANEL MEMBER SHIPPLEHOUTE: A question I have is, if we were to adopt or recommend the adoption of a change to the pool plan to accommodate a class price change, for example, wouldn't we indirectly be asking producers to vote on whether or not a class price change was acceptable?

DR. SCHIEK: Yeah. And that's of course another one of the problems with this approach is that we have what is essentially a pricing problem that is the purview of the Secretary to determine and not the producers. I mean this is essentially saying to producers, "You set your own price." And I don't really believe that that's -- you know, that's how the system has been set up, or the intent.

PANEL MEMBER SHIPPLEHOUTE: No other questions.

PANEL MEMBER IKARI: I'm going to go back to the question I've been asking all the witnesses. Searching for a middle ground.

If you assume that the Department sets a make allowance that covers 70 to 80 percent of the volume, as you've proposed in your testimony, and if the Department would simply eliminate the current formula calculations where you have the whey -- western dry whey price, subtract the make allowance of 26.7, multiply times 5.8 yield to get a value, and instead of that inserted a value that would be similar to like the price adjuster, some value that -- I suppose you could develop a schedule -- depending on the value of whey, some value, and it could range, that would provide positive value in the 4b price but yet not create the financial difficulty that 2007 experienced.

Is there room or a margin there that the processors could support?

DR. SCHIEK: Well, I'd like to point out just to kind of clarify the record a little bit that contrary to the assertions of previous witnesses that the Alliance put forth a compromise proposal, my understanding of a compromise is you need to get people on two sides of an issue to come to agreement, to have a compromise. And I don't think that was how their proposal was formulated.

Secondly, the petitioner proposal in and of itself is a compromise because they recommend removing the dry whey formula but they don't adjust the cheese make allowance upward. Okay? So that -- in a sense you could characterize that as giving back 22, 25 cent, or something like that, whey revenue back to producers because they're not setting the cheese make allowance at the current levels. And actually that's more revenue going back to the producer for whey than whey revenue coming the other direction from the producers' compromised proposals.

So as you know from past hearing records in 2003, we did propose some sort of adjustment to an adjuster. Our proposal at this hearing is for the elimination of the whey factor because, for the reasons I've stated, we feel like the situation is so bad -- the impending situation on plant capacity is so bad you need incentives right away to deal with plant capacity.

Is there something that would work? I was approached by producer representatives back in August at the powder price hearing asking if there was some sort of compromise that might work. And I stated that I believe there probably was. But you got to understand what happened and how this hearing all came about and how this petition all came about from the petitioners.

These guys were -- these companies were experiencing severe financial stress, concern about going out of business. And the fact that three cheesemakers have ended up on trust fund ineligible lists I think supports that crisis nature of the situation. And they came forward asking what they could do. And of course really the only way to address their problems was through a petition for a hearing. And I volunteered under the auspices of Dairy Institute to start our process of getting the Institute together to formulate a hearing position.

And the reality is they couldn't wait that long. So they did not have time to sit down and have a cup of coffee with producers and say, "Gee, can we come up with a position?" They had immediate need that they had to deal with. And so I said, "Well, there's probably some changes that could be made that would mitigate the whey factor substantially enough." But for whatever reason I was not engaged in that discussion with the producer representatives. When they formulated their position, I don't think they -- they certainly didn't contact me and ask me to come to their formulation.

So beyond that, I guess our feeling is that, again, the need for plant capacity, the need to address the situation, the need to preserve these companies that are, you know, in severe financial stress kind of outweighed those other needs.

Now, if you removed the whey factor from the formula and then the rest of us can get together and see if there's some other way to accommodate it, that would be an acceptable way to go maybe. But we feel like it needs to be out of there.

PANEL MEMBER IKARI: What about a concept of suspending the whey for a period of time -- the dry whey factor for a period of time, to give the industry -- stakeholders the opportunity to develop a compromise?

DR. SCHIEK: I think it really comes down to the question of, you know, where are you going to assign the property rights? Are you going to start on the presumption that the whey revenue belongs to the producer or are you going to start on the assumption that the whey revenue belongs to the plant and we need to find a way so that people can share in it?

If you were to put a suspension in and then we didn't reach a compromise, the assumption is then the whey factor comes back. And we would certainly not support something like that.

And we have a position -- you know, like Tiffany said, you know, we have a board position. So I can't change our board position. But I will say that, you know, some of the elements that would need to be in place if you were going to have a formula that worked for -- it wouldn't work for everybody, it wouldn't work for all the cheese plants -- but if it were to work for some, you would have to have a much lower yield, you would have to have some way of capping the amount of contribution coming from whey so that when we have these -- you know, these sort of tidal wave milk movements, it doesn't take out, you know, bunches of small plants.

So, you know, there's probably some room. But, you know, we feel like the correct economic choice, not a compromise or arbitration choice, but the correct economic choice, and the way milk would be valued in the marketplace, has to do with allowing the market to work. And if you take whey out of there, if plants are earning a lot of money from whey, they're going to be -- that money is going to be going back to producers. It just won't be going through the pool.

PANEL MEMBER IKARI: I suppose I can ask the producers this, but I'll ask you the alternative.

If I asked the producers, if we drop the whey out of the formula, would they appeal, would they stop? Probably no.

If I -- you know, I asked you, the processor, if we adopted the Alliance proposal to provide a credit, the issue will continue on, correct, from the processor perspective?

DR. SCHIEK: Yeah, without a doubt. But I guess, you know, our view is that the role of the Department here is not to make everyone happy. The role of the Department we would say is to use sound economic principles to make the choice that's needed in the industry given the current conditions. As conditions change, maybe we have different policies. But given current conditions, you know, we kind of feel like it's the Department's job to make the economically correct choice. And it won't be pleasant for everybody.

PANEL MEMBER IKARI: Thank you.

HEARING OFFICER LOYER: Any further questions from the Panel?

Thank you, Mr. Schiek, for your testimony.

And at this time I'd like to call California Diaries, Incorporated.

May I have two exhibits from California Diaries, Incorporated. The first one, Exhibit 55, is the -- looks like it's the testimony of Eric Erba. And the second exhibit, which is Exhibit 56, is testimony of Joe Heffington.

(Exhibit marked.)

HEARING OFFICER LOYER: Who is going to go first?

DR. ERBA: I'll go first.

HEARING OFFICER LOYER: Okay. Sir, will you please state and spell your name for the record.

DR. ERBA: My name is Eric Erba, E-r-i-c, E-r-b-a.

HEARING OFFICER LOYER: Okay. Sir, do you solemnly swear or affirm to tell the truth and nothing but the truth?

DR. ERBA: I do.

HEARING OFFICER LOYER: Then we have Mr. Heffington?

MR. HEFFINGTON: Yes.

HEARING OFFICER LOYER: Sir, do you also swear to tell the truth and nothing but the truth?

MR. HEFFINGTON: I do.

HEARING OFFICER LOYER: Okay. And then, Mr. Erba, if you'd like to proceed then.

DR. ERBA: Certainly.

My name is Eric Erba, and I'm Vice President of Governmental Relations for California Dairies, whom I'm here representing today.

California Dairies is a full service milk processing cooperative owned by approximately 600 producer-owners located throughout the State of California and collectively producing over 17 billion pounds of milk per year, or 42 percent of the milk produced in California.

California Dairies supplies nearly 50 percent of its milk directly to customers located in California. Additionally, our producer-owners have invested over $250 million in five large processing plants which produce butter, powdered milk products, cheese, and bulk processed fluid products.

In 2006, CDI's plants produced about 225 million pounds of butter and 525 million pounds of powdered milk products. California Dairies is currently building its sixth plant, which will have the capability of handling over five million pounds of milk per day.

On September 25th, 2007, California Dairies Board of Directors nominally approved the proposals I'll be presenting today.

The most critical issue facing California dairy producers today is the lack of sufficient processing plant capacity. Our testimony presented today will be consistent with the idea of not only maintaining current plant capacity, but encouraging investments in new plant capacity in California. We recognize that many of the factors that companies would consider before investing in new facilities or expanding current facilities will not be influenced by the Department's decision. However, the results of this hearing do determine whether or not plant margins are adequate to ensure each plant's continued operation. Furthermore, we are proposing a new and targeted mechanism that uses pool revenues to create an incentive for companies to construct new plants or expand existing plants. We are hopeful that the Department will adopt and implement our plant capacity credit proposal.

The dairy industry is at a critical tipping point where the state cannot afford to lose any of its processing capacity and must make a significant and concerted effort to attract more processing capacity to the state.

Class 4a Pricing Formula Changes. CDI's proposed changes are consistent with the objectives stated in previous hearings. The Class 4a formula should reflect the most currently available cost-justified changes. This applies to not only manufacturing cost allowances for butter and nonfat dry milk, but to f.o.b. price adjuster for butter as well. Simply, the manufacturing cost allowances should be consistent with actual costs of processing, and the butter commodity price should be adjusted by a factor that reflects what California plants actually receive for the products they produce.

We'd like to point out that changes in the Class 4a make allowances that are not cost-justified, that is to say, either reducing the allowances or increasing them by less than what can be justified by the cost studies, reduces our producer-owners net income and the value of their investment in milk processing facilities.

Moreover, changes in the Class 4a make allowance that are not cost-justified favor those producers in California who do not have investments in milk processing facilities and, therefore, carry no responsibility in balancing and stabilizing the state's growing milk supply.

Butter and Nonfat Powder Make Allowance. CDI proposes that the Department increase the butter and nonfat dry milk manufacturing cost allowances to the weighted average of the costs incurred by CDI's own plants in 2006.

For butter, the manufacturing cost allowance would be increased from 15.6 cents to 16.07 cents, an increase of 47/100 cents per pound.

For nonfat dry milk, the manufacturing cost allowance would be increased from 16 cents to 16.98 cents, an increase of 98/100 cents per pound.

We submit to you that the costs derived from CDI's own plants are more relevant than the composite of plant costs compiled and reported in the Department's manufacturing cost studies for 2006, released in September 2007. Whereas some of the plants in the cost studies are multi-product plants, CDI's plants manufacture butter and nonfat dry milk nearly exclusively, making the allocation of costs, particularly overhead costs, much more transparent and more accurate. CDI produces butter at three of its five plants and powder at all five plants. All of the five plants have large volumes of milk, are well managed and operate efficiently. More importantly, all five plants are at capacity nearly all of the time because of our commitment and responsibility to balance most of the state's milk supply.

We make our proposal with a full understanding that our proposed make allowance for nonfat powder is such that two of our five plants that manufacture powdered milk products will not be covered by the make allowance. However, we think it is appropriate that manufacturing cost allowance be set so that our largest and most efficient plants are covered. It should be clear that establishing manufacturing cost allowances that do not cover the costs incurred by large efficient plants has grave ramifications for the processing capacity in this state.

In summary, the costs incurred by CDI's plants are representative of what it costs to produce butter and nonfat powder, and these are the costs that ought to be the basis for setting the manufacturing cost allowance in the Class 4a pricing formula.

Cost Study Updates. It is unfortunate that none of the hearing participants were given sufficient time to request the Department provide the most current cost information for energy, labor and packaging materials. In its report to the Dairy Advisory Committee last month, the Dairy Marketing Branch noted that a primary function of the Manufacturing Cost Unit is to update the costs studies for labor, packaging and energy costs to reflect current conditions whenever a Class 4 hearing is called.

In 2006, the Department followed the advice of the consulting group and renamed and repackaged the manufacturing cost updates that have been performed as a standard practice by the Department for over 20 years. The changes included a new format, a new title, and instruction as to what the information represented. Notwithstanding the Department's attempt to distinguish and separate the cost updates from the cost studies, the updates that were conducted in the past underscored the point that when there are significant changes in plant cost categories, they ought to be -- they are relevant and are to be considered in the process of adjusting pricing formulas. However, the accelerated timeline of this hearing barely gave the Department sufficient time to distribute the cost studies themselves, and clearly did not allow near enough time to request cost updates, let alone the time to actually collect and compile the relevant updated cost information. As a result, CDI proposes its manufacturing costs changes, knowing that we and other manufacturers will be operating with manufacturing cost allowances based on historical data that is not representative of our current higher costs.

Percentage of Volume Covered. Prior Panel reports have typically referenced the volume of product in the cost studies that would be covered at a given level of make manufacturing cost allowance. The Department has repeatedly stated in its Panel reports that the level of volume covered is not pre-determined and has attempted to choose manufacturing cost allowances such that 50 to 80 percent of a cost study product volume is covered. Reporting that the percentage of product covered.

Reporting the percent of product covered is not at issue here. However, selecting a manufacturing cost allowance using the percent of volume covered as a guide is at issue. The process is problematic. Using the percent of volume covered as a guideline, even one that's loose as the Department has used in the past, has a built-in circularity to it. Let me provide you with an example.

Say that initially manufacturing cost allowance is set to cover 70 percent of the volume of product produced. In subsequent cost studies, the plants that were less efficient and had higher costs exit the business, leaving only those plants that were considered more efficient plants in the study. After the next cost study is completed and the volume covered rule of thumb is applied to this group, a plant once considered to be efficient may now be deemed inefficient simply because the volume covered approach necessarily places some volume and, consequently, some plants on the unfavorable side of the dividing line.

The obvious question is: What then should the Department consider as an alternative to the volume covered rule of thumb? Eliminating the volume covered tool will shift a great deal of responsibility to the Department staff for knowing intimately what the plants in the cost study are. If the higher cost plants in the study do in fact drop out and there are only efficient plants left, and this situation can be verified by Department staff, then setting the manufacturing cost allowance to cover all of the volume or most of the volume would be an acceptable and correct decision and far preferred to blindly strike a line at 60 percent or 70 percent or 80 percent. Considering the current state of milk production and the lack of available processing capacity in the state, the Panel may want to consider seriously eliminating from the decision-making process any implicit constraints on the volume of product covered by the manufacturing cost allowances.

F.O.B. Butter Price Adjuster. The manufacturing cost allowances represent a significant and contestable part of the pricing formulas and have received their fair share of scrutiny for many years. Consequently, many of the kinks in the system have been worked out -- although you wouldn't know that from today's testimony -- using the dairy industry's input to the point where the cost study methods are generally accepted, leaving the debate only how the data should be used. We would like to see that level of investigation and review applied to the f.o.b. price adjusters as well.

As California has continued to a manufacturing state, the f.o.b. price adjusters have taken on a greater role in the Class 4a and 4b pricing formulas, particularly in the last five years. However, the methods used for determining an appropriate adjustment off of the prices obtained from the Chicago Mercantile Exchange were developed and have evolved without much direction or input from the dairy industry.

As a major butter producer and seller, CDI has firsthand knowledge of how butter sales contracts are structured. The method on which the Department has relied for calculating the f.o.b. price adjusters does not appear to reflect the pricing structure that we know exists between our company and its customers. One of the primary elements that appears to be missing is a mechanism that accounts for the month-to-month and seasonal fluctuations in sales volume. This variability is real, and the method for calculating the f.o.b. price adjuster needs to recognize and capture these differences. The method used by the Department ignores the variation in pounds of product actually sold in each month. Instead, all months are weighted equally in the process of averaging monthly observations, a process that has been used ever since 2003 when the f.o.b. price adjuster replaced the butter freight adjustment in the Class 4a pricing formula.

CDI requested that the Department calculate the Chicago Mercantile Exchange less the California price difference using an alternative method. The method that we suggested can be applied to the monthly price data that has been collected and is only a slight modification of the method that is used currently but has the ability to account for monthly variations in volume of product sold. It also has the advantage over previously suggested methods of not using plant volume data twice, an approach the Panel has found to be objectionable. In short, the new approach satisfies CDI's repeated requests to use an approach that recognizes monthly sales volume differences and simultaneously addresses the Department's reluctance to use weighting procedure that might bias the estimator by using the volume data twice. The Department accepted our request and published the figure resulting from the new approach to calculating the f.o.b. price adjuster for butter. For the 24 months analyzed, the new approach would yield a difference of 4.08 cents per pound using the revised data sheet provided at the Department's pre-hearing workshop.

While we feel this new method is an improvement over what has been used in the past, we view this request as an easily implemented stopgap measure that may improve the determination of the price difference of California manufacturing plants and the CME. A more comprehensive review of the methods used by the Department should occur in the near future to consider another improvement which touches on another concern we have: The use of monthly price data instead of weekly price data. As a major butter seller in the U.S., CDI knows that butter sales are made and adjusted on a weekly basis, not on a monthly basis. Late last year, CDI contacted the Department about the need to collect weekly sales data for butter and cheddar cheese so that a basic price data foundation could be established to which a more appropriate method for the f.o.b. price adjuster calculation could be applied. The Department responded with a change in policy. And beginning January 1st, 2007, the Department required each plant to submit weekly price information for butter and cheddar cheese sales. The Department also took the extra step of initiating plant audits of the weekly sales price data submitted. We very much appreciate both of these improvements. They will be valuable cornerstones to the cause at hand, that is to say, developing a more appropriate method for calculating representative f.o.b.

price adjusters.

Although not enough price data has been collected to justify a change from the monthly prices to the weekly prices, we are confident that a transition will occur in the future because the Department is seeking to use the best data and find the best analytical methods to capture accurately the true underlying difference of the prices received by California butter and cheddar cheese processing plants and the CME prices. We look forward to working with the Department to achieve this goal.

Proposed Plant Processing Capacity Credit. As has been mentioned in the past several hearings by both hearing participants and the Panel itself, plant processing capacity in California is approaching a critical point of imbalance relative to the volume of milk being produced in the state. The Department has recognized the plant capacity problem but has been apparently reluctant to use more fully the only major tool it has available to it, the make allowance, to encourage the expansion of processing plant capacity in California. Perhaps the Department's reluctance is justified. As powerful as that tool may be, it has unpredictable results. Increasing the make allowance is a generalized and untargeted approach to encourage plant capacity. In the more recent past, increasing make allowance has resulted in lower prices to dairy producers without increasing processing capacity in California. In other words, increasing the manufacturing cost allowance does not assure that money diverted from dairy producers to milk processors will be used to increase plant capacity in the state. While there has been much discussion on the issue, no concept or mechanism has been introduced during a hearing that would give the Department the ability to encourage specifically those companies that are considering adding new milk processing capacity to California.

CDI proposes that an incentive be given to plants that add processing capacity to the state, either through a new facility or an expansion of an existing facility. In the case of an expansion of an existing facility, the credit would only apply to the expanded portion of the plant, not to the entire facility. Furthermore, the credit would not apply to a plant that simply processes more milk without changing its structure or equipment.

We propose a credit of 50 cents per hundredweight this will be available to eligible plants for a period of three years. CDI has firsthand experience with the costs of constructing new butter and nonfat dry milk powder plants, and we note that the cost of constructing a greenfield butter and nonfat powder plant has more than doubled in the last ten years. Considering the sum of the costs for interest, depreciation, and property taxes on the portion that only represents the increase in construction costs amounts to about 50 cents per hundredweight of milk processed. Given our experience with plant start-ups, the length of time that will be required before a new plant's costs are fully captured in a cost study and those results considered in a Class 4 pricing hearing, and our thought that bankers will be more apt to consider financing a plant or a plant expansion if the processing capacity incentive is available well beyond one year, we propose that the credit apply to eligible plants for a period of three years starting on the first day milk is processed by the facility.

We envision the mechanics of the plant capacity incentive being similar to that used by the Milk Pooling Branch providing transportation credits to qualifying plants, which would require plants to submit a document each month to request adjustments from the pool. Like the transportation credit mechanism that is now in place, the processing plant capacity incentive would be in the form of a credit to the plant's pool obligation. For simplicity, we propose that the plant capacity incentive credit be assigned entirely to the solids not fat price.

The operative part of our proposal is increasing plant processing capacity, and determining what constitutes an actual and verifiable processing plant capacity increase is a key. We propose a two-step approach to ascertain the eligibility of plants. First, a baseline for volume of milk handled must be determined. For new plants, all the milk processed by the plant would be eligible for the credit for the first 36 months of operation. For plant expansions, the baseline processing capacity shall be the highest monthly average volume of milk processed for the most recent 24 months as of the first month for which a plant applies for the credit. The difference of the baseline and the volumes specified in the application shall be eligible for the processing plant capacity credit provided that the second condition is met, which is simply a verification by Manufacturing Cost Unit staff or Milk Pooling Branch auditors. Fortunately, Milk Pooling auditors, as part of their audits, regularly tour each facility and note any changes in the physical structure, equipment, and layout of the plant compared to what was recorded during the last audit. Thus, the Department already has ample records that document historic descriptors of each facility, and it should be relatively easy for the Department to determine if any structural or equipment changes have been made.

Concluding Remarks. As the largest supplier of milk -- largest supplier to milk processing plants in California, CDI balances milk on a daily basis. Any change in our producer-owners' milk production or in our customers' orders must be accommodated by using the capacity in our plants 24 hours a day, 7 days a week, and 365 days a year.

Maintaining existing processing capacity in the state is a must. California Dairies believes that the Department should adjust its historical approach to establishing make allowances and f.o.b. price adjusters, and we have detailed in our testimony what the Department should consider instead.

It is critical that the Department's decision maintain standby balancing capacity in California, particularly when we as an industry are faced with ever-increasing milk supplies and relatively stagnant plant processing capacities. The burden of carrying inefficient, high-cost plants because the state cannot afford to lose any of its current processing plant capacity is not a notion embraced by anyone. However, with each passing month the state's balancing requirements increase, and any available processing capacity becomes important. Furthermore, the time has already passed to begin developing policies that will help to encourage more plant processing capacity in the state. Notwithstanding that, we have proposed a new and targeted mechanism that uses pool revenues to create an incentive for companies to construct new plants or expand existing plants. We urge the Department to adopt our proposal and insert the enabling language in the Stabilization Plans and Pooling Plan needed to activate this proposal as soon as possible.

Thank you for your attention. And I request the opportunity to file a post-hearing brief.

HEARING OFFICER LOYER: Post-hearing brief is granted.

Proceed.

MR. HEFFINGTON: I'll continue on.

Ms. Hearing Officer and members of the Panel. My name is Joe Heffington and I am Senior Vice President and Chief Financial Officer for California Dairies, whom I'm representing here today.

Although I was not present at the pre-hearing workshop, I understand that there was some discussion and concerns about the return on investment, or ROI, analysis and comparison of ROI by type that was provided by the Department as an exhibit to this hearing. My testimony today will focus on this subject.

In the past, the ROI factor included in the Department's manufacturing cost study has been just that, one of many factors included in the cost study.

California Dairies is concerned with the benchmarking of data to the ROI factor that has been released by the Department. And I've attached Exhibit A and B.

We suggest that the ROI information on these schedules is misleading as an indication of profitability and is likely to be misunderstood by industry stakeholders for a number of reasons:

1. The industry has not seen this analysis before and has not had an opportunity to understand the logic behind the calculations and the possible ramifications of using the results based on their face value.

2. The Panel report from the June 2006 hearing indicated that the make allowance was benchmarked based on this new ROI calculation, and yet stakeholders have had little or no input or opportunity to discuss exactly what ROI represents.

3. ROI may be calculated a number of ways. And in California Dairy's opinion, using depreciated values based on historic cost, as is the Department's current practice, does not reflect current economic sacrifice and is not the best benchmark.

For example, an investment of $100,000 in equipment with a ten-year life should yield a return on the full $100,000 each and every year, as stated by others testifying today. Using depreciated values provides a return on the declining value over the life of the equipment.

4. The ROI analysis shown on Exhibit B would be very misleading if one product segment with older, more fully depreciated assets were compared to another with newer, more recently constructed assets. This may be the case with the Department's exhibits when comparing the ROI for cheese and whey to butter and powder. The implication here is that one product segment shows a higher ROI as a result of the use of older and therefore more fully depreciated assets to calculate ROI than another. Adding a single new large butter-powder plant would greatly change the results of that analysis.

5. Butter plants are not built separately from powder plants, and the two products should be considered together, just as cheese and whey should be evaluated together.

6. And complicating the comparison, there is no consideration given for leased assets in the ROI calculation.

And I'm aware of several large evaporators and driers in this state that have been historically financed through lease because it's a better method of financing. That's not just California Dairies or its predecessors, but it's also other operations in the state.

It is our understanding that the inclusion of a return on investment factor in the Department's cost studies has been controversial from the time it was added. The method of calculating the ROI has been debated and there are many alternatives.

During 2003, 2004, and 2005 california Dairies corresponded with the Department regarding the proper benchmark rate of return and proper base for calculation of the return on investment that is included as a factor in the cost studies. The topic was discussed at various Dairy Advisory Committee meetings, and the Department asked the industry for input at that time.

Subsequently, the Department chose to make changes based on its own internal study and paid consultant's suggestions. These suggested changes were released to the industry in August of 2005. In spite of the Department's efforts on this subject, it remains one that is contentious and misunderstood.

There are many reasons why the current ROI factor should remain just a factor to be included in the manufacturing cost studies and not serve as a measure of profitability for dairy manufacturing cost comparison purposes. The Department should exclude the ROI analysis as shown an Exhibits A and B from this hearing decision and should call a special meeting of the Dairy Advisory Committee to review exactly how the ROI factor is calculated, with hopes of better industry and stakeholder understanding. Absent a revision to the calculation of ROI that truly puts all industry segments on an equal basis, the type of ROI analysis presented by the Department at this hearing should not be duplicated in the future.

Thank you for your attention to my testimony.

HEARING OFFICER LOYER: Will you be submitting a post-hearing brief?

MR. HEFFINGTON: I would like the opportunity.

HEARING OFFICER LOYER: Granted.

Questions from the Panel?

PANEL MEMBER GOSSARD: I'll initially just ask a couple questions of Mr. Heffington about his comments on the ROI.

On page 2 you mentioned that the -- or if a method was developed, one of the things that you would request in point 5 is that some sort of weighted average be given to butter-powder operations rather than having separate ROIs for butter and nonfat dry milk separately; is that correct?

MR. HEFFINGTON: There needs to be considered -- they need to be evaluated as a unit. You don't build separate butter plants.

PANEL MEMBER GOSSARD: Okay. So my question was, then you would want some sort of weighted average across butter and nonfat dry milk as a single number for butter-powder plants rather than two separate numbers for butter and for nonfat dry milk?

MR. HEFFINGTON: That would be a better presentation.

PANEL MEMBER GOSSARD: Okay. Thank you.

You object to the use of the ROI factor as presented in the attachment. But doesn't the Food and Ag Code say that we're supposed to consider any relevant economic factor? Do you think this is totally irrelevant?

MR. HEFFINGTON: It's not totally irrelevant. If you read my concluding remark, you can see that I would like for all product types to be on an equal footing and an equal basis and a chance to be evaluated equally. Currently it's not.

PANEL MEMBER GOSSARD: And, finally, you say on the first page you'd not seen this analysis before, but then you acknowledge that it was in the June 2006 Hearing Panel report. That was over twelve months ago. So is twelve months not seen before?

MR. HEFFINGTON: These exhibits were not presented as a part of the hearing record for that hearing in advance. These are new exhibits that are being presented to the Department -- to the industry I believe, Mr. Gossard.

PANEL MEMBER GOSSARD: But you have had a chance to see -- it was twelve months ago when you first had a chance to see this data, this presentation?

MR. HEFFINGTON: Not this exact presentation. There was words in your Hearing Panel report, I believe.

PANEL MEMBER GOSSARD: You're not aware of what you have attached as Exhibit A was in its entirety part of the Panel report from the June hearing? You were not aware that that was the case?

MR. HEFFINGTON: Are you answering that for me?

PANEL MEMBER GOSSARD: No, I'm asking.

Then you believe that Exhibit A was not in the Panel report from the June 2006 hearing?

MR. HEFFINGTON: Again, I don't believe it was an exhibit presented at the June 2006 hearing before the Panel report came out.

PANEL MEMBER GOSSARD: So I'll rephrase it.

Then you do not believe that Exhibit A was in the Panel report from the June 2006 hearing?

MR. HEFFINGTON: It may have been. I said it was not presented as an exhibit prior to the hearing.

PANEL MEMBER GOSSARD: Thank you very much.

I may have additional questions of Dr. Erba, but I will defer to the other Panel members.

HEARING OFFICER LOYER: Any further questions from the Panel?

PANEL MEMBER SHIPPLEHOUTE: Yes.

Dr. Erba, I'll limit my questions to the credit concept that you have proposed. And the questions I have for you are similar to questions I've asked of earlier witnesses. And, that is, that your proposal as presented is listed as a pool credit and not a credit to class prices.

And I'm just curious if you could speak to the Food and Ag Code not allowing for the operation of the pool plan to generate unequal raw product cost for distributors operating in the same marketing area.

DR. ERBA: Sure, Don. Seems like we've already got that situation with the availability of transportation credits and fortification allowances. Those are available through the pooling plan. The adjustments are made through the pooling plan.

So I don't know exactly what that code section says. But I would just point out that we have the opinion of Mr. Lemmon here in the Dairy Institute proposal as an attachment and the words of Mr. Vlahos this morning, two attorneys who differ on what that should be. So I don't know that my opinion really matters. I'm not an attorney, I'm not trained to be an attorney.

I don't think that's an issue. But not having looked at that section carefully, I couldn't tell you.

PANEL MEMBER SHIPPLEHOUTE: No other questions.

PANEL MEMBER IKARI: Can I ask a slightly different question but staying on the same topic.

What is the legislative authority either in Chapter 1 or Chapter 2 or Chapter 3, which is pooling, that gives the Department the authority to provide a credit for plant expansion?

DR. ERBA: I doubt that that's spoken to specifically. But, again, I point out that there are similar mechanisms in the transportation credit that obviously are working and have worked for some time. And this would be structured the same way. I don't see what the difference would be.

PANEL MEMBER IKARI: The fact that one's Class 4 versus trying to -- the producers accepted the responsibility to ensure that Class 1 milk would be served. Wasn't there an issue at the time of pooling that processors were elected to support the pooling plan unless the producers made a commitment to serve the Class 1 market? Isn't that a difference between the transportation allowance versus what you're proposing in terms of plant credits?

DR. ERBA: It may be, Dave. I don't really know. I know that what you're talking about is not in writing anywhere. That commitment was made at the time of this discussion, but you couldn't find that in writing anywhere. And we've talked about that before in the past. But I don't see our proposal as being any different than what's in place right now.

PANEL MEMBER IKARI: What about the concept -- is this a major amendment? Would it require a vote, in your view, of the pooling plan?

DR. ERBA: Yes, probably. In discussions in the past about what constitutes a major change to the pooling plan, we've talked about changes in RQAs being a major change to the pooling plan. I'm not sure I would agree with that. But this would certainly be more along the lines of a major change. And, yes, it probably would have to go to a referendum. And I think we're okay with that. We wouldn't have a problem with that.

PANEL MEMBER IKARI: If the authority is there to provide this credit -- I'm having a difficulty in terms of, can any good idea be born in the pooling -- you know, put in place in the pooling plan and a credit be given? Where is the criteria? Where's the limit on what can and -- is it just dependant on the Department's discretion and the support of industry leadership? Or is there something that we can look at and exam or use as a reference in making these calls?

DR. ERBA: That question is similar to the one you asked Mr. Vlahos this morning. And when he gave his response, I was nodding my head saying I completely agree with what he said. And that was, that if there is a good idea out there that somebody thinks ought to come before the panel through a hearing process and that proposition can be made articulately, then, yes, it is incumbent on the Department to make that call, to make that decision - is this a viable option or not? And as far as I know, there is nothing out there, nothing written that says I draw that line. That's up to the discretion of the Panel and ultimately to the Department itself.

PANEL MEMBER IKARI: Most of your testimony focused on the 4a in terms of setting the 4a price.

Can I assume that we should use the same principles that you've outlined in your testimony and also apply it to 4b in setting the make allowance for 4b?

DR. ERBA: No, we don't have a position on Class 4b in any of those changes. So, no, I would not say that's --

PANEL MEMBER IKARI: Even though you don't have a position, shouldn't there be some consistency in the manner in which the Department establishes the 4a versus the 4b pricing formulas?

DR. ERBA: I know that's been a concern in the past. And I know some other folks here today have testified to that. I'm not sure the consistency needs to be there just for the sake of being consistent. I think what needs to happen is that these be reflective of how the products are made and are marketed. And I'm not sure that cheese and butter, for example, are made or marketed in the same way. So I don't really see that there needs to be that consistency. This is again the point going toward we need to have the Department and the industry meeting together and talking outside of these hearing sessions and trying to come to some resolution about how these things ought to be handled. In the past consistency has been very much a focus, a primary focus. I'm not sure that needs to be there. These products are not made or marketed the same way.

PANEL MEMBER IKARI: And so I don't misinterpret your testimony on page five where you're talking about -- you mention that the make allowance -- or setting the manufacturing allowance is the major tool that could address the plant capacity issue.

Am I right in interpreting your comments as meaning that your first preference is the Department set reasonable make allowances that would encourage plant capacity as the first step?

DR. ERBA: I don't think you can truly construct or expand a plant based on changes in the make allowance. I think that ship has sailed. We're on to a new category now. And I submit to you that costs have increased so much in the recent past that changes in the make allowance are not going to be able to build you I new plant. They are not going to be able to expand an existing plant. You can make the changes on the make allowance I think that are consistent with the cost study. But as far as using the make allowance to encourage the building a new plant, I don't think you could -- you would have to move the make allowance a huge amount to make that viable, and I don't think that's going to be an option in the future. Construction costs are not going to come down. And I don't think you can move a make allowance enough to get that to happen.

PANEL MEMBER IKARI: Finally, in other regulated industries that -- we have the Public Utilities Commission. Energy, for example, we have energy companies.

Is there a special credit or a special -- isn't it the rate that determines -- the rate that's approved that ultimately determines what the plants are going to do in terms of expansion to ensure that we have adequate energy suppliers?

DR. ERBA: I couldn't answer that. I couldn't answer that. I don't really know.

PANEL MEMBER SHIPPLEHOUTE: I have a follow-up statement/question. And perhaps you could address this in your post hearing brief.

First, you mentioned the RQAs. And I point out that the pool plan requires -- or sets a low standard as to when we would have to put the RQAs to a referendum of the producers if we were to recommend a change on those. The transportation credits and -- well, transportation credits specifically are a credit to the Class 1 price. And that's why they are in the stabilization and marketing plans. The pool plan is simply the accounting mechanism that the Department chooses to account for milk revenues for producers. Transportation allowances are dollars that have already been paid into the pool via the class prices by the handlers, and it's just a redistribution amongst producers to fulfill their commitment to make milk available to Class 1 plants.

And I'm wondering perhaps, thinking along those lines, if you could address how your proposal fits in with the transportation credits and allowances and how the mechanism is the same as what we already have in place.

DR. ERBA: I shall attempt to do so.

PANEL MEMBER LEE: I have a question for Mr. Erba. It kind of goes in line with Mr. Ikari's comments and Mr. Shipplehoute's comments regarding credits in the system that you mentioned.

If you look at Section 62074.5 of the stabilization plan, I think that's the section that kind of gives the authority to the Department regarding transportation allowance and credits. Let me quote this: "A stabilization 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." And that's just to make a statement to you regarding that.

Also, I do have some -- would like to know -- or hear from you a little more as to some of the factors that you would think that we should apply in this credit process. I was wondering if you could maybe digress a little further in your post-hearing brief as to what factors the Department should use in allowing a credit to occur or not to occur if this proposal was adopted.

DR. ERBA: You mean beyond what I've talked to today?

PANEL MEMBER LEE: Yes, a little more specific.

DR. ERBA: I'll try to do that.

PANEL MEMBER LEE: All right. Thank you.

HEARING OFFICER LOYER: Any further questions from the Panel?

Okay. Before we proceed with the public testimony, I'm going to call a brief recess. And we will reconvene at 3:00.

We're off the record.

(Thereupon a recess was taken.)

HEARING OFFICER LOYER: The hearing will now come to order.

Okay. We will now proceed with the public testimony section of the hearing. And as I mentioned before, it was first come, first serve.

So I'm going to call first David Larsen from Imperial Valley Cheese of California.

Mr. Larsen, I'm going to mark your exhibit number 57.

MR. LARSEN: Thank you.

(Exhibit marked.)

HEARING OFFICER LOYER: Mr. Larson, would you please state and spell your name for the record.

MR. LARSEN: David Larsen, D-a-v-i-d, L-a-r-s-e-n.

HEARING OFFICER LOYER: And you represent Imperial Valley Cheese?

MR. LARSEN: I do.

HEARING OFFICER LOYER: Please identify the process by which the organization finalized your testimony today.

MR. LARSEN: It was done by a process through our management team. Our President/CEO, Dolores Wheeler, approved the testimony that I will provide today.

HEARING OFFICER LOYER: Okay. Thank you.

You may proceed with your testimony.

MR. LARSEN: Thank you.

As I mentioned, I'm with Imperial Valley Cheese. I'm actually the cheese plant manager for Gossner Foods, Logan, Utah, cheese plant. But I have been involved in the California Imperial Valley Cheese Milk Procurement Division since it was built in 1999.

Imperial Valley Cheese, just a little bit about us. We're a joint venture between Gossner Foods, who's based in Logan, Utah, and a dairy producer down in El Centro, California. The plant was built in 1999. We're a very small cheese plant. And I would like to read a letter that we sent to the Secretary in regards to this hearing.

Members of the Panel:

"As a small cheese producer in California, we would like to announce our support to remove the dry whey factor from the Class 4b pricing formula as described in the petition filed by F&A Dairy of California and others.

"Imperial Valley Cheese of California is a small cheese plant and unable to recover the multi-million dollar investment required to install whey drying equipment. Therefore, we are left with very few options. We currently provide the liquid whey to a local farmer at no return to our cheese plant. If the whey factor remains in the Class 4b formula, we will have an incentive to move additional production from our California plant to one of our other plants outside of the state that does have whey processing capacity. We feel that others may have the same incentive, which will leave California short on production capacity, at a time when dairymen are increasing milk production. This decrease in production capacity and increase in milk production will cost California dairymen unnecessary transportation costs.

"We urge the Department" -- and this Panel -- "to consider the many cheese plants in the state that have similar concerns and the economic impact the whey factor has on our business."

Thank you for allowing us to testify. And we request the opportunity to file a post-hearing brief.

HEARING OFFICER LOYER: Your request is granted.

Are there any questions from the panel?

Okay. Thank you very much, Mr. Larsen.

No questions being heard, I'll call the next witness.

John Jeter from Hilmar Cheese Company.

Mr. Jeter, I'll mark your exhibit number 58.

(Exhibit marked.)

HEARING OFFICER LOYER: Sir, will you please state and spell your name for the record.

MR. JETER: John Jeter, J-e-t-e-r.

HEARING OFFICER LOYER: Okay. Do you swear or affirm to tell the truth and nothing but the truth?

MR. JETER: I do.

HEARING OFFICER LOYER: And you are testifying today on behalf of Hilmar Cheese Company?

MR. JETER: Yes.

HEARING OFFICER LOYER: Please identify the process by which that organization finalized your testimony today.

MR. JETER: The testimony was developed as a group by our staff and approved by our board of directors. And I'm authorized to give it as an officer of the corporation.

HEARING OFFICER LOYER: Thank you. You may proceed.

MR. JETER: Thank you.

My name's John Jeter and I work for Hilmar Cheese Company, a cheese and whey products manufacturer in California and Texas. Our California operation processes approximately 12 million pounds of milk a day into American-style and value-added whey products. Recently, we started up a new plant in Dalhart, Texas.

Hilmar Cheese Company procures milk from about 270 direct-ship California dairy farms, several California cooperatives, and other proprietary milk handlers, which equates to approximately 12 percent of the milk in the State of California. Founded upon the ideal of paying producers a competitive price for the value of their milk, Hilmar Cheese believes in low regulated prices and high market driven prices that allow both milk producers and processors the opportunity to remain viable.

Today I represent Hilmar Cheese Company as I testify in support of the Dairy Institute of California's request to eliminate the whey factor and update the cost factors in the 4a and 4b pricing formulas.

A few comments about the general dairy situation.

The California dairy industry today is characterized by good general demand opportunities, a growing milk supply and too little plant capacity. While the U.S. is experiencing great dairy demand opportunities, California is struggling to process the surplus milk supply to fill that demand. Milk is going on the ground; united Dairymen of Arizona is taking 20 loads of California milk per day; and our Texas plant, which opened in September, is receiving surplus California milk as well. Cheese plants both in and out of this state are struggling, shutting down or being sold. The only new facility investments are currently in butter-powder plants except for Leprino Foods because of significant infrastructure they have already in place.

The global environment is one of very good market opportunities that someone will capture, particularly in dry products, cheese and butter. And it is a widely accepted fact that the U.S. is in the best position to be the supplier of many new global markets if we remove the existing barriers to innovation and trade imbedded in our pricing and support system and strengthen our competitive advantage.

Regarding support for the dairy institute position:

How did we get in a place of high raw product supply, high domestic and international demand, but not enough processing capacity and a limited product mix?

We got here by relying on a system that no longer fits the current dairy industry dynamics. It's a system based on product-driven formulas that do not accurately reflect true market realities and massive income redistribution.

Past CDFA hearing panels have recognized this. The last two times that the whey factor was brought before the Panel, it was suggested to the Secretary of Agriculture that the whey factor be eliminated. These experts were correct, but unfortunately were overruled for political purposes to the detriment of the industry. And I think Bill Schiek's comments were very clear on that.

Our regulated system does not create revenue, but rather redistributes income by increasing the cost for some processors and sharing that income with everyone. It's the ultimate false milk price enhancer that has gutted the cheese industry. Both California and federal cheese industries have been damaged as a result of very high product-driven regulated prices. Regulation has extracted what used to be profits and incorporated them into the regulated milk price, to be paid out to all producers regardless of whether they invested in the product creation. There is no incentive to innovate and create new products to meet market demand when any return on investment is redirected into the pool. Rather, the incentive is to minimize risk or move to less regulated areas.

And about the whey business:

Historically, success in the whey business is critical to the survival of any midsize to large cheese plant. The current regulated price has simply paid cheese plants the cost of producing whey and given all the potential profit from it and more to dairymen through regulation. And this has gutted the cheese industry.

The cost of the whey factor to Hilmar Cheese in 2006 and 2007 has gone from a low of $2 million a month to a high of over $12 million a month. We lost money in our whey operations during some of the strongest whey markets in history during this entire period as a result, after having invested over $136 million in our whey operations.

Further, the whey factor has increased the milk price to the extent that milk does not clear the market and it does not allow market signals to work and allocate milk and capacity efficiently. High milk prices need to come from the market through innovation, products, and customers, not from a milk hearing and regulation.

The market is very efficient if it is allowed to work. But it cannot work with a highly disconnected regulated price driven by the whey factor.

A few comments about Federal Orders and unregulated areas:

Cheesemakers in Federal Orders that are subject to paying the regulated price -- and that would be the

Class III price -- are hurting financially also.

Manufacturing price levels in Federal Orders are not comparable to California. Cheese plants in Federal Orders do not have to pay the minimum price if they opt out of the pool. And in Federal Orders, co-ops do not have to be paid the minimum price. They are not treated like individual dairies as the California co-ops are. Federally, the assumption is that in cooperatives dairies have banded together and do not need that level of protection. In California, a co-op is treated like a hundred cow dairy with all the same protections, and private handlers must pay the minimum price for Grade A milk and cannot escape the minimum price. This adds another layer of regulation in California that does not exist in Federal Orders.

And I believe you've recognized this clearly in past hearings.

The California system should allow co-ops to sell at below the minimum price to clear the market. CDI we believe has been effectively selling milk to DFA in their Corona cheese plant at below minimum price to clear the market. DFA simply would not pay the minimum because they could not afford it, for good reasons, which is why the regulated price should decrease in order to clear the market, and let the market-based prices be paid. You can always pay more than the minimum if it's earned.

Also, there is much dissatisfaction in Federal Orders with product-driven regulated price formulas because they simply put too much value into the regulated price. There is a movement to go back to some type of surveyed unregulated price, much like the old MW, as the driver, rather than product-driven formulas that don't reflect local market realities. If product-driven formulas are to work, they can only work if the regulated product-driven pay price are very low, letting the market establish the real price above those.

Idaho is currently fully unregulated. When it was regulated, the primary cheese processors in that Federal Order that compete with us were effectively unregulated. The cheesemakers in Idaho that are our primary competitors have in effect been unregulated for the last 20 years.

California, along with Japan, is the most milk price regulated place in the world.

What is and what is not the solution: Hilmar Cheese Company believes in low regulated prices and high market-driven prices that allow both milk producers and processors the opportunity to remain viable. In order for this to happen, regulated prices must decrease to allow market forces to efficiently set price. The current whey factor is putting cheesemakers in a vulnerable position, and many cannot and will not survive under these conditions. The whey factor is speeding up industry consolidation. The answer is not to further complicate the system or provide subsidies to processors, but rather to shed a layer of crippling complexity by removing the whey factor from the 4b formula. Do not go down the path of more control and complexity with more classes of milk and subsidies. Move toward less regulation and more market efficiencies by removing the whey factor and pushing the California dairy industry to be a more global dynamic competitor.

Based on our internal market-sensitive pay formula, which we call the market basket, Hilmar Cheese Company has been forced to pay over $49 million for milk above its true value during the past 33 months in our pay price. Despite extensive investments -- and we earlier mentioned $136 million in our whey operations -- and exceptional market conditions, the regulated price has caused our whey operation to operate at a loss for these 33 months. The raw cost of whey imposed by the whey factor has been well above what we could extract from our value-added whey markets. All the monies paid into the pool at these high rates were paid out to dairymen, even though at times some were selling their milk to make products that were in surplus.

Western United Dairymen and Milk Producers Council may say that this is exactly why we have hearings, to force payment out of processors that would not have otherwise been paid absent the hearing. They are right in that this is what actually happened throughout the cheese industry as a result of regulation. The regulated price forced cheese plants to pay this overpayment into the pool and redistribute it to dairymen disconnected from the cheese industry. And as a result, we have in California far too much milk to process; milk being sold to calf ranches or dumped; milk being shipped out of state; milk contracts with cooperatives terminated because the plants cannot buy the milk; not enough processing plants; cheese plants up for sale or shutting down completely; cheese plants expanding out of state in less regulated areas; cheese plants not investing in new whey products; entities with no R&D, applications, or marketing groups building more butter-powder plants to produce baseline commodities rather than value-added products. And, finally, we have dairymen who have received letters decreasing their volumes and in some cases terminating their contracts altogether.

If we don't have significant change, meaning elimination of the whey factor, we will have more of the same including lower pool proceeds from much higher 4a milk utilization over a long period of time. The time has gone when dairy trade associations could say, "Make the cheese plants pay all the whey proceeds to dairymen through the pool." This is what they said to the Secretary and this is what he listened to and today we suffer the consequences. Cheese plants throughout California and the U.S. were required to pay too much for milk and great damage was done. You cannot set a market-clearing price too high for a raw product. It is intervention that clearly does not work.

The solution is not found in many of the alternate proposals, which introduce more regulation through added classes and credits based on the size of the processor and when plants are built. These proposals essentially increase the level of regulation and further allocate economic resources via regulation. The different make allowance and whey factors by plant size is a system to subsidize high cost manufacturers and discourage expansion of efficient manufacturers with farmers' money. It is especially damaging given the state's current need for more processing capacity. The expansion credit will just work to accelerate the McKinsey prediction. Spending an extra 50 cents a hundredweight to build a plant that will over time lower pool proceeds is the pool paying to destroy itself. Basically, it asks all dairymen in the State of California to pay for a cooperative's plant for its members through subsidies. Decrease the regulated price and allow the market to work.

The McKinsey report specifically stated that differences in manufacturing class prices are the number one problem facing the state. If things continue unchanged, they estimate even further 4a infrastructure development, which would create a pool drain larger than the past, and that would cause the entire pool and quota system to implode as more exit the pool. As it stands today, the butter-powder industry is the only area increasing processing capacity because that's what the payment system encourages them to do. And I've already mentioned that if Leprino had not already built the additional infrastructure at their Lemoore West facility, they would not be expanding in California.

Impacts of the regulated price:

Cooperatives are investing in more of the same rather than what the market is demanding. They're doing this because they are rewarded for it through the pooling system and subsidies. Their producers via the pool are benefiting from other handlers' investments without bearing appropriate risk themselves. This was clear in the McKinsey report.

The approach by most co-ops as a result of the current pricing philosophy is to manage their businesses with the goal of minimizing risk and simply managing narrow margins. There is no push to expand the margins through the creation and marketing of new product.

There's a massive need for new plant capacity to produce new market-driven products. The current system only encourages more of the same old products.

Setting a regulated price too high significantly damages an industry because it stops the market from working efficiently. No other agricultural commodity is sold on this basis. What if this was the case with grapes, for example? Imagine sitting around calculating the make allowance for chardonnay versus white zin. It would damage product innovation, as the focus would be on how to use the system versus innovation. The wine industry would not have developed the diversity and strength had they done what dairy has done.

Daniel Sumner, Director of the Agricultural Issues Center located at UC Davis, summarized the effects of subsidies and intervention in a recent San Francisco Chronicle article. In it Dr. Sumner theorizes what might have happened to the lettuce industry in California had vegetable farmers received crop subsidies. Had salad been subsidized in 1933, we'd all still be eating Iceberg lettuce. That's because no one would give up their subsidy to be innovative and produce another product, such as Romaine, regardless of what the market demanded. This scenario has played out in the dairy industry and our Iceberg lettuce is nonfat dry milk.

The current proposal to have the pool, dairymen in total, subsidize new plant capacity is another example of a massive co-op trying to minimize risk by setting up more classes of prices for milk with more regulations and intervention. This same entity wanted a subsidy to make milk protein concentrates, while others did it without the subsidy. This entity also used their primary international competitor as a customer for simplicity, all to the loss of the industry. Should we help them do more?

Many of the current alternate proposals are more regulation, classes, and subsidies. It's the wrong direction if we hope to be successful in the global and U.S. markets in the battle for share of stomach.

The major change before us today is the removal of the whey factor. It needs to be removed. Elimination of the whey factor would cause an average drop in the 4b price of 25 cents a hundredweight over the last five years. And I think these are your numbers. In some cases this drop in price would be replaced in part by market-based premiums going directly to the supplier of those plants. And, frankly, that's the compromise that you keep asking about. Without significant change, the cheese industry in California will diminish while the powder industry will grow with its dependence on Fonterra as the exporter, making the pool less attractive in the long run.

The current cheese make allowances have been below the state's audited cost of production for many years and they need to be updated.

And, in conclusion, on behalf of Hilmar Cheese Company and cheesemakers in the state, I urge you to once again recommend the removal of the whey factor before it's too late. The time for change is now.

Thank you for your time and consideration.

And I would like to ask for the opportunity for a post-hearing brief.

HEARING OFFICER LOYER: That's granted.

Does the Panel have any questions for Mr. Jeter?

PANEL MEMBER DOEGEY: I have one question.

On page 4 of your testimony on the first paragraph, that's next to the letter B, the first statement says that you've been forced to pay over $49 million for the milk above its true market value.

Did you find what the true market value is or is that something that you could speak to or possibly include in your post-hearing brief what your definition of that would be or how that was calculated?

MR. JETER: Yeah, we pay yield-base -- we pay for milk based on yield-based formulas for all the products we produce. So we have a pay formula that incorporates cheese, whey protein, and lactose. And we call that a market basket pay formula. And we changed that formula from time to time based on conditions. And so that's what we believe is our pay price. And, for instance, when we buy Grade B milk, that's what we pay.

So that's what a buyer and seller agree to in an unregulated market. And so when we compare that to what we had to pay, we had to pay $49 million more in 33 months. That's an average of a million and a half a month. And in one given month we paid over five and a half million over those prices.

PANEL MEMBER DOEGEY: All right. Thank you.

HEARING OFFICER LOYER: Any further questions?

All right. Thank you.

PANEL MEMBER IKARI: I do.

HEARING OFFICER LOYER: Oh, okay.

PANEL MEMBER IKARI: John, just as a follow-up.

In the calculation of that -- I was wondering if you could in your post-hearing brief provide the formula that you determine your market base and share with us what you think was the right value.

MR. JETER: Now, that's an interesting question. We used to give our formulas out. We found everybody copied them. And so we literally do -- we run people's numbers to give us their fat, protein. And we tell you I'm giving markets what we pay. But we don't give out our pay formulas. We just found they were a big target and everybody tried to duplicate --

PANEL MEMBER IKARI: Well, I don't want to ask you something that's proprietary. But could you run the numbers and share with us what those numbers were over the past couple of years?

MR. JETER: We run every month what our pay would have been. And a lot of -- and of course on the old system it was designed to pay over the minimum price, you know, based on our -- and that's typically what it does in these recent markets.

So we'll see what we can put together for you that would help.

PANEL MEMBER IKARI: Okay. John, on your first page where you talk about milk is going on the ground, United Dairymen is taking 20 loads, could you give us a little more detail -- is that milk that was supposed to go to Hilmar or are you including things that you've heard from other sources or --

MR. JETER: We've heard it from our field men. We've had a couple instances in our cases where our trucks were late. And we've heard it from, you know, other handlers. Talked to Keith Muirfield at UDA. He was buying 20 loads a day of California milk.

PANEL MEMBER IKARI: Okay. And then the Texas plant is receiving surplus California milk.

Is that milk that you're shipping over there or --

MR. JETER: That's our milk that we can't handle. Yeah, that's been going on for probably two or three weeks.

We're also selling milk under the class price to other handlers that we can't handle.

And one of the reasons we're having difficulties, we just contracted with some co-ops for more milk than we could really handle. So in a sense we have capacity to handle our own direct-ships. We contracted to buy some milk. And our direct-ships came up so rapidly this year, and I -- at least in the old days milk would peak in, you know, early June, early July. And we peeked out August 19th, I think was the days that -- so the milk kept climbing and I think it caught everybody off guard to a large extent.

PANEL MEMBER IKARI: Similarly, on page 4 you mention a whole bunch of things. You have a list of ten items. Any kind of details that you can -- if you can quote field manuals, on such and such a date got the information. But any more details that puts some facts to what you're indicating here.

MR. JETER: I think I've given you most of those.

Too much milk to process. That's fairly clear.

Milk being sold to calf ranches. I think you can call any calf ranch and they'll tell you they used to pay 20 cents a gallon. They're paying maybe 55 cents a gallon now and getting probably all the milk they need. And that's nice milk. That's just distressed milk that doesn't have a home.

Again, we hear from our field people from time to time that, you know, milk is going down the drain, going into the lagoons.

Milk contracts. We've terminated two contracts with cooperatives. We have a contract with CDI that's not renewed as of the end of the year. And we terminated another one with a co-op we've done business with for 18 years.

PANEL MEMBER IKARI: Are you aware of other plants that have terminated their contracts with co-ops?

MR. JETER: I probably could find out. You know, it's not -- that's pretty available. I think there's a --

in one sense there's also a real scramble, if you can imagine co-ops that have too much milk and one co-op is selling to a handler at 50 cents over, the other co-op's going to come in and say, "We'll sell it to you at in-plant usage." And so there's a lot of jockeying right now for milk contracts. I mean -- and I just heard the last few days some contracts between big co-ops fighting legitimately for homes for milk. I mean those homes are like gold.

PANEL MEMBER IKARI: Well, I think it's just important to ferret out the difference between hearsay and things that can be factualized.

MR. JETER: And then the -- you know, obviously we expanded out of state in Texas. You know, three, four years ago I went and probably visited with every producer leader in this room one on one and told them that the system was not working and did not work, the overregulation. I was competing against unregulated handlers in Idaho. I've testified to that. And one of the -- I mean I think they acknowledged there were issues, but -- you know, one of them told me, "I don't think anything's going to change until milk hits the ground." And, you know, that's what's happened.

We sent a note out to all our producers. You know, the old way we did it as we grew, and we've averaged almost 20 percent growth a year, although it slowed down dramatically recently, you know, we would let people ship what they wanted because we had markets for that milk. We're fairly good at what we do. We have customers who wanted more business with us. And we just can't do that anymore. So we sent them a letter warning them that we were going through a process where those days would be over. We couldn't grow here anymore in this type of environment. And it was more just a heads-up that this was coming.

And they are key people. They've supported us, you know. And so those are really changing the rules of the game. But those are market realities. And I think there'll be further testimony of other handlers terminating contracts or cutting people back. And our intent is not to cut our people back but to limit the growth just to run our business. We need to run our business, and I think that's in our suppliers' best interest.

PANEL MEMBER IKARI: Thank you.

PANEL MEMBER SHIPPLEHOUTE: I have a question.

The market basket price that you mentioned, you indicated that's based on cheese, lactose, and whey protein concentrate, was it, products that you make?

MR. JETER: Actually it has a whey cream factor in it also.

PANEL MEMBER SHIPPLEHOUTE: So you take the product value via through -- so essentially you have your own end-product pricing mechanism in place?

MR. JETER: Yeah. We've done that for 23 years. I mean that's why the owners built a plant.

PANEL MEMBER SHIPPLEHOUTE: Thank you.

HEARING OFFICER LOYER: Any further questions from the panel?

Okay. Thank you very much.

MR. JETER: Thank you.

HEARING OFFICER LOYER: Next I'd like to call Joe Paris.

Mr. Paris, I'll mark your exhibit Exhibit 59.

(Exhibit marked.)

HEARING OFFICER LOYER: And, sir, could you please state and spell your name for the record.

MR. PARIS: Yes, my name is Joe, middle initial E, Paris. Last name is P-a-r-i-s, first name J-o-e.

HEARING OFFICER LOYER: Okay. Do you swear or affirm to tell the truth and nothing but the truth?

MR. PARIS: Absolutely.

HEARING OFFICER LOYER: And you are testifying today on behalf of an organization?

MR. PARIS: Yes, I'm testifying today on behalf of Gallo Cattle Company doing business as Joseph Gallo Farms.

HEARING OFFICER LOYER: Okay. And please identify the process by which the organization finalized your testimony today.

MR. PARIS: This testimony was put together by Michael D. Gallo, who is the CEO of Joseph Gallo Farmers; Carl Morris, who's the General Manager there; and myself. And it is endorsed by Michael Gallo.

HEARING OFFICER LOYER: Thank you, sir.

Please proceed.

MR. PARIS: Thank you.

Joseph Gallo Farms is a family-owned dairy and cheese plant with its principal offices located at 10561 West Highway 140 in Atwater, California.

Gallo is primarily a milk producer that markets the majority of its milk to its own cheese plant. However, Gallo is testifying today in support of the Dairy Institute proposal. It is the opinion of Gallo that the greatest challenge facing dairy producers in California is insufficient milk plant capacity. We feel the Dairy Institute proposal will more adequately address the lack of cheese plant capacity in California than any of the other proposals in this hearing.

Gallo strongly opposes the proposal submitted by

Western United Dairymen, the Alliance of Western Milk Producers, and Milk Producers Council. Though we generally support the stands these organizations take on behalf of the California milk producers, we cannot support this proposal. We feel that this proposal is discriminatory on its face and will open CDFA to legal action if adopted. Although it appears to be equal on the same amount of solids not fat to each plant, the benefit on a per hundredweight milk basis or a pound of cheese basis will vary greatly for each individual plant. These cheese prices in the marketplace are extremely competitive. The proposal would give some plants an advantage and disadvantage others. Whatever the Secretary adopts must not be discriminatory in any form.

Many cheese plants in California are non-pool plants. The Western United Dairymen, et al., proposal would distribute the credit through the pool. Non-pool plants do not have access to pool monies and would have to rely on their milk supply handler or handlers to pass on the pool credit. This is not acceptable. Any credit would have to be deducted from the 4b price.

Gallo is also opposed to Humboldt Creamery and Land O'Lakes proposals. We take no positions on the proposal submitted by F&A Dairy or California Dairies, Inc.

We urge the Panel to recommend to the Secretary to adopt the proposal submitted by the Dairy Institute and reject the other proposals we have opposed in our testimony.

We thank you for the opportunity to express our position, and would like to file a post-hearing brief if necessary.

HEARING OFFICER LOYER: Okay. That's granted.

And does the Panel have any questions for Mr. Paris?

Okay. Hearing none.

Thank you, sir.

I will call the next witness.

MR. PARIS: I thought I'd get the question from Dave. I had his answer.

(Laughter.)

PANEL MEMBER IKARI: I'd like to hear the answer. Yes, if you think you've got the answer, let's hear it.

MR. PARIS: Your question has been: Where is the compromise?

Here's what you need to do. You need to take it out of the formula. And the cooperatives that supply milk to these cheese plants then know that there's some value there in the whey. Let them negotiate it into the price of whatever their supply contract is with those particular plants. Well, somebody might say, "Well, how about a plant that's got their own producers?" They're going to have to be competitive to what the co-ops are paying out there. Let it be a market-driven thing rather than something that's regulated.

PANEL MEMBER IKARI: So what you're proposing is that producers who supply the milk would get the benefit, but there would be no sharing of those revenues with all producers?

MR. PARIS: No, what I'm -- in my testimony, I'm saying if the 4b plant is an unregulated plant and the credit from the pool comes, how's he going to get the credit?

PANEL MEMBER IKARI: Okay.

MR. PARIS: Because he's not pooled. That's in the testimony.

But in answer to the question on compromise, don't regulate the whey value. The cooperatives out there, they're negotiating for the producers, understand there's value in whey. Let them negotiate that in supply agreements as part of the overall pricing in their supply agreements.

Years ago when whey was not a big factor, there was always a whey cream factor in the whey. And when you negotiated with a cheese plant, you knew what that value was. And part of the negotiations in order to get a premium over and above the market, and not just the service charge, would be the value of whey cream. This is no different.

PANEL MEMBER IKARI: I understand.

Thank you.

HEARING OFFICER LOYER: Any further questions?

PANEL MEMBER SHIPPLEHOUTE: I do have a follow-up question, now that you've provided the answer.

(Laughter.)

PANEL MEMBER SHIPPLEHOUTE: When Mr. Jeter was up here, he indicated that he's had or heard of co-ops negotiating with homes for their milk at the plant blends. So no -- premium whatsoever. So in today's market condition, does your answer still work? In other words, would the co-ops be able to get any sort of premium or any type of whey value for that milk?

MR. PARIS: It might be much -- well, put it this way. In July and August it would have been a whole lot more difficult. But in a normal market situation there could be some value there. We know there's value there or the producer wouldn't be in here fighting to keep it. We know what it's been like.

There was a proposal put in in 2006 in the hearing that would have shared that increase or decrease over a base -- whatever the make allowance was to both producer and processor. I think it was about 50 percent. In other words of the increase that we got over the summer that's been so devastating to cheese plants, that would only have been half the amount had that been adopted back in 2006, but it wasn't.

PANEL MEMBER SHIPPLEHOUTE: No other questions.

HEARING OFFICER LOYER: Any further questions?

Thank you.

I'd like to call next Kevin Abernathy.

Mr. Abernathy, I'm marking your testimony Exhibit No. 60.

(Exhibit marked.)

MR. ABERNATHY: Thank you.

HEARING OFFICER LOYER: Sir, could you please state and spell your full name for the record.

MR. ABERNATHY: My name is Kevin Abernathy, A-b-e-r-n-a-t-h-y.

HEARING OFFICER LOYER: Do you swear or affirm to tell the truth and nothing but the truth?

MR. ABERNATHY: Yes, I do.

HEARING OFFICER LOYER: And you're testifying today on behalf of an organization?

MR. ABERNATHY: That's correct.

HEARING OFFICER LOYER: Please state your affiliation for the record.

MR. ABERNATHY: My affiliation is I'm the Executive Director with the California Dairy Campaign and the California Farmers Union.

HEARING OFFICER LOYER: Okay. And please identify the process by which the organization finalized your testimony today.

MR. ABERNATHY: The testimony that I will present today is based on positions adopted by the CDC Board of Directors during its August board meeting

HEARING OFFICER LOYER: Thank you, sir.

You may proceed.

MR. ABERNATHY: I'd like to make a note, Ms. Hearing Officer, that there is three attachments to Exhibit 60.

HEARING OFFICER LOYER: I'm seeing pages one through four and one attachment.

PANEL MEMBER IKARI: Yours is missing.

HEARING OFFICER LOYER: Apparently. I'll trade with you then.

Now I have the exhibit. And that duly noted then.

MR. ABERNATHY: And also my treasurer, Mr. Magneson, if the Panel has any questions, will be here to answer those questions.

HEARING OFFICER LOYER: Actually, Mr. Magneson, I'll also have you state and spell your name for the record please.

MR. MAGNESON: My name is Scott Magneson M-a-g-n-e-s-o-n.

HEARING OFFICER LOYER: Do you swear or affirm to tell the truth and nothing but the truth?

MR. MAGNESON: I do.

HEARING OFFICER LOYER: And you are also testifying today on behalf of an organization?

MR. MAGNESON: On behalf of the California Dairy Campaign.

HEARING OFFICER LOYER: Okay. And your affiliation?

MR. MAGNESON: I am the officer on the board of directors.

HEARING OFFICER LOYER: Okay. You may both proceed.

MR. ABERNATHY: Thank you.

Without reiterating what we've already just went through, CDC is opposed to the petition submitted by F&A Dairy of California and a group of other cheese processors to remove the dry whey factor from the Class 4b formula. Although the petitioner, F&A, claims that the reason for its financial trouble is a result of additional costs it incurred due to the dry whey component in the 4b formula, we believe that there are far bigger forces that are responsible for its recent troubles.

For processors to testify here today to eliminate the whey value in the 4b pricing formula is simply unjustified. I'm going to defer away from my written notes here for just one moment for a verbal comment.

The willingness to remove the dry whey factor, in our opinion, there's two very important reasons: Number one, the 14-year running average of a 46 cent price advantage that California processors have had and continue to have over the Federal Milk Marketing Order Class III prices in contiguous states, even after the inclusion of the dry whey factor. Number two, as of January of 2006, their competitive advantage increased to .7475 cents, according to the Department's analysis of the California 4b Federal Milk Marketing Order Class III prices.

According to the 2003 study by the USDA's Economic Research Service titled Concentration and Structural Change in the Dairy Processing and Manufacturing, "Whey and its products have emerged as a serious competitor to nonfat dry milk for uses in foods over time." The study further states that since the 1970s "whey has made significant progress as a substitute for nonfat dry milk in various food uses." In fact, whey has also replaced nonfat dry milk in some other non-dairy food categories, including prepared mixes and confectionary. We believe the milk pricing system should be more market oriented and, therefore, the whey value should remain in the formula because it holds significant value in the marketplace.

Dairy producers have the right to be compensated for the whey they produce. The total solids in milk are close to 12 pounds in the 100 pounds of milk. The amount of lactose and the small amount of fat and protein that become whey is almost one half of all the solids the cow produces. Not to account the value for that much volume would be an injustice for a system of end-product pricing. Dairy producers for some time did not receive a fair return on this value, while processors have been receiving at least a dollar for the whey value since 2003. Attached please find a chart that shows the amount processors received for the whey value compared to the amount producers received. And that would be Attachment 1a.

Due to the fact that many dairy producers do not have any other choices about where to sell their milk, many continue to sell their milk to F&A Dairy and other processors on the ineligible list from the Milk Producers Security Trust Fund. The fund was created to protect producers from handlers who defaulted on their payments.

However, there are no real repercussions for a processor when it's placed on the ineligible list, while there are real impacts to producers who are unable to sustain their operations without income from their milk sales.

F&A Dairy and other cheesemakers supporting its petition claim cheese manufacturers are facing an economic crisis due to the current 4b milk pricing formula. We strongly disagree with the claim that cheese manufacturers do not realize the full revenue attributed to them in the 4b formula. F&A dairy produces higher moisture cheese like mozzarella rather than low moisture cheese used in the 4b formula. In fact, cheese producers who produce higher moisture cheeses, like F&A Dairy, profit from greater cheese yields than those included in the 4b formula that is based on the price of cheddar cheese, one of the least profitable cheeses sold in the market today. To meet USDA specifications, cheddar cheese must contain 37 to 38 percent moisture. However, USDA specifications for mozzarella cheese allow 52 to 60 percent moisture. Cheese manufacturers are benefiting from a significantly higher yield than the cheddar yield included in the 4b formula.

We believe that the 4b formula should be based on the current market demand and prevailing market prices. Mozzarella is the cheese that is the highest demand, accounting for 47 percent of the cheese market, which equates to 15 percent of all milk produced. Therefore, we believe that the 4b price should be based on the mozzarella or that a new price be formed to better reflect today's cheese market. Incorporating mozzarella into the 4b formula would also ensure that current moisture levels are reflected in the price that producers receive. Processors have realized the profitability of mozzarella cheese at the expense of dairy farmers. Today half of the plants in the state are mozzarella plants. We believe producers should be able to realize the profitability of this product as our end-product pricing formula intended. Again, according to the USDA Economic Research Service study, until 1998 American cheese varieties, including cheddar, were the majority of cheese production in the United States. Since 1998, other than American cheese production has continued to grow relatively rapidly. Italian cheese accounted for just over 72 percent of other cheeses in 2001 and, in turn, mozzarella was the largest share of Italian cheese produced. Again, according to the study, proprietary firms, like Leprino, are the larger producers and marketers of this fast-growing cheese type.

According to the CDFA publication "Why is Milk regulated?" prior to state or federal government's involvement in milk markets, a smaller number of large, well-organized processor/handlers controlled milk price negotiations. We contend that the current state of the dairy industry today is similar to the situation in the 1930s when a small number of processors controlled milk price negotiations. Although today there are pricing formulas to ensure producers receive minimum prices, producers have fewer and fewer choices about where to sell their milk due to the concentration and consolidation that have occurred throughout our industry.

Concentration of dairy processing and manufacturing firms has been notable in recent years and has now altered now traditional wholesale markets function. The Chicago Mercantile Exchange, CME, which serves as the basis for our cheese price, is a thinly traded market that enables large processors to manipulate prices. In June of this year, the General Accounting Office, GAO, published a report on the spot cheese market and found that the thinness of that market combined with other factors contribute to questions about possible price manipulation.

According to the USDA Economic Research Service, "Spot markets for the major bulk storable dairy products have long been a cornerstone of dairy markets and programs. However, traders increasingly are bypassing these key markets, a trend accelerated by increasing concentrations of both sellers and buyers in recent years. Large firms generally prefer tailored flows of products of absolutely consistent quality, something that is most easily assured through contracts. Large manufacturers and large users may well find it mutually advantageous to produce product to custom specification, keeping that product from ever being traded on any spot market. Concentration creates problems for spot markets beyond simply removing product volume. Not only are there fewer traders, but individual decisions become more potent. Decisions by a very large firm can have a significant effect on spot prices, even if that firm does no spot trading."

In our system today, large processors are able to manipulate our market by keeping producer prices artificially low. Far more must be done to address the concentration of the dairy sector that has allowed much of the market manipulation and led to an increased consolidation which is harming both producers and consumers. Producers should not be held liable for the adverse effects of increased consolidation that is harming smaller processors, producer, and consumers.

CDC supports the proposal included in the petition put forward by the Alliance of Western Milk Producers, Milk Producers Council, and Western United

Dairymen calling for CDFA to implement a snubber on the dry whey component of the 4b formula to prevent the whey component from becoming negative. We further support their efforts to address the potential cost of the inclusion of the dry whey component in the formula to smaller plants that are not capable of processing whey.

CDC opposes the petition put forward by the Dairy Institute that would lower producer prices by 28 cents per hundredweight. And we further oppose the petitions put forward by Land O'Lakes, CDI, and Humboldt.

I'd like to make a comment that's not in the written testimony.

Due to the 14-year cost advantage again on the 4a price compared to Federal Milk Marketing Order Class III of 22 cents and, more importantly, the $1.16 price advantage over the last twelve months, again California processors are at a serious price advantage over their competition to the east. To further distort this price advantage by increasing this disparity would be a travesty, taking more away from the value that's currently being paid to California producers.

Producers throughout the state will continue to work to recover from the 17 months of prices that were well below their cost of production. Perhaps the greatest complaint that I hear from producers regarding today's hearing is the simple fact that they are not able to recoup their rising costs under the current system. They cannot appeal to CDFA when their input costs rise, as they continued doing so for so many months of low prices. Today's higher prices are enabling producers to gain some ground that they lost during those 17 months when their prices were 30 percent below cost of production. But most have a long way to go due to the extreme loses that they incurred. According to the Department of Food and Ag website, the Dairy Marketing Branch and Milk Pooling Branches work together to administer a regulated dairy program structure that is fair to all parties involved. I'd have to ask where was that fairness a few months ago? I urge members of the Panel to uphold this important goal as they consider the petitions put forth and before them today.

In conclusion, we oppose any petitions put forth to the Department today that would lower the 4b prices paid to producers. Cheese processors, including F&A, have ample opportunity to profit in today's marketplace due to the higher yields achieved in manufacturing of high moisture cheeses, including mozzarella and pizza cheeses. Producers should be compensated in the 4b formula for dry whey because it holds considerable value in the market.

We would like to also request an opportunity to submit a post-hearing brief.

Thank you.

HEARING OFFICER LOYER: Granted.

Is there any further testimony?

MR. MAGNESON: No.

HEARING OFFICER LOYER: Any questions from the panel?

PANEL MEMBER GATES: I just have one.

Kevin, can you define for me what market orientated means to your organization?

You outlined in your testimony -- at one point you said you're in favor of market orientated prices. So I wasn't sure what that meant.

MR. MAGNESON: Well, market oriented would be -- could be a lot of different things. But a price that is derived based on market conditions but also negotiated with the cost of production that producers have involved also. I mean there's several factors in the cost of production. A producer's cost of production should be a factor in that. Also the surrounding states' price --

PANEL MEMBER GATES: So you're not speaking --

MR. MAGNESON: -- is relevant.

PANEL MEMBER GATES: So you're not speaking to deregulation at all?

MR. MAGNESON: No.

PANEL MEMBER GATES: Thanks.

HEARING OFFICER LOYER: Okay. Hearing no further questions.

Thank you, gentlemen.

And I will call on next Robert Vandenheuvel. Excuse me if I mispronounced your name.

MR. VANDENHEUVEL: Vandenheuvel.

HEARING OFFICER LOYER: Vandenheuvel, yes.

I'm marking the testimony of Mr. Vandenheuvel as Exhibit 61.

(Exhibit marked.)

HEARING OFFICER LOYER: Sir, would you please state your full name and spell your name for the record.

MR. VANDENHEUVEL: My name is Robert Vandenheuvel, R-o-b-e-r-t, V-a-n-d-e-n-h-e-u-v-e-l.

HEARING OFFICER LOYER: Thank you.

Do you swear or affirm to tell the truth and nothing but the truth?

MR. VANDENHEUVEL: Yes.

HEARING OFFICER LOYER: And are you testifying today on behalf of an organization?

MR. VANDENHEUVEL: Testifying on behalf of the Milk Producers Council as its general manager.

HEARING OFFICER LOYER: Okay. And please identify the process by which your organization finalized your testimony today.

MR. VANDENHEUVEL: This testimony has been approved by the board of directors at our October meeting.

HEARING OFFICER LOYER: Thank you.

You may proceed.

MR. VANDENHEUVEL: Thank you.

It's been a long day, so I'll try to get through this as quickly as possible.

Ms. Hearing Officer and members of the Panel. My name is Rob Vandenheuvel. I represent Milk Producers Council. We're a producer trade association with an office located in Chino, California, and approximately 100 dairy members located primarily in southern and central California.

The Secretary called this hearing in response to a petition submitted by the specialty cheese makers who contend that the current 4b formula must be radically changed by eliminating any producer value for the whey solids because they're unable to capture positive whey solids value from the market.

In an August 21, 2007, letter to the Secretary opposing the call of this hearing, MPC pointed out that while the specialty cheesemakers may be limited in the value they can derive from the whey solids stream, they are able to capitalize on the fact that they are selling a specialty cheese product that has a substantially higher market value than the 40 pound block size of cheddar cheese, which is the product value that sets the Class 4b price. We still assert that the specialty cheesemakers do have the ability to recover higher costs -- higher values from their cheese because their products are worth more and should therefore normally be able to pay the minimum price established by the current 4b formula. Therefore, we adamantly oppose the petitioners' proposal to eliminate a positive value for the whey solids portion of the Class 4b formula.

That being said, we recognize that the dry whey market has been anything but normal over the past six months. We appreciate the price shock that cheese plants have faced. Producers too have experienced sticker shock this spring, as hay and grain dealers explained the new price realities of the feed market to them.

MPC also recognizes that in the past two class 4b hearings, the Hearing Panel has been very sympathetic to the arguments of cheesemakers regarding not paying producers for the value of whey solids. MPC, as well as all producer groups in California, strongly believe that producers are entitled to a share of the value derived from whey solids. The prices paid for whey solid products over the past six months should prove once and for all that there is a real and substantial value to the whey solids derived from cheese making activities.

MPC has asserted and continues to assert that Section 62062 and Section 62076 of the Food and Agricultural Code, under which California's minimum milk pricing formulas are established, require that producers receive a share of the value earned on milk we produce because of the net value of those products and in order to keep CDFA-established milk prices in a reasonable and sound economic relationship with the national value of milk for manufacturing purposes.

We recognize that the challenge is how to appropriately construct a formula that will equitably distribute these real whey solid values to producers. Dry whey powder has historically been viewed as the lowest value whey solids product and therefore the proper surrogate for determining a net value for the whey solids stream. The Federal Milk Marketing Order program set the pattern for this when they adopted a dry whey value in the Milk Marketing Order Class III formula.

So what should we do given the realities of this hearing? In an effort to offer a compromise that will address the small cheesemakers' concerns, Milk Producers Council collaborated closely with our producer colleagues and developed a unified producer alternative proposal. In our memory, this is the first time since 1997 that this large a share of the producer community has joined together on a major milk pricing issue facing our industry.

The Unified Producer Proposal:

This proposal would establish a credit against the Class 4b pool obligation for every pooled cheese plant in California, equal to the net value of the whey solids portion of the Class 4b formula price for the equivalent of up to two loads of milk per day. According to data supplied by CDFA, this pool credit would completely relieve 35 of California's 60 cheese plants from paying for the value of the whey solids. It would also represent substantial relief for a number of other plants. In our view, this is a very fair offer. What we seek in exchange is a snubber that will prevent the whey solids value for producers from becoming negative and a whey solids make allowance that is more reflective of national norms with regard to the cost of drying whey.

The current dry whey make allowance of 26.7 cents per pound is substantially higher than the 19.76 cents per pound weighted average dry whey processing cost testified to by Dr. Mark Stephenson at a recent Federal Milk Marketing Order hearing. Dr. Stephenson is employed by Cornell University's Program on Dairy Markets and Policy and submitted his processing cost study results at an FMMO hearing in Pittsburgh, Pennsylvania. The study primarily reflected costs incurred by whey processing plants during calendar year 2006. A written copy of his testimony is attached.

I'd add, that's attached to the back of this testimony.

A prior cost study done by Mr. Stephenson had shown a dry whey manufacturing cost of 19.41 cents per pound. Based in part on that prior study, USDA established a dry whey make allowance at a 19.56 cents per pound for the FMMO Class III formula which went into effect on February 1, 2007. The current CDFA cost study, which shows a nearly 31 cents per pound, is clearly extreme and not a valid guide for setting a make allowance. Very little of the whey stream from California's cheese plants is processed into dry whey, and therefore California cost studies for dry whey are skewed. A much larger proportion of the whey stream is processed into the historically higher value whey protein concentrate products for which standardized yields and costs are not known by the Department or to the general public.

A substantial part of the difference between the California Class 4b price and the Federal Order Class III price can be attributed to this vast difference between the make allowance for dry whey in the two formulas. Our belief is that part of the reason CDFA adopted such a generous make allowance is to act as an incentive to expand cheese plant capacity in California.

No doubt, much has been said in this hearing about the need for expanded processing plant capacity in California. We reluctantly admit that some incentive to expand processing capacity is probably needed. But minimum producer price reductions applied across the board are not an efficient way to incentivize new plant capacity.

Support for the CDI Proposal:

The Milk Producers Council board has discussed the CDI proposal to establish an incentive for new plant capacity in the state. CDI is proposing that a pool credit equal to 50 cents per hundredweight be granted to new and expanding plant capacity for the first three years of their operation. MPC is willing to support this proposal in exchange for a continuance of a whey solids value in the 4b formula coupled with a reduced dry whey make allowance. In our view, this would constitute good public policy. As a policy, make allowances should reflect normal costs, and incentives for new plant capacity should be targeted and transparent.

In our view, CDI has offered a way for the Department to address the issue of plant capacity without significantly diminishing producer income. Other proposals which simply seek to slash producer income may work for a while, but when the inevitable collapse of butter, powder, cheese, and dry whey prices occurs, the generous make allowance asked for today will come back to haunt producers in those dark days. While $20 milk will solve many problems for producers, we would be foolish to think that this situation will continue long term. We must ensure that any plant capacity incentive be as efficient as possible. We urge the adoption of the CDI proposal.

Opposition to the Humboldt Proposal:

Producers should not be asked to subsidize small commodity butter, powder and cheese plants. Small plants were established because they found a market niche. The whey issue is separate, and we have addressed that in our alternative proposal. Humboldt Creamery has been in business for decades and should be fully capable of recovering the costs of processing under the current make allowance policies. Their proposal for special treatment should be denied.

The Dairy Institute, Land O'Lakes, and CDI Make Allowance Proposals:

From time to time MPC understands that make allowances and price adjusters need to be modestly modified to keep up with the most current cost and pricing data. MPC does not object to modest cost-justified adjustments to these factors as long as they are consistent with the alternative proposal we made above.

Finally, the Milk Producers Council Class 4a Proposal:

For the record, MPC reminds the Department that our proposal to change the product value in the Class 4a formula from the current California weighted average, or CWAP, price to the average of the Mostly Western Nonfat Dry Milk Price as reported in the Dairy Market News is still under consideration as part of the August 28th hearing for which there's been no finding as of today. MPC reiterates our support for that proposal for the reasons outlined in our testimony of August 28, 2007, and our post-hearing brief following that hearing.

In Conclusion:

This is the worst possible time for producers to be facing a hearing like this one. Milk prices are high, production is increasing. The cheesemakers are complaining and the temptation to stick it to producers is great.

Producers were facing a similar situation in the early 1980s. Milk prices were high, production was increasing, and plant capacity was an issue.

But there are some differences now that must be recognized. The milk price run up in the early '80s was stimulated and backed by the federal government's support price program. The industry was assured, foolishly, that the government would purchase all of the butter, powder and cheese offered to it at what turned out to be a very profitable price.

Today, it is a strong export market for powder that is driving milk prices. How long will it last? How wise is it to really gear up for a major expansion of milk production in California? Yes, today production is up. Milk Producers Council is supporting both some relief for the specialty cheesemakers and CDI's plant capacity incentive. But these are moderate measures, not extreme measures.

Twenty-five years ago cooperatives were not as strong as they are today. Now virtually all milk in California is under cooperative control. It is these cooperatives that either need to build the capacity or apply some long overdue discipline to their members. The State of California can no longer take on the responsibility to find a California home for every gallon of milk any California producer wants to produce.

Moderate measures made in accordance with the law are what are called for as a result of this hearing. Milk Producers Council and our fellow producers have outlined such changes.

Extreme changes, such as those proposed on behalf of some cheese plants today, would result in significant differences between the California and Federal Order price formulas, and they cannot be legally or morally justified.

We urge the Secretary to adopt our proposal.

Thank you for the opportunity to testify. And I respectfully request the opportunity to file a post-hearing brief.

HEARING OFFICER LOYER: That's granted.

And are there any questions from the panel?

PANEL MEMBER GOSSARD: On page 2 of your testimony you site two Cornell studies, the more current one that shows average whey cost of 19.76 and the prior one that shows whey cost of 19.41.

Could you review that second study. I believe they have whey costs for plants of different size. And could you in your post-hearing brief compare those size and cost to the size and cost of our California plants?

MR. VANDENHEUVEL: Yes.

PANEL MEMBER GOSSARD: Thank you.

No further questions.

HEARING OFFICER LOYER: Does anyone have anything further for this witness?

Okay. Hearing nothing, the witness is excused.

Thank you.

I'd like to call Jay Wilverding.

This may be the last witness today.

MR. WILVERDING: And I'll keep it nice and short.

HEARING OFFICER LOYER: Mr. Wilverding's testimony is marked exhibit 61.

Excuse me. Correction. 62.

(Exhibit marked.)

HEARING OFFICER LOYER: Sir, could you please state and spell your full name for the record.

MR. WILVERDING: My name is Jay Wilverding. And my name is spelled W-i-l-v-e-r-d-i-n-g.

HEARING OFFICER LOYER: Do you swear or affirm to tell the truth and nothing but the truth?

MR. WILVERDING: Yes, I do.

HEARING OFFICER LOYER: And are you testifying today on behalf of an organization?

MR. WILVERDING: Yes, I am. I'm testifying on behalf of Andrew Branagh, who's the Founder and President of Mozzarella Fresca, headquartered out of Concord, California, who's at a prior commitment in New York today.

HEARING OFFICER LOYER: Okay. And please state your affiliation for the record.

MR. WILVERDING: I am the Corporate Controller of Mozzarella Fresca.

HEARING OFFICER LOYER: Okay. And please identify the process by which the organization finalized your testimony today.

MR. WILVERDING: It was drafted by Andrew Branagh.

HEARING OFFICER LOYER: Thank you.

You may proceed.

MR. WILVERDING: And we appreciate the opportunity to present our position at this hearing today.

HEARING OFFICER LOYER: Thank you.

MR. WILVERDING: Mozzarella Fresca is a stand-alone California cheese corporation that's wholly owned by the larger national and worldwide Groupe Lactalis. Mozzarella Fresca has been producing cheese in California since 1995. In 1995, our annual sales were under a million dollars. We have grown our sales almost 30 percent per year. In early 2007, we estimated that we had grown to become possibly the largest fresh mozzarella manufacturer in the United States. Since early 2007, with the high price of milk, our sales have stalled. We are no longer able to promote. We're no longer able to invest in an aggressive sales program. We are no longer able to reinvest in our manufacturing base. Mozzarella Fresca is now posting monthly sales that are much lower than our traditional annual monthly growth trend has been.

If there was a shortage of milk in California or the Western States, we could understand the high prices and resulting constricted demand from the consumer and, finally, from the production plants. However, as is evident, the exact opposite is true. The California dairy industry's most pressing problem is too much milk. Now that we are moving out of the traditionally lower milk production summer season and will soon be facing the spring flush, can we in this hearing imagine the amount of milk our industry will be facing this coming spring?

For 2008, Groupe Lactalis, our parent, has a planned expansion budget of just under $8 million earmarked for our Tipton, California, plant. The projects include a second pasteurizer, a new ricotta room, new cold and dry storage buildings, an ultra-filtration system, and even a new parking lot for employees we may eventually hire.

The first priority of Mozzarella Fresca is to invest back into the Tipton plant, invest in promotions, invest in our sales team and our employees. However, we are now faced with a question of where is the best location for Groupe Lactalis to make the cheese.

Groupe Lactalis has a total of five manufacturing plants located throughout the United States. This past summer, Mozzarella Fresca transferred almost 6 percent of our total cheese production to our Nampa, Idaho, facility. And now with the present California milk pricing system, we have undertaken a comprehensive cost benefit study to determine if the planned Tipton capital investment is appropriate, or if the capital should be deployed in another manufacturing facility. If a more favorable milk pricing formula decision is made as a result of this hearing, Mozzarella Fresca will be encouraged to move forward with the planned Tipton plant expansion, thereby keeping the plant a viable investment for Groupe Lactalis and creating jobs in California. We note that we closed our Turlock plant this past June and moved the cheese production out of state.

In December of 2005, Mozzarella Fresca made the decision to install a large whey evaporator. The evaporator became operational in January of this year. Upon operation, Mozzarella Fresca partnered with a company to utilize our condensed whey as a manufacturing ingredient. While this was a beneficial undertaking from our part, we are recouping a mere 18 percent of the revenue that we would have received if we had been able to install a whey drier. Unfortunately, we have been unable to raise the capital required to install the drier. Please keep in mind that the capital required to install a drier is tremendous. In order to make such large investments economical, a certain amount of volume must be present. To illustrate that point, please note that of 60 cheese plants in California, there are eight cheese plants with food-grade operational driers. Without a drier, we are unable to realize the revenue stream that is assumed in the logic of the present milk formula, which includes a whey factor.

To further explain the situation facing the California dairy industry, let us go back to our existing whey partnership I mentioned earlier. The company with whom we have partnered is Calva Products. Calva Products is one of the larger milk replacer animal feed companies in the Western United States. Calva purchases our condensed whey as a primary ingredient in one of their proprietary milk replacer formulas. Over the last month, they have ordered only one-quarter of their product needs from our company because their customers are receiving milk from many local co-ops for $4 per hundredweight. There is so much excess milk in California that producers can't find production homes for the milk and are discounting it or dumping it. There is an obvious need to encourage investment in milk processing facilities in the state to help meet customer demand and the continued expansion of milk production.

We promise the producers at this hearing and the Department that Mozzarella Fresca will reinvest in our plant and consume significantly larger volumes of milk and thereby return a dramatically better value to the producers if we can procure milk at a more reasonable economic price.

Jim Cook is the President of Calva, Inc. We quote him: "In my years of running Calva" -- which has been since 1974 -- "I have never seen a more destructive cycle than we have witnessed over the last three years. This state is swimming in milk. I can't imagine an industry that can't or hasn't recognized the direct relationship between supply and demand."

In summary, Mozzarella Fresca and Groupe Lactalis first support the Dairy Institute proposal and then secondarily support the F&A, et al., proposal. Our inability to capture the protein whey value puts us at a distinct economic disadvantage. We are ready and willing to expand in California if we can obtain more favorable milk pricing. Without this commitment, we have the ability to produce in other locations and may utilize our other plants. The huge surplus of milk in California that is being diverted to animal feed, out of state, or out of the country has destroyed our only path to recoup some of the lost protein revenue. We recognize that the Department has hard decisions to make in each of these proposals presented at the hearing. We would ask that the Department consider the conditions as they exist today and the very real fact that we must encourage the growth of our dairy processing capacity in California.

HEARING OFFICER LOYER: Are there any questions from the panel?

PANEL MEMBER LEE: Yes, I have one.

You say that you support the F&A proposal and the Dairy Institute proposal.

What are your feelings regarding the Alliance's proposal on the credit?

MR. WILVERDING: I would prefer to reserve comment on that, and would like to file a post-hearing brief, after I've had a chance to talk with my boss.

PANEL MEMBER LEE: Thank you.

HEARING OFFICER LOYER: Request for the post-hearing brief is granted, by the way.

MR. WILVERDING: Thank you.

PANEL MEMBER SHIPPLEHOUTE: I have a question.

In your testimony you indicate that a certain scale of volume must be present in order for a drying facility to be viable. There was some testimony earlier on the volume of whey that would be required to have a drier be economically viable.

Do you have any thoughts on what that number should be or that the number presented earlier is accurate or --

MR. WILVERDING: All that I can say is that we were internally developing a project proposal for Groupe Lactalis for a drier and they squashed the project last summer. I know that doesn't give you any numerical data.

Again, I'm not sure that would be information I should be releasing at this point. I don't know what's proprietary or not.

PANEL MEMBER SHIPPLEHOUTE: All right. Thank you.

HEARING OFFICER LOYER: Are there any further questions from the panel?

PANEL MEMBER IKARI: I have one.

MR. WILVERDING: Yes, sir.

PANEL MEMBER IKARI: If you're going to file a post-hearing brief, I wondered if you could elaborate a little bit.

MR. WILVERDING: Sure.

PANEL MEMBER IKARI: There could be a lot of reasons why you transferred some of your production to out-of-state facilities. Could you go into that a little bit in your post-hearing brief?

MR. WILVERDING: Yes.

PANEL MEMBER IKARI: Were those old plants? Were they -- what's the difference in raw product costs?

Also, on your Turlock plant this June that moved production out of state.

MR. WILVERDING: I will take care of that.

PANEL MEMBER IKARI: Thank you.

HEARING OFFICER LOYER: Anything further?

Okay. Thank you.

That will conclude our testimony for today. We will reconvene tomorrow in this room at 8:00 in the morning.

In the event I have failed to admit any document, all documents that have been marked as exhibits so far are hereby admitted into evidence.

In your request to file a post-hearing brief, if I failed to adequately respond, are granted.

And we'll see you in the morning.

We're off the record.

(Thereupon the Department of Food and
Agriculture Market Milk Hearing recessed
at 4:22 p.m.)

CERTIFICATE OF REPORTER

I, TIFFANY C. KRAFT, a Certified Shorthand Reporter of the State of California, and Registered Professional Reporter, do hereby certify:

That I am a disinterested person herein; that the foregoing hearing was reported in shorthand by me, Tiffany C. Kraft, a Certified Shorthand Reporter of the State of California, and thereafter transcribed into typewriting.

I further certify that I am not of counsel or attorney for any of the parties to said hearing nor in any way interested in the outcome of said hearing.

IN WITNESS WHEREOF, I have hereunto set my hand this 17th day of October, 2007.

TIFFANY C. KRAFT, CSR, RPR
Certified Shorthand Reporter
License No. 12277