

Dairy Institute

Of California

October 16, 2007

Mr. David Ikari, Chief
Dairy Marketing Branch
California Department of Food and Agriculture
560 J Street, Suite 150
Sacramento, CA 95814

RE: October 10-11, 2007 Class 4a and 4b Hearing -- Post Hearing Brief

Ms. Hearing Officer and Members of the Panel:

Dairy Institute appreciates the opportunity to submit the following post-hearing brief to amplify portions of our testimony presented in Sacramento on October 10th and 11th, 2007. The paragraphs that follow build on the propositions that we put forth in our testimony.

Can You Provide More Detail About The Over-Supply Of Milk In California?

The panel asked for source materials and more detail related to our assertion that milk was leaving the state and that some milk was not being marketed. The source of our information was the fluid milk market summaries from the weekly Dairy Market News reports issued by USDA. We have attached the summaries as they pertain to the California milk market for 2005 – 2007 (Attachment 1). We have also attached a table which chronicles the number of weeks where milk plants had difficulty handling all the milk produced, as well as the reports of milk moving out-of-state and milk not-being marketed (Attachment 2). Also attached is a letter from Nestle, which details the difficulties that handler has had managing their milk flows in recent weeks (Attachment 3).

Is There An Acceptable Compromise Position On Dry Whey?

The Panel asked whether there was an acceptable compromise position laying somewhere between the cheesemaker petitioners' request and the producer proposal put forth by the Alliance of Western Milk Producers, *et al.* We believe quite firmly that the premise of this question is not appropriate. While the Department has maintained in past hearing decisions that it must balance the competing interests of producers, processors, and consumers, it is also required by the legislature to base its pricing decisions on a defined set of *economic* principles (Food and Agricultural Code Section 62062). Therefore, the producer, processor, and consumer interests that must be balanced are their economic interests, not their various "wish lists." The Secretary must do as directed by the

legislature and establish pricing formulas that are appropriate for the current economic conditions that exist in the marketplace. The legislature has not directed the Secretary to establish prices by selecting some arbitrary position somewhere between the revenue wishes of the dairymen and the milk cost wishes of the processors. The relative economic merits of the proposals must be evaluated, and the Secretary's decision must be based on the proposal that most adequately addresses the economic factors found in statute. There was ample evidence at this hearing that current economic conditions are characterized by growing milk output, inadequate plant capacity in the state, and milk leaving the state to find processing homes. The situation will not improve in the coming year, but will likely worsen as milk production continues to grow and net plant capacity does not.

The testimony of producer witnesses illustrates this point quite well. The Alliance witness stated that the whey factor had contributed one billion dollars to producers through the Class 4b formula since it was first introduced in 2003. If producers had not received all of this revenue, economic theory and common sense would suggest there would have been less investment in dairy cows and other milk production assets, and more money available for cheesemakers to invest in plant capacity. To the extent that cheesemakers were able to earn positive revenues on their whey operations, a portion of that money would have found its way back to dairymen in the form of premiums, while the remainder would have been available to the plant operators for reinvestment in their businesses. The net outcome for the industry, had the dry whey *not* been in the formula since 2003, is that milk supply would have been less and plant capacity would have been greater, and the market would be in balance. Under the current formula, it is not.

The Alliance witness also noted that eliminating the dry whey factor in calendar year 2007 (a year of extraordinarily high dry whey prices) would have cost producers an average of \$160,000 per dairy. These numbers should be placed in some context. The milk revenue for the average California dairy in 2006 was approximately \$2,275,000 according to data from USDA's *Milk: Production, Disposition and Income* report. Based on the ratio of the 2007 4a and 4b prices to 2006 4a and 4b prices, it can be reasonably expected that the milk revenues of the average California dairy in 2007 will be approximately \$3,500,000. Therefore, elimination of the dry whey factor in 2007 would have had the same net result as a drop in the average milk price of about 4.6%, and would send a much needed signal to dairymen to curtail production. We note that so far in 2007, producers have seen an increase of 53 % in 4a and 4b prices compared to 2006. Again, it is no wonder that some cheese plants are having severe financial difficulties when so much of their revenue stream have been diverted to milk producers over the last 4 ½ years.

We disagree with producer assertions that CDFA need not concern itself with the adequacy of existing plant capacity. An examination of all the statutes governing milk pricing in California would lead any reasonable person to conclude that the legislature has required the Secretary to examine whether there is adequate plant capacity as it is one of the most relevant economic factors to be considered in establishing the pricing formulas of the various classes of milk.

If the state wishes to encourage investment in plant capacity in California, the industry must receive a clear signal from the Department. Adoption of the Alliance *et al.* proposal will send a clear signal. It will tell the industry that cheese plants are not welcome in California (unless they are very small). Adoption of the cheesemaker petition or the Dairy Institute alternative proposal will send a clear signal that the Department is prepared to take the steps necessary to ensure that cheesemakers investing in California will be able to make a return that will justify the scale of the investment they will be required to make. Adoption of a “compromise formula” or “middle ground” will send a muddled signal to the industry and will not give cheesemakers the confidence in the regulated system that they need in order to justify the investment expense of operating in California. The regulated milk price level is one of the primary factors plant operators examine when determining where to invest. Gimmicks like new plant investment credits or credits for small milk purchase volumes will not encourage plant investment, nor do they treat all plants equitably. They also fail in that producers receive virtually no signal to reduce their milk output. A regulated milk price level that is low enough to allow plants to make a reasonable return is the only viable policy tool that the Department has to encourage new plant investment and to foster orderly marketing and intelligent production of milk given the current market conditions in the state’s dairy industry.

Are the Proposed Pool Credits Authorized by Legislation?

Our analysis of the statutes contained in the California Food and Agricultural Code lead us conclude that the pool credits proposed by the Alliance *et al.* and California Dairies Inc. (CDI) are not authorized by the legislature; and therefore, adoption of these proposal would violate state law. We have attached a legal analysis of this issue by Dairy Institute Legal Counsel, John M. Lemmon (Attachment 4). We again urge the Department to reject these proposals.

Do The Milk Pricing And Pooling Statutes Allow For Different Raw Product Costs To Competing Handlers?

Section 61805(b) of the Food and Agricultural Code (the Code) contains the following language: “...In determining minimum prices to be paid producers by handlers, the director shall endeavor under like conditions to achieve uniformity of cost to handlers for market milk within any market area. *However, no minimum prices established or determined under this chapter shall be invalid because uniformity of cost to handlers for market milk in any marketing area is not achieved as a result of the minimum prices so established or determined*” (*emphasis added*). Furthermore, Section 62720 of the Code contains the following: “No pooling plan formulated pursuant to this chapter shall restrict the free movement of fluid milk and no pooling plan shall result in unequal raw product cost between distributors in the same marketing areas.” Section 62723 (a) of the Code clarifies Section 62720 noting that: “The terms distributor and processor shall have the same definition as the term handler contained in Section 61826.”

Taken together, these Code provisions would seem to preclude the kinds of amendments that have been suggested by CDI and the Alliance *et al.*, but for the qualifying language at the end of Section 61805 (b) as shown in *italics* above. However, the qualifying

language was added subsequent to the establishment of milk pooling for the explicit purpose of not invalidating the limited exception to the equal raw product cost requirement that the legislature allowed type 70 producer handlers (See Section 62708). Absent any other statutory directive from the legislature, any pooling plan or pricing formula that would result in unequal raw product costs to competing handlers (other than in the case of producer handlers) would violate state law.

Thank you for the opportunity to submit this post-hearing brief.

Sincerely,

William A. Schiek
Economist

Attachment 1

2005 Dairy Market News Extracts – West Fluid Milk Report— California

2/25/05

volumes are also rising despite wet conditions. Class 1 milk sales are slower than anticipated. Several processing plants are down for parts of the week due to scheduled and unplanned maintenance. This is creating some problems in placing milk. ARIZONA milk production levels range from flat to several percentages

3/4/05

components to keep plants on schedule. Milk output is stronger than year ago levels across much of the Central Valley. Weather conditions have been ideal and fresh cows and heifers are entering the milking herds. The northern California dairy producing areas are doing well and seeing milk output steady to slightly stronger than last year. Milk output in ARIZONA has been tempered by recent

3/11/05

Milk output is moving higher across most of CALIFORNIA. The southern milk shed is still feeling lingering effects of the wet season. However, plant intakes are beginning to increase as weather conditions are warm and dry. In the Central Valley, milk supplies are moving upwards at levels 2 to 5% above last March. Conditions are very cow friendly and allowing for increases. Supplies are manageable and processing plants have capacity for additional milk. ARIZONA milk production is recovering some of the recent declines

3/18/05

trending higher. With good weather conditions, milk production is moving higher across the Central Valley. Early green chop is being fed to cows which should boost output in the short term. Some plants are down for scheduled maintenance, but other plants are willing to take the extra milk. There are future concerns about hay availability and pricing with some expectation that these could be tight and expensive with competition from other states. Milk output

3/25/05

Following several weeks of near ideal milk producing weather and subsequent recovery from heavy rains, more rain fell across most of CALIFORNIA this week. The effects were not seen initially, but the concerns are that cows and milk output will be impacted. There are also concerns over the hay crop and the condition of the first and usually better cutting of hay. Processing plants in the state have capacity for additional milk and there are some cheese plants wanting extra milk for current cheese needs. Bottled milk demand is often lower around spring breaks of schools and colleges. ARIZONA milk production

4/1/05

more than a year earlier. On February 1 & 2, 2005, the Department of Food and Agriculture in California held a public hearing to consider amendments to the Stabilization and Marketing Plans for Market Milk. The amendments under consideration regarded changes to the Class 4a and 4b pricing formulas that would also have a pass-through effect on the Class 2 and 3 pricing formulas. The adjustments to the Plans will take effect for milk delivered to processing plants on or after April 1, 2005. The industry is examining the results to gauge the impact on the various participants. The results may influence which portion of the industry will grow over the next few years. Weather patterns have become wet and cool again over much of CALIFORNIA. The impact on milk production is not all that much, but contacts do state that it is reducing the normal spring flush. The cows just seem to be getting tired of all the rain.

4/8/05

and colleges break. The milk flow in the Central Valley is very strong with some processors seeing 4% to nearly double digit intake growth from a year ago. The additional milk is being processed within normal channels. Some mozzarella cheese producers want some downtime to balance stocks with heavier supplies versus a more limited demand. In the northern producing areas, the milk flow is slowly building seasonally at higher than year ago levels. NEW MEXICO milk

4/15/05

2004. Milk output remains seasonally active across most of CALIFORNIA at levels trending steady to slightly higher on a weekly average basis. Plant intakes are sharply higher than year ago levels in the Central Valley, slightly higher in the north, and mostly steady in the far south. Several plant-related problem in the state caused milk to be moved around to other plants. Weather

4/22/05

by 2.6%. Milk production is moving higher in CALIFORNIA at levels above a year ago in most areas. The normal, seasonal increases are generally being handled efficiently and normally. There are some cheese producers wanting to take some down time. The highest growth area in production versus a year ago is in the Central Valley. Temperatures are good and new crop hay is being

4/29/05

a year earlier. CALIFORNIA milk output has leveled off in the South and to some extent in the Central Valley. Volumes are higher by varying degrees than year ago levels in all areas. The Northern producing areas are seeing some increases where cows are moving to pastures. The general trend in milk production is due to decent weather conditions and the availability of new crop

5/6/05

Federal Order Class III price for April at \$14.61. Milk production remains active across much of CALIFORNIA and continues to move upwards on a weekly basis. Volumes are steady to slightly higher in the South where conditions have been relatively cool and insects have not been a problem. Additional rain is being forecast over the next few days. Milk output is moving higher in the Central Valley with conditions good for cow comfort. Hay harvest continues with higher prices noted. Milk is moving higher in the North and able to be readily handled. Fluid milk sales across the state are steady.

5/13/05

2004. CALIFORNIA milk production is holding steady to slightly lower in the southern areas and the Central Valley. Biting flies are beginning to hatch in the South which can signal problems for milk cow comfort. Milk output levels are typically above last year. Some locations may have seen the seasonal peak. Milk plants are running well and the milk is being processed orderly. Protein and fat

5/20/05

this year. Plants in the region are being run at or near capacity to handle the milk supplies. Plant receipts indicate that milk production is down a bit from the likely seasonal peak. There have been a few plants down days that have caused milk juggling, but supplies are being handled. Limited reports in the northern milk producing areas indicate that pastures and milk supplies are growing. Bottled milk sales in the state are flat. Home and school buying patterns

5/27/05

further north. Plants are running on extended schedules to process the seasonal milk supplies. Milk is expected to be handled well over the holiday weekend. Fluid milk sales are fair at best and orders ahead of the weekend have slowed, especially from school accounts. ARIZONA milk production is trending lower from the

6/3/05

in the Central Valley and South. Hotter conditions were common in the middle portion of the state and flies continue to be a nuisance. Processors in the state were able to handle the milk supplies in a relatively orderly fashion over the holiday weekend and were returning to normal schedules by midweek. Fluid milk orders

2006 Dairy Market News, Fluid Milk-West, California Highlights

3/3/06

lower than a year earlier. Solid gains continue to be made in milk receipts at plants across the state. The impact is beginning to stress processors, especially when their customers reduce orders or take down days. The general sense of milk production is that levels are 4-5% higher than last year's levels. Several processors are commenting that current daily intakes are higher than during the peak days in 2005. Weather conditions have been good to ideal for milk cows

3/10/06

CALIFORNIA production continues to move higher. Milk handling is being stretched with processing plants wanting to take a down day but being asked to run. Others, trying to update equipment or do maintenance, are also being asked to keep going. Additional milk is moving out of state for processing homes. Processors are deeply concerned with the building milk supplies and the fact that the peak will likely be a couple months away. Class 1 usage is lower for several

3/17/06

April 2005. CALIFORNIA milk output remains heavy across the state and is not expected to slow in the near future. Surplus milk and components are moving greater distances and being discounted further to keep product moving. Capacity to handle the building milk supply is being stretched. There are reports that milk has been diverted away from manufacturing to alleviate the situation. Class 1 needs are slow to grow and bottlers' schedules are light to

3/24/06

over February 2005 levels. CALIFORNIA milk supplies continue to trend higher with some local areas seeing only slight, tempering effects from recent rains. The upwards trend in milk output continues to build and processors are concerned about handling the peak milk supplies this year. Plant capacities are being taxed and down days are being discouraged. Fluid milk demand is mainly flat with limited

3/31/06

not been impacted much by these conditions. Milk production remains very heavy. Some impact is noted in the far northern region where rainfall is way

can't pay as much for hay supplies as milk prices continue to decline. Some plant production problems have caused milk to move around to find a home. This has been a difficult process and is expected to get worse as the milk flush approaches. Some plant inspections conducted by governmental agencies are also causing plants to lose capacity for various periods of time. Plant managers are becoming more concerned with how all the milk in the state will be handled this spring. Significant rain has fallen in ARIZONA for the first

4/7/06

expected to be down slightly from one year ago. CALIFORNIA milk production is mostly steady to higher. The recent trend upwards has been tempered by widespread rainfall across much of the Central Valley and the northern milk producing areas. The impact has been minimal yet, but the potential is that milk production could decline or the top taken off the upcoming flush. A major factor is that many dairies in these regions are under cover and the rains don't have the impact they once did. Processors are seeing lots of milk and several would not mind if the rains would take some of the milk increases. There are concerns over handling the milk supplies over the upcoming Easter weekend as schools recess and smaller processing plants take down days. Rains and wet conditions are affecting the alfalfa harvest. Stands in the Central Valley are ready for cutting. Fluid milk orders in the state are fair. Some bottlers are noting increases in demand as schools return from spring breaks, while other bottlers experience declines as schools they service go on break. Retail orders are steady. NEW MEXICO milk

4/13/06

and \$4.07 less than May 2005. Milk production in CALIFORNIA is holding mostly steady at levels in the 4-6% higher than year ago levels. The rains and wet conditions don't seem to have much of an impact on milk production, but the growth has been slowed. The rains are posing problems for cutting hay and green chopping. The lack of new crop hay and chop are said to be affecting milk production. The bigger concern is that hay producers will lose a crop and that the first crop will be past maturity and be poor quality. Prices for top quality hay could then be high this year. Handling milk has been a struggle for processors. The holiday weekend is expected to provide additional challenged as fluid orders have declined and smaller dairy plants are taking an extra day off around the holiday weekend. ARIZONA milk output has

4/28/06

February and \$2.79 lower than a year earlier. Most contacts indicate that the recent wet weather has not had much impact on milk production in CALIFORNIA. With all the housing improvements and changes made over the past decade, wet weather does not have as much impact as it did a few years ago. The harvesting of the first cutting

very well over the Easter weekend. Few disruptions were noted and milk did not have to be hauled too far to find a home. Plant operators are expressing concern about the upcoming Memorial Day weekend and thinking there could be many more problems, but they are hoping for the best. It is noted that the March Cow Slaughter report

5/12/06

areas are seeing milk output steady to higher. Overall, there remains a surplus of milk in the state. Milk and components are moving to available processing plants.

5/19/06

but there will be more than normal in the next 30 to 60 days. Plants are running at or near capacity levels in the state. Surplus milk is being handled, but sometimes requiring shipping and delays. Fluid milk orders are becoming more sporadic as

6/9/07

the seasonal peak. Milk volumes are moderate to heavy and most often above year ago levels. Processing plants in the state are running at or near capacity to handle the current milk supplies. Bottled milk needs are good for active

2007 West Fluid Milk Summaries from USDA's Dairy Market News

Jan 5

[California] Processing plants were often "snug" over the year end as surplus milk was handled. Comments were that the situation was one of the better handled year ends in recent memory.
[Arizona] plants had room for unplanned milk from nearby states.

Jan 12

[California] Milk processors in the state are running as planned.
[Arizona] Processing plants have capacity and are able to take surplus milk from nearby states when available.

Jan 19

[California] Some bottling operations are noting that it is harder to find a home for the cream that they are skimming from the producer milk to standardize it. Churns are running quite full and they don't want to pay much for outside cream. Manufacturing plants in general are running well and have adequate capacity to handle milk supplies efficiently. Some contacts note that they had many more problems handling the milk volumes last year at this time.
[Arizona] Plants have capacity to handle additional milk supplies.

Jan 26

[Arizona] Plants in the state have room for additional milk supplies and are seeing little surplus milk offerings. Surplus cream is ending up at the butter churns to find a processing home. Most churns are near capacity and don't want any more cream.

Feb 2

[Arizona and New Mexico] Milk is moving to normal processing channels. CREAM supplies are heavy in the state [New Mexico] and processors are not as willing to lower prices to move cream. Surplus cream volumes are moving to churns where there is currently ample room to handle current cream supplies.

Feb 9

[Arizona] Processing plants are running well and have capacity to handle additional milk.
[Pacific Northwest] Plants have capacity to handle the milk easily.

Feb 16

[California] Many processors are running at higher than expected levels and more milk than expected is being moved to nearby processing plants.

Feb 23

[California] Some processors are seeing milk intakes at 3-5% higher than a year ago. Solids and fat levels in the milk are moderating and starting to decline. There are concerns that milk production could move even higher and how processors could be stretched to handle the growing milk supply.

[Arizona] Plants in the state are running at expected levels with only limited volumes of milk entering from nearby states....Finding tankers to move extra cream locally is a struggle; finding tankers to move cream out of region is a bigger challenge.

Mar 2

[California] The trend lines on milk intakes are higher at levels that are beginning to worry processors. There is milk that is being moved around to find available processing space.
[Arizona] Intakes at processing plants were also higher to handle additional outside milk.
[Midwest] Even some California condensed skim was shipped into the Midwest.

Mar 9

[California] Plant intakes are strong and at levels that were not projected. The milk volumes are keeping plants full in the state and some strategic balancing is taking place.

[Arizona] Processing plants are running on steady to higher schedules with some outside milk moving into the state to find a place to handle the loads.

[Midwest] Cream supplies seem tighter and imports from the West continue.

Mar 16

[California] CALIFORNIA milk output remains strong and is becoming more of a challenge to handle. There are more reports developing that not all milk is being picked up and/or processed. The main factor is there is too much milk. Plants are running full and on extended schedules to help alleviate the milk supplies. There are further concerns as milk intakes are still building seasonally.

[Arizona] Plants are taking in outside milk to help out other areas that are seeing heavy milk supplies.

[Pacific Northwest] Plants are not anticipating any problems in handling the milk supply this spring. They are wondering if they will be asked to help out other regions.

[Midwest] Cream imports from the West continue but finding trucking remains an issue.

Condensed skim interest remains strong and imports from California into the Midwest continue.

Mar 23

[California] Many manufacturing plants are running at capacity levels and milk has not peaked. The spring flush is happening earlier than normal and some plant operators hope that means the milk will drop off earlier also. The surplus milk seems to be handled more efficiently this week as some time has allowed for better arrangements to have been made. Some milk is leaving the state for other destinations in the region.

[Pacific Northwest] Manufacturing plants are not anticipating any problems in handling milk this spring. In fact some are positioning themselves to help plants in other regions.

Mar 30

[California] Processing plants are running on extended schedules to handle current milk supplies.

[Pacific Northwest] Plants in the region have capacity left and some milk is entering the region from other Western areas.

Apr 6

[California] The strains on handling milk efficiently in the system that had improved over the last two weeks are being stressed again this holiday week. More surplus milk is available and trucks are very hard to find to haul any form of liquid milk product to different destinations.

[Arizona] Milk is being handled efficiently and processing capacity is available for those areas not in such good shape.

[Cream] Some plants are running on different schedules so that more surplus cream is available for churning. There is plant capacity and the prices are right, but now trucks are the real problem.

[Pacific Northwest] Plants in the region have capacity to handle more milk and are taking some supplies from outside the region.

Apr 13

[California] CALIFORNIA milk production has turned higher this week after several weeks of more sporadic output. There is again pressure to place all the milk in the state on a timely basis.

Trucking and processing issues continue to be limiting factors. There are plants that would like to take down days to prepare for what has traditionally been the peak production time of year.

[New Mexico] Milk is moving to normal channels and being processed in a timely fashion.

[Pacific Northwest] Plants in the region are operating efficiently with room to spare to handle the spring milk flow.

Apr 20

[California] CALIFORNIA milk output remains at high levels and processors are being challenged to place all the milk. Total volumes are moving higher and are several percentage points above last year. A couple of plants were down for a part of the week, which is adding to the puzzle. Some processors are shipping milk and components to other areas to secure a home. Higher trucking rates and surcharges are making this more of a financial pain.

[Pacific Northwest] Manufacturing plants in the region have capacity to handle available milk supplies.

Apr 27

[California] Milk production remains strong across CALIFORNIA and there are some indications that intakes are declining. Most processors would like for milk to move lower, as plants are being stressed to handle current volumes. The heavy milk volumes are being processed by processors extending production runs and milk and components are being shipped out to other regional processors.

[Arizona] Processing plants are running well and have space to handle additional milk.

[New Mexico] Processors in the state are able to handle available milk supplies and cheese plants are welcoming additional milk.

[Midwest] Cream is still entering the Midwest from the West, though truck/truckers availability is limiting additional shipments.

May 4

[California] In general, milk is being handled better this week. Problems remain in handling the available milk supply. Plants continue to be stressed with many running on extended schedules to process available milk. There are few reports of issues placing milk. Milk and components are still moving to other locales to find processing homes.

[New Mexico] Plants are running well in the state with some room to help out other processors.

May 11

[California] Milk receipts in CALIFORNIA have begun to slow a bit over the past week or two.... Manufacturing plants now have some capacity to handle milk supplies more efficiently.

[Pacific Northwest] Plants appear to have adequate capacity to handle available milk supplies efficiently this season.

May 18

[California] CALIFORNIA milk production is noted to be coming off what could be the seasonal peak. There are some concerns that a second flush could redevelop as additional cows freshen in June or July. The potential then could be limited by hot summer weather. Processors are collectively pleased that milk intakes are easing, allowing milk to be handled more effectively and into normal channels.

[Arizona] Processing plants are running on expected schedules with little outside milk offered.

May 25

[California] There were some issues handling milk this week as several plants were down for scheduled maintenance and then others had some equipment issues.

[Pacific Northwest] Plant capacity will not be an issue over the upcoming holiday weekend.

Jun 1

[California] CALIFORNIA milk production levels are steady to trending lower. Processors reported that milk handling over the holiday weekend was generally uneventful. Plants were running on schedule and able to handle the current milk supply. Class 1 sales were sporadic and reflected in orders. Cheese plants are actively taking milk. Prices are higher for most dairy products and there are limited movements of milk made around product pricing decisions.

Jun 8

[California] Milk is past the seasonal peak and is declining. Plants are able to operate more efficiently now.

[Pacific Northwest] Manufacturing plants are operating efficiently in the region.

Jun 15

[California] Processing plants are running well in the state with only minor, often maintenance, downtimes noted.

[Pacific Northwest] Manufacturing plants are operating efficiently on current volumes.

Jun 22

[California] Minor mechanical issues hindered some NDM production midweek, but full plant capacities will be turned to NDM production next week. Demand for condensed skim is steady to higher into Class III plants, with some loads clearing to the Central region.

[Cream] Most California cream loads are staying within state lines due to interstate pricing concerns and good interest from California Class II plants.

Jun 29

[Arizona] Milk is able to clear normally. Plants have capacity if additional holiday milk shows up.

Jul 6

[California] Plants had few problems handling milk over the mid week holiday. The biggest issue was that smaller plants closed on and around the holiday and that milk moved into other plants for balancing.

[New Mexico] Processors were experiencing no issues handling milk over the holiday.

[Pacific Northwest] Manufacturing plants in OREGON and WASHINGTON are anticipating some extra milk to process because of the holiday at midweek. They will have no problem with the added milk.

Jul 13

[California] CALIFORNIA milk production was affected by the hot weather conditions late last week with some intakes lower by 2 to 7% on a daily average basis. As conditions moderated, most of the declines have returned. There is plenty of extra milk in the state and the short lived surplus capacity was utilized. Some processors were even looking to move additional milk outside of the state. As milk prices have increased and product prices have stagnated or declined slightly, there is not a best place to utilize milk. Generally, processors want to balance production and inventories with orders and do not want to build inventories. Fluid milk demand is steady at light levels. Higher retail prices are being rolled out as Class 1 prices move upwards. There is caution about the price effect on demand.

[New Mexico] Surplus milk volumes are moving into balancing plants.

[Pacific Northwest] Comments were heard this week that there was quite a bit more milk than plants were anticipating for the holiday week.

Jul 20

[California] CALIFORNIA milk output is steady to higher. Following weather related declines two weeks ago, milk has returned to or and even surpassed levels before the drop.... Processors are working hard to manage the milk supply in the state. Plants are running full and milk is being moved around to find a home.

[New Mexico] Plants are running well and have capacity.

Jul 27

[California] Production plants are running at capacity in the state and processors are searching for outside help to place all the milk. Several cheese producers want to take less milk to help balance inventories. Other plants in the state had minor problems this week, which compounded

the issues. There are reports that not all milk was able to be processed. Bottled milk sales are off seasonally.

[Cream] Cream is heaviest in California and there are adequate supplies in other parts of the West.

[Pacific Northwest] The milk is being handled efficiently. Some milk is also being offered from outside the region at attractive prices.

[Utah and Idaho] Plants still report running more milk than they expected and they are also being offered some outside milk in addition.

Aug 3

[California] Milk output in CALIFORNIA remains strong and is at levels that remain above projections and expectations. Good milk producing weather across the state and great milk prices are the reason and incentive for milk to flow. Processing plants continue to work hard to handle available milk and the strain did ease this week when compared to the last two weeks.

Processors continue to move milk and components out of state for processing. There are hopes that school milk will begin to ease the supply situation in coming weeks. Retail fluid milk sales are slower as higher milk costs are passed on.

[Pacific Northwest] Processing plants remain active as milk and components are being processed from nearby states.

[Midwest] Reported Class III spot sales ranged from around -\$3.00 to around flat class, net seller. A report of Western UF fluid priced below the reported range was also noted.

Aug 10

[California] Processing plants are running at capacity to handle the available milk and surplus is moving out of state for handling. Balancing plants are active to help alleviate the milk situation.

[Arizona] Current intakes are running at 5% or more over last year. Plants are generally running well and taking milk from nearby states for processing.

[New Mexico] There were some plant issues around the weekend that backed up milk supplies, but the situation returned to normal. Additional milk is moving out of the state towards the Southeast.

[Pacific Northwest] Plants are handling the milk efficiently.

Aug 17

[California] Milk production is mostly steady to lower across most of CALIFORNIA with several areas showing slight declines. The biggest factors keeping milk at high levels are high milk prices and favorable weather condition....Plants across the state are full and milk and components continue to move to nearby states for processing.

[Cream] Contacts are noting that cream can be brought into California for Class 2 usage at lower rates than cream can be bought in the state. The reason is the lag in the 2-month pricing format of the California system still reflecting higher butter prices in formulas.

Aug 24

[California] Processing plants are working long and hard to handle the abundant milk supplies. Despite increased demand for fluid milk into school lunch accounts, surplus milk and components are still moving out of state to find available processing homes. There are plants that typically use this time of year for maintenance, but this year they are actively running to help balance the milk flow.

[New Mexico] Surplus milk is being balanced at butter/powder facilities.

[Pacific Northwest] Plants are operating efficiently with current milk supplies. Offerings of milk from outside the region are noted.

[Utah and Idaho] Plants generally have more milk than anticipated for this time of year. Some outside milk is also being offered into the region.

Aug 31

[California] CALIFORNIA weather conditions are hotter across the major milk producing areas of the state. The effects are beginning to impact the milk flow with some receivers seeing drops in

milk intakes and load weights. Handlers in the state expect to be busy over the Labor Day holiday weekend, but there are no concerns about being able to process available offerings. A plant in the south is decreasing milk intakes on the last day of the month by several million pounds per day.

[Arizona] Processing plants are also handling surplus loads from nearby states. Plants are expected to be full over the holiday weekend. Bottlers' demands are steady to stronger as school milk accounts are being filled.

[Pacific Northwest] Summer weather has not stressed the milking herd. Plants have adequate capacity to handle the milk with no problems.

[Utah and Idaho] Plants are wondering if they will see any milk move into the region for processing over the holiday weekend.

Sep 7

[California] Processing plants were seeing intakes anywhere from 6% to 14% lower than a week ago. The decline made milk handling uneventful over the Labor Day weekend. Some plants would actually have liked more milk than what was available. There was a good call from Class 1 handlers as school lunch accounts were being serviced and the usual sporadic ordering patterns were common. Retail bottled milk needs were fair and along expectations.

[New Mexico] Processing plants in the state have been active to handle local and out of area milk supplies. The holiday weekend did not cause any major milk processing or handling issues.

[Pacific Northwest] Plants are operating efficiently and have additional capacity.

Sep 14

[California] Contacts are somewhat surprised that milk output has not rebounded to a greater extent in CALIFORNIA from the recent heat. The weather is again ideal but milk is slow to recover. This has allowed for some plant maintenance and has meant that milk was able to stay closer to home to find processing capacity.

[Pacific Northwest] Plants are able to operate efficiently. Contacts are wondering if some outside milk might become available over the next few weeks.

Sep 21

[California] CALIFORNIA milk production is rebounding from the widespread decline at the beginning of the month, but volumes are not back up to the levels before the decline....

Processing plants in the state are running on extended schedules to handle available milk supplies. Milk is also moving out of the state to find processing homes. Bottled milk needs have leveled off as buying patterns for school and retailers have found balance.

[Arizona] Processing plants in the state are running on extended schedules to handle both local and surplus milk from nearby states.

[Pacific Northwest] Processing plants are seeing local receipts as mostly flat, but offerings of milk from nearby states are being shown on a continuous basis.

[Utah and Idaho] Additional milk and components are being offered and shipped into plants, which are running at or near capacity levels.

Sep 28

[California] CALIFORNIA milk production is running higher and has regained most, if not all, volumes lost during the hot spell at the beginning of September. Currently, milk volumes are heavy and are stretching operating capacity in the state. Milk and components continue to move out of state on a regular basis to find processing homes. Weather conditions are conducive to milk cow comfort. High milk prices remain a big factor in milk growth in the state. Currently, bottled milk demand is steady to slightly lower.

[Arizona] Processing plants are actively running to handle local and out of area milk. Local milk production is moving higher from seasonal lows.

[Utah and Idaho] Milk supplies are heavier than anticipated in UTAH and IDAHO. Some offers of milk from outside the region continue to be noted.

October 5

Washington \$140, +\$10. Supplies of milk in CALIFORNIA are very heavy for this time of year. Some milk is being offered around to find plant capacity with little success noted. It was extremely hard to place milk at the end of September with buyers knowing that October prices would be much lower. All of the milk that was lost in the state during the hot spell of a few weeks ago is back and then some. Weather conditions are ideal for strong milk output. Milk producers are expressing

October 12

November 2006. CALIFORNIA milk output is strong across the major milk production areas. Current milk supplies are stressing processing capacity and the ability to balance. There are reports of milk not being picked up at the farm because of the lack of space. There were several plants that had issues this week, which compounded handling concerns. There are reports that several processors in the state will implement base plans to limit milk that they will process from their producers. Fluid milk orders are steady and along projected levels. Milk is being shipped to nearby states to find processing homes.

Attachment 2

California Milk Handling Situation, Summarized From Dairy Market News

Number of weeks in each month where the described situation occurred in California and was reported in Dairy Market News

| <u>Year</u> | <u>Month</u> | <u>Plant Operators Had Difficulty Handling Milk all the Milk in CA</u> | <u>CA Milk Moved Outside CA to find a Processing Home</u> | <u>Milk was not marketed, dumped, not placed, not picked up</u> |
|-------------|--------------|--|---|---|
| 2005 | February | 1 | 0 | 0 |
| | March | 0 | 0 | 0 |
| | April | 1 | 0 | 0 |
| | May | 2 | 0 | 0 |
| | June | 0 | 0 | 0 |
| 2006 | February | 0 | 0 | 0 |
| | March | 5 | 2 | 1 |
| | April | 2 | 0 | 0 |
| | May | 2 | 1 | 0 |
| | June | 1 | 0 | 0 |
| | July | 0 | 0 | 0 |
| | August | 0 | 0 | 0 |
| | September | 0 | 0 | 0 |
| | October | 0 | 0 | 0 |
| 2007 | February | 2 | 2 | 0 |
| | March | 5 | 5 | 1 |
| | April | 4 | 4 | 1 |
| | May | 2 | 1 | 0 |
| | June | 0 | 0 | 0 |
| | July | 3 | 1 | 1 |
| | August | 4 | 4 | 0 |
| | September | 2 | 2 | 0 |
| | October | 2 | 1 | 2 |

Given that milk marketers are often reluctant to report milk not being marketed due to environmental concerns, it is likely that these numbers are extremely conservative estimates about the times when milk was being dumped or left at the farm.

ATTACHMENT 3

NBS



800 N. Brand Blvd.
Glendale, CA 91203

October 15, 2007

Dr. Bill Schiek
Dairy Institute of California
1127 11th St., Suite 718
Sacramento, CA 95814

I would like to share with you the milk supply and capacity issues we are facing this year in California. As you know, we operate, among other facilities, an evaporated milk plant in Modesto, California. Approximately 28 dairy farmers supply milk to that plant through direct-ship supply agreements with us. As with many consumer products, we face demand fluctuations both seasonally and because of price elasticities. Because of this, in the normal course of our business, we occasionally need to divert milk away from our plant. In the past, we have been able to sell this milk to local cheese plants or even to more distant butter/powder plants.

As we made plans to divert our seasonal milk this year (for October, November, December), we found that we could not find a buyer. We offered the milk at a significant discount and could still not find a buyer. In fact, we could not find a buyer at ANY price. Every potential buyer that we approached told us that not only could they not take our milk, no matter what the price, but they were not sure if they would have room for their own milk. In fact, one buyer told us that they had already dumped or sent to calf ranches 50 loads of milk.

We looked beyond California to try to find homes for milk elsewhere, at a significant cost to us, but were not able to find enough trucks willing to commit to the volumes that we needed to move (up to eight loads of milk or even just two loads of condensed skim per day).

In reality, we do not see this situation changing over the next several years. We expect milk prices to continue at higher than average levels and that the milk-to-feed cost ratio will continue to promote strong milk production going forward. In the meantime, we do not foresee the net addition of significant capacity in the state given current disincentives in the regulated pricing system, such as the whey factor and lagging make allowances.

Given these realities, last month we asked our patron suppliers to each cut their milk production by ten percent by the middle of November. Without these supply reductions, the only other option we could envision was having to dump milk during our upcoming diversions, and that does not seem to be a good solution for either our dairy farmers or for us. Frankly, with the conditions in the industry today, Nestle is unable to manage its business effectively. If something is not done immediately to improve the position of supply and demand imbalance, the entire industry will suffer. We are committed to long-term solutions and long-term prosperity for the entire dairy industry in California. The current system is not promoting either.

Sincerely,

A handwritten signature in black ink that reads "Patricia D. Stroup". The signature is written in a cursive style.

Patricia D. Stroup
Group Manger, Dairy

ATTACHMENT 4

KNOX
LEMMON
ANAPOLSKY LLP

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October 17, 2007

William Schiek, Ph.D.
Dairy Institute of California
1127 Eleventh Street, Suite 718
Sacramento, CA 95814

Re: *Alternative Proposals Submitted by California Dairies, Inc. and the Alliance of Western Milk Producers*

Dear Dr. Schiek:

You have indicated that Dairy Institute of California is filing a Post Hearing Brief following the October 10, 2007 hearing held by the Department of Food and Agriculture in order to consider proposed changes to California's Class 4a and 4b milk pricing. As part of the argument that you are making in Dairy Institute's Post Hearing Brief, you have asked us to examine whether the Secretary has the legal power to validly implement the Alternative Proposals submitted by California Dairies, Inc. ("CDI") and the Alliance of Western Milk Producers (the "Alliance") under the applicable provisions of California's Food and Agricultural Code (the "Code")¹. After examining the applicable provisions of the Code, and other aspects of relevant California law, we conclude that the Code does not permit the Secretary to implement the changes proposed by CDI and the Alliance. Our conclusions are based on the analysis explained in the balance of this letter.

Alliance and CDI Alternative Proposals

A central component of the Alliance's Alternative Proposal asks the Secretary to create a "dry whey credit" that would be provided to Class 4b manufacturing plants up to 264,480 pounds solid not fat monthly used in the production of cheese.²

¹ Unless otherwise indicated, all references to statutes or sections of statutes in this letter are references to provisions of California's Food and Agricultural Code.

² The amount of the proposed Alliance credit would be valued at the dry whey price as determined in § (E)(1)(c) of the applicable Stabilization and Marketing Plan, divided by 8.7. To implement this credit, the Alliance also advocates making changes to §§ 900 and 901 of the Pooling Plan for Market Milk that would enable a handler's

The CDI Alternative Proposal asks the Secretary to add a new § 300.5 to the Stabilization and Marketing Plans for Northern and Southern California. This new § 300.5 would grant a new “plant capacity credit” to 4a/4b handlers who have constructed a processing plant or have expanded an existing plant after January 1, 2008.³

Adopting the Alliance’s Proposed “Dry Whey” Credit Would Exceed the Secretary’s Powers Under Chapter 2.

Code § 62031 permits the Secretary to amend a Stabilization and Marketing Plan if he makes at least one of two findings - either that the existing Plan is no longer in conformity with the standards that are prescribed in Chapter 2 of Division 21 of the Code, or that the Plan will not tend to effectuate the purposes of Chapter 2. § 62031 goes on to provide that “Any order...amending...any stabilization and marketing plan shall be subject to § 61996.” In turn, before declaring that an amendment to the Plan is effective, § 61996 obligates the Secretary to determine that the amendment “...will tend to accomplish the purposes...[of Chapter 2]...within the standards that are prescribed in it....” (emphasis added). Taken together, these Sections require the Secretary to refuse any proffered amendment that *does not tend to accomplish the purposes of Chapter 2* or that is *not within the standards prescribed in Chapter 2*.

Sections 62031 and 61996 essentially require the Secretary to evaluate any proposed amendments against the stated purposes of Chapter 2 § 61805(b) states, in relevant part, that the purposes of Chapter 2 include the following:

“Authorize and enable the director to prescribe marketing areas and to *determine minimum prices to be paid to producers* by handlers for market milk which are necessary due to varying factors of costs of production, health regulations, transportation, and other factors in the marketing areas of this state. In determining *minimum prices to be paid producers* by handlers, the director shall endeavor under like conditions to achieve uniformity of cost to handlers for market milk within any marketing area. However, *no minimum prices established or determined under this chapter shall be invalid* because uniformity of cost to handlers for market milk in any marketing area is not achieved as a result of the minimum producer prices so established or determined.”(emphasis added).

Even a cursory reading of this provision shows that the Legislature’s primary purpose in enacting Chapter 2 was to empower the Secretary to determine and establish minimum producer prices and to implement measures designed to ensure producers received the minimum price once it was established. No provision of Chapter 2 suggests that the Legislature wanted the Secretary, in the course of this process, to adopt measures aimed at advancing the interests of certain handlers at the expense of either producers or other handlers.

plant located in California engaged in purchasing milk for Class 4b utilization to deduct a “dry whey credit” computed in accordance with the changes the Alliance proposed to the Stabilization and Marketing Plans.

³ To implement this “plant capacity credit”, CDI asks the Secretary to add a new Article 8.5 to the Pooling Plan for Market Milk.

It is equally clear that the Alliance's proposal does not advance the purposes described in § 61805(b). As numerous witnesses testified at the October 10, 2007 hearing, implementing the Alliance's "dry whey credit" will result in producers receiving less than the minimum price determined by the Secretary. Moreover, the avowed purpose of the Alliance proposal falls well outside the purposes recognized by Chapter 2. As the Alliance acknowledges, the purpose of the "dry whey credit" is to provide an "adjustment" to certain handlers (those who have cheese plants and who) "...process volumes of milk below a level that could support an investment in whey processing equipment."⁴ Both the purpose and the fundamental effect of the Alliance proposal demonstrate that the proposed "dry whey credit" will not "tend to accomplish the purposes of Chapter 2." Accordingly, under §§ 62031 and § 61996, the Secretary has no power to adopt the Alliance's amendment.

The Alliance's "dry whey credit" suffers from a second, related, fatal deficiency. As has already been noted, Code §§ 62031 and 61996 require the Secretary to refuse any proffered amendment that falls outside of the "...standards prescribed in..." Chapter 2. §§ 62070 through 62072 create the only means by which the Secretary can permit a handler to legitimately "charge" a producer and thereby obtain a "credit" against amounts it otherwise owes that producer; no other portions of Chapter 2 empower the Secretary to recognize such "credits." In keeping with the Legislature's announced purpose of protecting a determined minimum producer price, however, the standards described in §§ 62070-62071 are very limited. For example, § 62070 only allows the Secretary to provide "...maximum charges for plant processing and transportation service..." §§ 62071 and 62072 are similarly limited to allowing a Stabilization and Marketing Plan to provide for "...minimum charges for the various services performed or rendered by a nonprofit cooperative association in respect to Class 1 market milk sold or delivered to another handler" and "minimum charges for the handling of intermittent or irregular deliveries of market milk and plant standby services."⁵

Producer leaders have argued that, although the Code does not specifically authorize a "dry whey credit", the Secretary nevertheless has the legal authority to implement such a credit because other sections of the Code (like §§ 62070-62072) allow other credits. This argument overlooks a settled rule courts employ in construing statutes. This rule, commonly described by the Latin phrase "expressio unius est exclusio alterius," states that the expression of one thing in a statute ordinarily implies the exclusion of other things. *In re J.W.* (2002) 29 Cal.4th 200. Use of specific words and phrases in statutes connotes intent to exclude that which is not specifically stated. *In re Hubbard* (1964) 62 Cal.2d 119. The California Appellate Court, Second District, expanded on this principle, describing what it called "three of the most fundamental principles of statutory construction":

⁴ Letter from the Alliance, Milk Producer Council and Western United Dairymen to Secretary Kawamura dated September 26, 2007.

⁵ These statutes provide the statutory underpinning for § 300.3 of the Stabilization and Marketing Plans which authorizes credits for handler-owned refrigeration equipment, use of nonfat dry milk or condensed skim milk to fortify Class 1 products, and concentrating Class 1 milk.

(1) in construing a statute, courts look first to the plain language of the statute; (2) the expression of some things in a statute necessarily implies the exclusion of things not expressed, and (3) a statute is construed to give effect to all of its parts and to avoid rendering some words surplusage. (*internal cites omitted*) *Federal Deposit Ins. Corp. v. Superior Court* (1997) 54 Cal.App.4th 337, 345.

It is obvious that the Alliance's "dry whey credit" does not fall within the severely restricted classes of marketing, transportation or processing services for which the Secretary is permitted to recognize "credits" under §§ 62070 or 62071. Since the "dry whey credit" does not therefore meet the standards prescribed by Chapter 2, the Secretary has no power to adopt it.⁶

Adopting the Proposed "Plant Capacity" Credit Would Exceed the Secretary's Powers Under Chapter 2.

The principles discussed above apply equally to CDI's proposed "plant capacity credit". Rather than protecting the right of producers to receive the minimum price established by the Secretary, CDI's "plant capacity credit" will cause producers to receive amounts less than the established price. Moreover, the avowed purpose of CDI's proposal falls outside the purposes recognized by Chapter 2. CDI acknowledges that the purpose of its "plant capacity credit" is to provide an "incentive" to certain handlers (those who have cheese plants and who) "...add processing capacity to the state, either through a new facility or an expansion of an existing facility."⁷ Both the avowed purpose and the fundamental effect of CDI's proposal demonstrate that the "plant capacity credit" will not "tend to effectuate the purposes" of Chapter 2. Accordingly, §§ 62031 and 61996 require the Secretary to reject CDI's proposal.

CDI's "plant capacity credit" proposes a change that, like the Alliance proposal, also falls well outside the boundaries of Chapter 2. The above discussion describes how Chapter 2 places severe restrictions on the Secretary's ability to recognize situations in which a handler may legitimately "charge" a producer and thereby obtain a "credit" against the minimum determined price it otherwise owes that producer. CDI's proposed "plant capacity credit" does not fall within the severely restricted classes of marketing, transportation or processing services for which the Secretary is permitted to recognize "credits" under §§ 62070 or 62071. Since CDI's proposed "plant capacity credit" is well outside of the standards prescribed by Chapter 2, the Secretary has no power to adopt it.

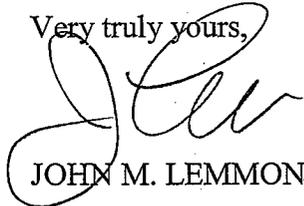
⁶ In addition to the legal barriers preventing the Secretary from accepting the "dry whey credit", practical considerations call for a similar result. Adopting either the Alliance proposal or the "plant capacity credit" advocated by CDI will set a precedent allowing any producer or handler adversely affected by particular challenges impacting its specific business operations to petition the Department for an offsetting "credit."

⁷ Letter from CDI to David Ikari, Chief of CDFA's Dairy marketing Branch, dated September 26, 2007.

Conclusion

Because neither the "dry whey credit" proposed by the Alliance nor the "plant capacity credit" proposed by CDI tend to effectuate the purposes of Chapter 2 of the Code within the standards prescribed in it, we believe that the Secretary has no legal authority to amend the Stabilization and Marketing Plans to include those credits.

Very truly yours,

A handwritten signature in black ink, appearing to read "J. Lemmon", written in a cursive style. The signature is positioned above the printed name "JOHN M. LEMMON".

JOHN M. LEMMON

JML/bns