

Post Hearing Brief of
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Related to

Consolidated Public Hearing
Considering Amendments to the Stabilization and Marketing Plans
And
Considering Amendments to the Pooling Plan for Market Milk

Held

Oct 10 and 11, 2007

The Alliance of Western Milk Producers appreciates the opportunity to submit this post-hearing brief. We opened and closed our testimony with the argument that “whey has value” and some of that value should be included in the Class 4b formula. That continues to be our position. However, we also recognized that the formula did not perform well in the first half of 2007 for two readily identifiable reasons. They are the small plant problem and the price inversion problem.

Small Plant Problem

The small plants that process less than 100,000 pounds of milk a day into cheese face the unfortunate situation that any investment in a whey ‘end product’ facility is simply not economically feasible. Their volume is not adequate to carry the investment. Thus the value of whey being added to the Class 4b price adds cost to their milk price that they cannot recover from the market. For these smaller plants we offered a full credit of the whey value included in the Class 4b price. The idea was dismissed by every original petitioner that testified as being “too little too late” or as too narrowly focused on the “extremely small processor”. Apparently the 35 smaller plants did not appreciate how helpful the credit would be to them because not a single one testified in favor of our proposal. Nonetheless that lack of comment does not lessen the validity or the value of our offered credit. It completely removes the problem for 58% of the cheese plants in the state.

As completely as I can remember the proceedings not a single proponent of the removal of whey from the Class 4b formula even commented upon the value of the credit to the medium sized plants. It is however a significant factor. If whey prices next year follow the existing futures price for dry whey the benefit to any plant processing more than 100,000 pounds of milk per day is estimated to be \$28,500 per month and this amount could support the interest payments on a \$4.5 million investment. This would be a

significant incentive to the midsized plant to add, expand or up-grade their whey processing facility.

In our joint proposal with Western United Dairymen and Milk Producers Council, we provided a good faith compromise that solved the problem of the small plants just as effectively as would the removal of the whey component of the formula. It is worth noting that there were no compromise positions offered by the proponents.

Price Inversion Problem

Although rarely mentioned by those testifying at this hearing the only legitimate complaint of the larger cheese plants that produce products other than dry whey is that the price of dry whey increased disproportionately to the prices of whey protein concentrate (WPC). The choice of dry whey as the basis of valuing whey is based on the understanding that dry whey is the lowest value whey product and that all other whey product options will generate greater income. This view was nearly always true prior to November 2005 at which time the value of the protein in dry whey exceeded the value of protein in WPC 34. That remained the case until August 2007. The net result was that the value attributed to whey in the Class 4b formula was, at times, greater than what could be recovered in the WPC product mix. Because of the lack of cost data we cannot be sure that the added milk value was greater than the value recovered in WPC but we can be sure that margins were reduced.

To address this value inversion, we propose an industry meeting to deliberate about a new Class 4b formula that will prevent this from happening again. The dry whey and WPC values at this moment are in normal alignment, and the potential for price inversion does not appear likely to happen again any time soon. However, that it did happen before indicates that it could happen again. It makes sense to correct the formula. It is not the desire of the producers of this state to ever have the formulas cause processors to lose money. In the long run that would be suicide for our industry. On the other hand, producers cannot be held responsible for those unavoidable brief periods when inventory value adjustments must be dealt with. The producers have been willing to assure the profitability of the processor side of the industry through the make allowance, and they rightfully expect to have recognition of the underlying value of their milk ingredients included in the price formulas.

The issues to deal with are certainly more complex than those involved in the other commodity products but they are not 'intractable'.

Conditions Precedent to Successful Industry Meeting

First, and most important, is that all parties must arrive with a genuine desire to resolve the issue. For example, if the result of this hearing is that the whey component of the Class 4b formula is removed (or suspended) then those who have the most detailed knowledge to share (the cheese makers) will have little incentive to participate in a meaningful way.

Second, any such meeting must be based on a clear statement from CDFA that whey does have value that should be included in the Class 4b formula and that the meeting purpose is to determine how that value should be calculated.

Third, establishing a credit for those plants too small to justify any investment in whey processing would correctly narrow the focus of the meeting on those whose size is large enough to justify whey processing investment.

Fourth, call for specific proposals from industry to be evaluated by the committee because a great deal of committee time can be wasted without something to focus discussion.

Fifth, the group must be doing its work at the request of CDFA and have its membership carefully selected to give balanced representation to the interested parties. The committee should also have access to the staff of CDFA to provide data and analysis. The Chair of the group should be from the Department or be a knowledgeable academic without an interest in the outcome (or a vote).

It is very likely that such a committee would be able to consider all the complex data and derive from it a formula that would establish a minimum value for the whey component that would be fair to all industry participants.

Submitted Oct 17, 2007 by William C. Van Dam

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