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October 17, 2007

Kelly Loyer, Hearing Officer
Members of the Hearing Panel
California Department of Food and Agriculture
1220 N Street
Sacramento, CA 95814

Re: Post-Hearing Brief for the October 10, 2007 Class 4a & 4b Hearing

Dear Ms. Loyer and Members of the Hearing Panel:

We thank you for the opportunity to file this post-hearing brief. There are a few items that we would like to address.

1. Statutory authorization, "substantive" or procedural and unequal raw product costs

These three issues pertaining to our proposed dry whey credit were raised by members of the hearing panel and are addressed fully in the attached letter from our legal counsel Mr. Vlahos and Ms. Johnson of Hanson, Bridgett, Marcus & Vlahos, LLP.

2. Dry whey credit - Divide by 8.8 instead of 8.7

To reflect our intent of offsetting the entire value of the whey component in the Class 4b price up to 264,480 pounds of SNF per month used in cheesemaking for each eligible plant, our proposed credit formula as established in Section 300.3 of the Stabilization Plan should read:

(G) Each handlers' plant located in California purchasing milk for Class 4b utilization in the current month may deduct a dry whey credit for quantities of solids not fat processed equal to the value determined in Section 300 (E)(1)(c), divided by 8.8, not to exceed 264,480 of solids not fat per month.

That is, a divisor of 8.8 instead of 8.7 should be used.

3. Implied change to Class 4b price

Questions from the hearing panel seemed to imply that our proposed "dry whey credit" in effect changes the minimum Class 4b price. We want to make clear that it is not our intent to change the Class 4b price or to create a second Class 4b price. We structured the proposed language to mimic that of fortification allowances. That is, the rate of the allowance (or in our case credit) is established in Section 300.3 (Marketing Services) of the Stabilization plan and then implemented in Sections 900 and 901 of the Pooling plan. It is our understanding that the deduction in milk solids-not-fat for

fortification allowances is a deduction in the handler's pool obligation, and is not treated as a deduction in the Class 1 price. We anticipated that our proposed "dry whey credit" would be the same – a deduction in the handler pool obligation, not Class 4b price. We reiterate that 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.

4. Comparison of Cornell dry whey plant volume to CDFA dry whey plant volume

We were asked to compare the volume of the high cost dry whey plants in the Cornell manufacturing cost study to the volume of the representative plants in the CDFA cost study. To the best of our knowledge, a volume by cost category breakout is not available for the most recent update of the Cornell study which covers the 2006 period. The volume breakout available is for the costs released September 1, 2006. According to testimony provided by Mark Stephenson, "Data were collected from plants which covered a 26 month period. However, 63 percent of observations were during the 12 month time period from July 2004 through June 2005. Another 21 percent of the observations were from earlier months and the remaining 16 percent were more recent." Based on the span of observations, the 2005 CDFA cost study seems to be the closest fit for comparison purposes.

CDFA 2005 cost study:

Total volume of 3 dry whey plants: 97,953,043 pounds
Assuming equal volume across three plants: 32,654,014 pounds each
Volume of low cost plants: unknown
Volume of high cost plants: unknown
Weighted average cost: \$0.2851
Costs associated with lower volume plant: unknown
Costs associated with higher volume plant: unknown

Cornell cost study (mainly July 2004-June 2005):

Average volume of 6 low cost plants: 65,549,194 pounds
Average volume of 6 high cost plants: 29,240,120 pounds
Weighted average cost: \$0.1941
Costs associated with lower volume plant: \$0.3007
Costs associated with higher volume plant: \$0.1466

The 2005 CDFA cost study does not break the plants into low and high cost categories with associated volumes. Accordingly, we have to make the broad assumption that each of the 3 plants process equal volumes. We have no way to verify whether or not this assumption is accurate and feel uncomfortable assuming that, in fact, all three CDFA plants are "low volume" and should be compared to the "low volume" costs in the Cornell study. It is possible that one plant out of the three could in fact have a higher volume and extremely high manufacturing cost, thus impacting the weighted average. We simply do not know. For this reason, we continue to support the assertion in our testimony that the divergence between the two studies is difficult to interpret and that due to the

inevitable loss of the CDFA dry whey cost study, a different method of establishing a dry whey manufacturing cost allowance should be employed.

5. Dry Whey Component

Since California has become a significant player in the market for whey products, it makes little sense for whey to be excluded from the California Class 4b pricing formula. The value associated with whey products has clearly been established. At the same time, testimony from California cheese manufacturers seemed to indicate 2007 losses associated with whey protein product production. It is hard to fathom that the number two cheese manufacturing state in the nation did not fully participate in the tremendous demand and record prices for dairy protein products derived from the whey stream. This is especially hard to understand given a dry whey manufacturing cost allowance provided to California cheesemakers that exceeds those of their competitors by nearly \$0.11 per pound.

A plea by cheese manufacturers to eliminate the dry whey component in the Class 4b pricing formula seems contrary to the concept of pooling. Testimony provided at the hearing suggests that the classified pricing formulas should result in *minimum* prices paid to producers and that competition will result in additional incentives to be paid to producers in other forms such as premiums. It is quite obvious, and has been demonstrated numerous times, that premiums are completely discretionary on the part of processors. The only price that producers are guaranteed to receive for their milk is through the regulated minimum pricing formulas. To that point, it is vital that the formulas be set appropriately to derive a value for the producer's raw milk. Eliminating a valued component, such as dry whey, and assuming plants will pay similar premiums in its absence in the formulas, is speculative at best and unsupported. To support pooling is to support the pooling of all components in each class of milk.

6. Industry compromise

A reoccurring question was asked by a member of the hearing panel along the lines of, "Have producers and processors gotten together to determine whether a compromise could be reached in terms of the dry whey component in the Class 4b formula?" We urge the Secretary and Hearing Panel to recognize the tremendous effort put forth by staff and members of the Alliance, Milk Producers Council and Western United Dairymen to not only form consensus but to offer a compromise. All three organizations have a long history of supporting the dry whey component at the highest possible value without compromise. In sincere effort to deal directly with the plight of the petitioners, we put together a compromise to offer a dry whey credit to those plants that argue they truly do not have the ability to process their whey stream. Unfortunately, it seems as though the small to mid-size manufacturers have dismissed the concept due to the lucrative possibility of complete elimination of the component in the Class 4b formula. This is unfortunate, since our compromise would directly address the problem they claim.

Finally, please recognize that efforts to work towards a compromise did extend beyond the three organizations (Alliance, MPC and WUD) that signed on to the proposal. Contact was made with a major independent processing representative as well as with an additional California

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cooperative. It was clear that the processor representative was unable to alter their all or nothing position of complete elimination of the component and the other cooperative adopted policy different than that proposed by our group.

7. Plant Capacity

The broader issue of California's plant capacity was a concern expressed at the hearing and is clearly outside the scope of this hearing. However, we too, share this concern and are willing to work as an industry to address the issue. As noted in our testimony, we have invited the Dairy Institute of California to work with us to establish an industry committee to deal directly with plant capacity and develop a strategic plan. 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.

Any attempt by the Department to adapt the classified pricing system to address these larger industry issues would be a dramatic shift in policy. A reduction in class prices in order to provide incentives for plant capacity would put the Department in a position of setting policy — a role that is properly filled by industry stakeholders. We have proposed the appropriate venue to do just that. Again, the issue of plant capacity is beyond the scope of this hearing.

We thank you for the opportunity to file a post-hearing brief and look forward to the Department's hearing determination.

Very truly yours,

A handwritten signature in black ink, appearing to read "Michael L. H. Marsh". The signature is fluid and cursive, with a large initial "M" and "L".

Michael L. H. Marsh, CPA
Chief Executive Officer

cc: Board of Directors, Western United Dairymen

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October 17, 2007

Via E-Mail

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1220 N Street
Sacramento, CA 95814

Re: ***Post-Hearing Brief for the October 10, 2007 Class 4a & 4b Hearing***

Dear Ms. Loyer and Members of the Hearing Panel:

As counsel for Western United Dairymen, we submit this post-hearing brief in response to questions raised at the hearing on October 10, 2007 about the alternative proposal ("Proposal") made by Western United Dairymen, the Alliance of Western Milk Producers and Milk Producers Council with respect to the dry whey component of the Class 4b price and a proposed dry whey credit. To preserve the value recognized by the existing dry whey component for milk which may be used to produce whey products, in addition to an adjustment of the dry whey component formula, the Proposal provides a uniform dry whey credit for up to 264,480 pounds of solids-not-fat per month under a new subdivision (G) of section 300.3 of the Stabilization and Marketing Plans for the Northern and California Marketing Areas (sometimes referred to as "S&M Plans"). The only effect of the Proposal's change to section 900 of the Pooling and Marketing Plan for Market Milk ("Pooling Plan") is to provide a procedure to implement the dry whey credit effected in the S&M Plans.

As explained below, the law authorizes the Secretary to adopt the Proposal, which involves only a procedural amendment to the Pooling Plan and which maintains a uniform Class 4b price and does not create prohibited unequal raw product costs.

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1. The Secretary Is Authorized To Adopt The Proposed Dry Whey Credit.

At the hearing, members of the Hearing Panel inquired as to the legal authority for the provision of credits. The answer is that no specific authorization is required for credits, be they fortification deductions (S&M Plans § 300.3 (B)), transportation credits (S&M Plans § 300.2) or the dry whey credits involved here (proposed S&M Plans § 300.3(G)). The Stabilization and Marketing Act gives the Secretary substantial discretion regarding pricing and related matters. (See Food & Agricultural Code sections 62061 - 62079.) The Act is intended as a broad policy guideline, not a detailed road map, and the Secretary is empowered to adopt plan provisions that promote the purposes of the statute and are consistent with the policy guidelines set forth therein.

But should a specific statutory authorization for dry whey credits be required (putting aside any comparison to other credits and deductions that have no specific authorization), that authorization can be found in section 62076. It requires that in establishing prices for class 2, 3 and 4a or 4b, that "the director [sic] shall take into consideration any relevant economic factors, including, but not limited to, the following: (a) The relative market value of the various products yielded from such market milk. . . ."

The petitioners sought total elimination of the dry whey component from the 4b formula on the grounds that, because of their smaller size and current economies of scale, they (or at least some of them, sometimes) could not derive value from the whey by-product of their operations. Assuming this claim to be true, the credit recognizes that cheese manufacturers processing volumes of bulk milk above 100,000 pounds per day are more likely to yield additional products from the whey stream and, therefore, a higher value of products from such milk. Thus, the proposed credit directly relates to the Secretary's mandate to consider the relative market value of products yielded from the milk.

2. The Dry Whey Credit Is A Procedure For Continuing To Recognize The Value Of Milk Which May Be Used To Produce Whey Products.

At the hearing, a member of the Hearing Panel questioned whether the Proposal effected a substantive or a procedural change to the Pooling Act, for, if the latter, a referendum would be required under section 62717, subdivision (b) of that Act. The testimony of the Dairy Institute of California attached a letter from its legal counsel, dated October 9, 2007, arguing that the change proposed to the Pooling Plan was substantive. That argument is clearly wrong, and none of the cases summarily cited by the Dairy Institute's counsel in his letter even purport to address the Stabilization & Marketing Act, the Pooling Act, the plans adopted thereunder, or the requirements for amendments to such plans.

First, the Proposal's principal change would be made in the Stabilization & Marketing Plans. The changes to the Pooling Plan (new proposed subdivisions (e) and (f) to section 900, and (d)(1) and (2) to section 901) merely provide a procedure to implement the credit defined in a new subdivision (G) of section 300.3 of the Stabilization & Marketing Plans, just as the

fortification and transportation credits established by the S&M Plans are procedurally implemented in the Pooling Plan.¹

Second, the Proposal is a response to the petitioner's request to eliminate completely the dry whey component of the Class 4b price, which has been in place since 2003. As discussed above, the dry whey component recognizes the additional value of milk derived from the ability to process whey into marketable products. The proposed dry whey credit is a procedure for continuing to recognize the value of milk which may be used to produce whey products and it has widespread producer support. Substantively, the Proposal does not add a new element to either the Stabilization & Marketing Plan or the Pooling Plan, but seeks to preserve value that is already recognized by the existing pricing system.

Unlike the petition, which seeks to deprive producers of the full value of their milk, the dry whey credit is a procedure for preserving much, if not all, of that value for the benefit of the producers. It would make no sense to require a producer referendum on the proposed dry whey credit, when no one has suggested that a referendum is required to eliminate the dry whey component from the class 4b price altogether. No authority exists to support such an unfair and unreasonable proposition.

3. The Proposal Maintains A Uniform Class 4b Price And Does Not Create Prohibited Unequal Raw Product Costs.

Questions were posed by the hearing panel as to whether the Proposal violates statutory provisions regarding equal or uniform raw product cost. As explained below, contrary to some of the testimony received by the Proposal's opponents, the Proposal does not create prohibited unequal raw product costs. It maintains a uniform Class 4b price and provides for a uniform pool credit by volume of milk.

The dry whey credit is uniform, as it is available to ALL cheese manufacturers on the qualified pounds, applying to the first 100,000 pounds of bulk milk processed daily (approximately 264,480 pounds of solids-not-fat per month) by every cheese plant, large or small. And every pound of milk processed by any cheese manufacturer above the qualified volume is treated the same.

There is no question that the proposed dry whey credit complies with the relevant code section regarding uniformity of costs, which is found in the Stabilization & Marketing Act, Food & Agricultural Code section 61805, subd. (b). It requires only that the Secretary "shall

¹ The fortification deductions established under S&M Plans section 300.3(B) are procedurally implemented by Pooling Plan sections 900, subdivision (c) and 901, subdivision (a)(2) by a deduction from, or a credit against, a handler's gross pool obligation. The transportation credits provided for in section 300.2 of the S&M Plans are implemented by Article 8.1 of the Pooling Plan (commencing with section 810) and section 906, subdivision 906(c)(1) and (e)(1).

endeavor under like conditions to achieve uniformity of cost to handlers for market milk within any marketing area.” This is the only portion of the statute that the testimony of the Dairy Institute quotes, ignoring the following sentence:

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.

Thus, even if the Proposal did establish non-uniform costs to cheese plants, that would not invalidate the Proposal if it otherwise promotes the purposes and pricing provisions of the Act. The pricing provision most relevant here is section 62706 that requires the director to “take into consideration any relevant economic factors, including, but not limited to: (a) The relative market value of the various products yielded from such market milk. . . .”

Because of current economies of scale, volumes of bulk milk above 100,000 pounds per day processed by cheese manufacturers are more likely to yield additional products from the whey stream and, therefore, a higher value of products from such milk. Further, section 61805 itself recognizes that the attempt to achieve uniformity applies only “under like conditions.” The Proposal recognizes that the circumstances of smaller cheese processors may not be the same as those of larger processors because smaller processors may not be able to afford the investment needed to yield market value for the dry whey resulting from their operations. At the same time that the Proposal recognizes the existence of different conditions for processors of different sizes, every processor is treated the same by each volume of milk processed.

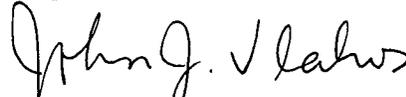
Opponents of the proposal attempt to establish non-uniformity by blending, i.e., by noting that for higher volume processors the credit applies to a smaller volume of their daily processing, hence making their “blended cost” higher than that of smaller volume processors. But nothing in the statute mandates blending, and the argument that credits which result in variations in processors’ ultimate costs violate the equal raw product rule would invalidate similar credits, such as “make” allowances, which only approximate, but do not equal every processor’s actual manufacturing costs, resulting in variations in actual costs. The goal of uniformity is met here, where for any given volume of processing, the credit (or lack of same) is the same.

Since the principal change that the Proposal would effect would be made under the Stabilization and Marketing Act, the controlling statute relevant to uniform raw product costs is

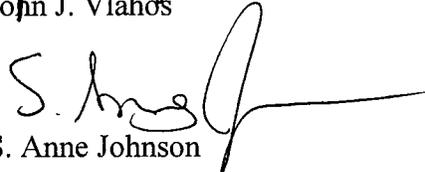
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section 61805, and not section 62720 found in the Pooling Act. But even if section 62720 did apply, the Proposal does not run afoul of its provisions, for the same reasons articulated above.

Respectfully submitted,



John J. Vlahos



S. Anne Johnson