MPC

MILK PRODUCERS COUNCIL

"Serving the Dairy Industry for More Than 50 Years"

November 7, 2008

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

Re: Post-Hearing Brief for October 30-31, 2008, Class 1, 2 & 3 hearing

Dear Mr. Cleary and Members of the Hearing Panel,

Milk Producers Council appreciates the opportunity to submit this post-hearing brief.

Most of the questions asked by members of the hearing panel regarding a potential increase, decrease, or no change in California's Class 1, 2, and 3 prices included: the effect on production of milk in California; the effect on production and sales of Class 1, 2, and 3 products in California; the effect on inter-state bulk milk movements; and the prospects for those producers in northern California whose contracts were recently terminated to find a home for their milk.

Those were excellent questions that go to the very core of the hearing. MPC believes the petitioners for a price increase did an excellent job in presenting the case for temporary relief in order to get through what everyone understands to be a period of rising production costs and lower prices. The following comments, therefore, are directed at the proposals made by processors and processor representatives for permanent price decreases as we head towards what is beginning to look like a price abyss.

The hearing record is very clear regarding milk production levels and trends in California. The closure of a major cheese manufacturing plant just about a year ago, followed by the opening of a major butter-powder plant early this year, combined to balance milk supply and plant capacity. However, last year's high milk prices lead to more milk than could be handled efficiently and equitably. This lead to the state's three largest producer cooperatives and a major cheese manufacturer to implement production control programs which, combined with the continuing increases in milk production costs and the tightening of credit, have started to show dramatic results.

Milk production in California in the first two quarters of 2008 increased by 2.6 percent above the same period in 2007, and decreased by 0.7 percent in the third quarter. We believe a net change in production of 3.3 percent over a short period of time is clear evidence that market forces (costs and prices), and steps taken by major marketers, are well on their way to correcting any over-supply of milk in California. The effect of a further decrease in income in the form of a permanent decrease in prices which were supported by nothing other than references to "historical relationships," and which

5370 Schaefer Avenue, Suite A, Chino, CA 91710 ~ phone: (909) 628-6018 ~ fax: (909) 591-7328
http://www.MilkProducersCouncil.org

were supposedly out of concern for the well-being of California producers, will definitely add to the financial distress already facing producers. Dairy Institute's important point that supply and demand for milk should help set milk prices clearly has been working.

Regarding inter-state Class 1 price relationships, Dairy Institute mischaracterizes the change in the pricing formula that resulted from the November 2006 hearing. The important change from that hearing was to add a whey component to California's price formula in order to help the California price track better with prices in federal order areas. No other significant changes were made. Since that time, cost-related adjustments were made to the make allowances for producing butter, powder, and cheese (effective December 2007), a decision was made to virtually ensure that California Class 2 and 3 prices will be lower that comparable prices in federal order areas because of the liberal rules used to permit the reporting of nonfat dry milk sales compared to the rules used for plants in federal order areas, and a significant adjustment were made to the state's transportation and allowance system which resulted in millions of dollars being removed from the pool in order to keep handlers from having to subsidize the cost of hauling milk to their plants. Each of these changes directly affected the state's Class 1, 2, and 3 price levels as well as their relationship to comparable prices in federal order areas. Over that same period, only one federal order hearing on make allowances was held, the effects of which took place on October 1st.

MPC believes that the current Class 1, 2, and 3 inter-state relationships are in proper alignment. The California and federal order base prices used to determine these prices are different and the month-to-month changes are "dynamic" as one witness testified. However, on average they appear to be sound. The simple average of California's Class 1 prices in southern California for the twenty-two months since the current Class 1 price formula became effective is $20.49 per cwt; for the same period the simple average of Class 1 prices for plants in Yuma, Arizona, was $20.50 per cwt. The prices for November, 2008, are $19.00 for Southern California and $19.43 for Yuma. Comparisons of California's Class 2 and 3 prices to Class II prices in federal order areas for the twenty-two months since January 2007 show that the prices for plants in southern California averaged $16.70 per cwt while the prices for plants in Phoenix, Arizona, averaged a dollar per cwt higher – a significant advantage for California plants.

Regarding inter-state bulk milk movements, Departmental exhibits track the beginning of bulk milk imports from Arizona in the mid 1990's, the increase in that volume through 2004-2005, and the subsequent decrease to where it was thirteen years ago. Market forces (in this case relationships of blend prices in Arizona to Class 1 prices in California, and the increase in hauling costs) again have self-corrected what has been an opportunistic, costly, and uncontrollable phenomenon. At the present time, the majority of the bulk milk coming into southern California is from southern Nevada dairies that are owned by a southern California processor. Departmental exhibits also document the historical imports of bulk milk into northern California from northern Nevada. These imports are largely related to agreements by California processors to purchase bulk milk from northern Nevada producers roughly equivalent to the volume of packaged milk shipped into Nevada which displaced locally-processed milk.

Except for the new processing plant in Yerington, Nevada, which effectively operates as a producer-handler exempt from Nevada pricing and pooling provisions because of the unique nature of its products and services, all the milk that can be used locally in that area is used in that area. A reduction in the Class 1 price in northern California will have no effect on the historical movement of bulk milk between those areas, nor can it materially affect the decisions made by the Yerington plant. Moreover, the Nevada Dairy Commission has given the Executive Director of the Commission the authority, supported by producers and handlers, to establish and maintain a price differential of $1.00 per cwt below the price for northern California. Dairy Institute apparently mischaracterizes the change that was made in August as a one time change.

Dairy Institute's characterization that there has been a "deterioration" of Class 1 price relationships uses a relatively short time period to try to justify a permanent major change to the detriment of California producers. The period from late 2006 through the present time cannot be considered representative of anything other than extra-ordinary and unprecedented during which milk prices rose and fell by historically large amounts. It cannot and should not be used to evaluate long-term relationships.

Finally, Dairy Institute also seems to be using the dynamic Class 1 vs. Overbase price spread to justify a permanent price change. Once again, the Department's own exhibits show how that price spread rises and falls based upon the month to month changes in classified prices. We believe the extra-ordinary situation where a number of producers' contracts were terminated by a single plant rather than to spread the reduced demand over all shippers (similar to what the cooperatives have done) is unfortunate, but is close to being resolved through the hard work of a small number of people and plants in California. Once again, Dairy Institute is "behind the curve" on this, not only on the timing but also because some Dairy Institute members could have taken that milk instead of Nevada milk. Moreover, the history of bulk milk movements between California and Arizona shows that strategic decisions which presumed that wide differences between Overbase prices and Arizona blend prices would be permanent ultimately caused great remorse and substantial losses for those who made those decisions.

MPC believes all proposals to make permanent reductions to classified prices in California based upon short-term imbalances should be soundly rejected.

MPC's Alternative Proposal

With regard to MPC's alternative proposal to include a "transportation surcharge" in the Class 1 formula to recover a small portion of the transportation subsidy costs, we would reiterate our position that it is impractical to ask producers to continue paying more money out of the producer pool to fund the ever-growing transportation subsidy system. This is not meant to be a debate about the merits of the subsidy system – we are merely pointing out that to continue digging deeper into the producer revenues to fund these subsidies is not sound policy.

In a free-market environment, the burden of increased transportation costs would be appropriately passed along to the buyers of the product through higher prices or some sort of surcharge. While we recognize that the California dairy industry is far from an unregulated market, MPC's proposal would inject a sliver of this free-market rationale into our heavily regulated environment. This is a modest proposal that we hope the Secretary will strongly consider implementing.

Sincerely,

Robert VandenHeuvel
General Manager

5370 Schaefer Avenue, Suite A, Chino, CA 91710 ~ phone: (909) 628-6018 ~ fax: (909) 591-7328
http://www.MilkProducersCouncil.org