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October 17, 2007

Mr. David Ikari, Branch Chief
Dairy Marketing Branch
California Department of Food and Agriculture
1220 N Street
Sacramento, California 95814
SENT BY FAX TO: David Ikari, 916-341-6697

Re: Hearing on October 10-11, 2007 to Consider Amendments to the Stabilization and Marketing Plans for Marketing Milk for the Northern California and Southern California Marketing Areas and to Consider Amendments to the Pooling Plan for Market Milk

Dear Mr. Ikari:

Thank you for the opportunity to submit a post-hearing brief. We would like to clarify our testimony, respond to the panel's questions and amplify several points.

First, the panel asked if we could provide any information about the availability of distress milk in the past months.

Land O'Lakes handled distress milk during this year's flush season. In early May 2007, Land O'Lakes purchased as many as five loads per day from a large cheese processor and balanced a fluid milk processor who both lacked the plant capacity to process these loads.

The availability of distress milk in California may be a sign that the manufacturing allowances, especially for cheese, may be inadequate. In evaluating our financial information, the make allowances for the cheese/whey complex are more inadequate than the make allowances for the butter/powder complex.

On a related note, handlers are required to pay minimum class prices for in-plant uses whether such handlers are operating pool or non-pool plants. Section 62078 of the code states that "All handlers who receive market milk within this state shall be obligated to pay minimum producer prices established under this chapter regardless of the area of origin of such milk, whether inside or outside the jurisdiction of the State of California." The code does not allow plants to pay producers of market milk less than the minimum class price according to use even though such milk is considered distress milk.

Buying distress milk at class prices does not make financial sense when the make allowance for manufactured products are inadequate. Furthermore, a handler purchasing distress milk at class prices exposes that handler to the risk of inventory devaluation stemming from falling commodity prices. For these reasons, California handlers are discouraged from buying distress milk.

By way of contrast, handlers regulated in Federal order markets or handlers operating in unregulated areas can purchase this same California distress milk at substantial discounts. These out-of-state handlers are practically guaranteed a profit on this distress milk while in California, especially in the case of cheese, the handlers are guaranteed a loss. Meanwhile, these same out-of-state cheese plants then compete against California cheese makers in the sale of the final product.

We realize that custom processing is another option of how to handle distress milk. Normally such custom processing is limited to Class 4a products. Charges for custom processing of the shipping handler's bulk milk into manufactured products shall be borne by the shipping handler. Title to the bulk milk and resulting manufactured products shall remain with the shipping handler until final disposition.

We understand that to custom process another handler's milk, a processor typically incurs additional handling and accounting costs necessary to properly record and report milk volumes processed to the CDFA. According to the Milk Pooling Branch Policy and Procedural Letter No. 5.5 states in part that "The processing handler shall report to the shipping handler the manufactured products yielded from such bulk milk which is custom processed." Furthermore the procedural letter also states, "Each processing handler who custom processes another handler's market milk into manufactured products shall maintain complete records of such transactions for review by the Director for a period of not less than three years."

Land O'Lakes does not currently participate nor is planning to participate in any customized processing agreements. Currently, we are unaware of any plants that have entered into such an agreement. Perhaps the burden of additional handling and accounting for custom processed products is why custom processing of distress milk does not occur more often.

Secondly, the panel asked what return on investment the Department should strive to cover in establishing make allowances.

Land O'Lakes suggests that the Department establish make allowances that result in a return on investment of 8% to 10% on the original equipment cost to adequately cover the risk premium of investing in manufacturing commodity dairy products (i.e., cheddar cheese, butter, NFDM and whey powder). We recommend that the return on investment be applied to the original plant and equipment costs rather than on depreciated values.

To close, we understand the detrimental effect that the current dry whey cost factor has had on cheese plants, but 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 agree that convening industry meetings may be a good way to develop proposals that would strike a compromise between processors and producers. Accordingly, the results of these meetings could be considered at future hearings.

Thank you again for the opportunity to file a brief and for your consideration of addressing the components of the Class 4a and 4b formulas. These issues are of critical importance to the member owners of Land O' Lakes.

Sincerely,

Tom Wegner
Director of Economics and Dairy Policy