



# MILK PRODUCERS COUNCIL

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October 27, 2009

Secretary A.G. Kawamura  
California Department of Food and Agriculture  
1220 N Street  
Sacramento, CA 95814

**RE: November 9<sup>th</sup> Hearing on Classes 1, 2, 3, 4a & 4b – Alternative Proposal**

Dear Secretary Kawamura,

Milk Producers Council (MPC) submits the following alternative proposal to be considered at the CDFA emergency hearing on the Class 1, 2, 3, 4a and 4b minimum price formulas scheduled for November 9, 2009.

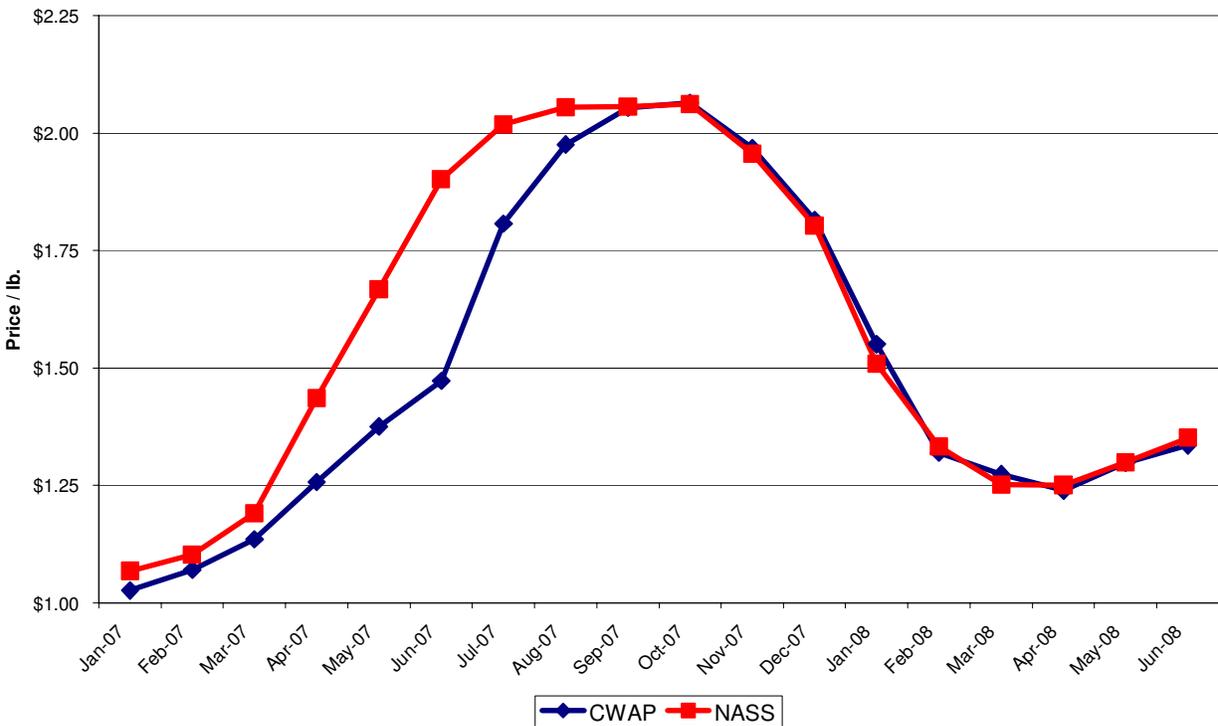
**Class 1 and 4a – Nonfat Dry Milk**

The solids-not-fat (SNF) price in California’s Class 4a formula utilizes the California Weighted Average Price (CWAP) survey to determine a product value for nonfat dry milk (NFDM). Milk Producers Council has been troubled for several years about the validity of this index.

While the CWAP has a long history in California’s pricing formula, the nature of the powder manufacturing industry in California has significantly changed over the past several years. It is our understanding that the vast majority (in excess of 90%) of the powder that makes up the CWAP comes from two cooperatives who jointly market their powder through a single marketing agency in common. The structure of the current 4a formula essentially insulates these handlers from being exposed to market forces because whatever price they decide to sell their powder for becomes the product value price that determines the milk price they are subjected to.

In 2007, a huge variance emerged between the price that drives the California 4a formula and the National Agricultural Statistics Service (NASS) nonfat dry milk price survey that is used in the Federal Order program. California producers were shorted millions of dollars in our opinion of legitimate revenue because of the inadequacies of the CWAP. Some modest changes were made in late 2007, based in some ways on assurances from the powder makers that while producers lost money as prices moved up, they would recover those higher prices as the market moved back down. However, as evidenced by the chart on the next page, the CWAP fell in lock step with the NASS price when market prices crashed in 2008.

**NFDM Price Surveys - NASS vs. CWAP  
January 2007 - June 2008**



Over the past year and a half powder prices have been at the bottom of the price cycle and the CWAP and NASS prices have tracked very closely. But the powder market is now recovering and once again we are seeing the CWAP lag behind the NASS powder price. We are very concerned that California producers who are in desperate need of income will be deprived of legitimate revenue because of the lack of incentive that California powder makers have in keeping California powder prices in line with the market price as revealed by NASS.

The price of NFDM has a huge impact on dairy farmers' revenue, as the Class 4a price moves up or down by approximately \$0.09 per hundredweight for every penny NDFM moves per pound. Further, NDFM not only drives the Class 4a price, but also the Class 2 and 3 prices. It also plays a role in the calculation of the Class 1 price. These four classes make up 55 – 60 percent of the California pool, making the NDFM value used in the California formulas of utmost importance to producers, particularly in a year like 2009, with devastating on-farm financial losses being experienced by our dairy producers.

In order to keep California producers in alignment with our fellow producers in neighboring states, **MPC proposes that the CDFA replaces the use of the CWAP in the Class 1 and 4a formulas, and instead utilizes the NASS survey to determine a value for NDFM.**

### **Class 1 and 4b – Dry Whey**

On December 1, 2007, CDFA replaced a variable dry whey factor that had been in the Class 4b formula with a static \$0.25 per hundredweight factor. While 2007 saw the value of dry whey get as high as \$0.80 per pound, in the roughly two years since CDFA's change in the formula, the value of dry whey has primarily ranged between \$0.15 - \$0.30 per pound. With dry whey valued at that level, the \$0.25 per pound static dry whey factor has been adequate to compensate producers for the value of the whey stream.

However, the market for dry whey has begun to show strength again in recent months, and there is concern amongst producers that if the value of dry whey continues to rise significantly, California producers will be deprived of legitimate value that is being earned on Class 4b milk.

Further, the value of dry whey is also used in calculating the Class 1 price. With roughly 55 percent of the California pool price being driven by the Class 1 and 4b prices, California producers cannot afford to be locked out of receiving at least a share of the revenues from a strengthening whey market, particularly given the financially devastating year our producers have had.

Therefore, MPC proposes that CDFA modify the whey factor in both the Class 1 and 4b formulas. There are two parts of this proposal:

- 1. In addition to the \$0.25 fixed whey factor in the Class 4b formula, we propose that when the NASS Dry Whey price exceeds \$0.35 per pound the additional value be split 50/50 between producers and processors.**
- 2. In calculating the value of the dry whey for both the Class 1 and 4b formulas, we propose using the weighted average dry whey price reported by NASS.**

Both of these proposals meet the emergency conditions criteria spelled out in the call of the hearing because in both cases if the department does not adopt the proposals we have made, potentially millions of dollars of legitimate, much needed, market-based revenue will not flow into producers' pockets. If the department does not act now, both of these issues will be dealt with in the future because the current 4a and 4b formulas are deficient as we outlined above, but the damage done to California's producer sector by waiting will be incalculable.

Please feel free to contact me if you have any questions.

Sincerely,



Robert Vandenheuvel  
General Manager

**Excerpts from the Stabilization and Marketing Plan for Market Milk – *Proposed Changes***  
***Highlighted***

**Northern California Marketing Area**

***(Same changes shall be applied to the Stabilization Plan for the Southern California marketing area)***

**Article III - Class Prices**

Section 300.0. The minimum class prices for the milk fat and skim milk components of market milk, market cream, and market skim milk f.o.b. the pool plant or nonpool plant located within this Marketing Area where the milk was first received from producers, shall be as follows:

- (A) The minimum monthly prices for components used for Class 1 shall be determined prior to the beginning of each month, using the following formulas and procedures, except as such formulas and procedures may be modified by Paragraph (H) of this Section:
- (1) For all milk fat, not less than the price per pound computed by the formula using the butter price determined pursuant to Subparagraph (A)(5) of this Section, less a butter adjuster of thirteen and fifteen hundredths cents (\$0.1315), and the result multiplied by a yield factor of 1.2.
  - (2) For all milk solids-not-fat, not less than the price per pound computed by the formula using the Commodity Reference price per hundredweight determined pursuant to Subparagraph (A)(4) of this Section, minus twenty and three-tenths cents (\$0.203), less 3.5 times the fat price per pound determined pursuant to Subparagraph (A)(1) of this Section, all multiplied by 0.76 and divided by 8.7.
  - (3) For all fluid carrier, not less than the price per pound computed by the formula using the Commodity Reference Price per hundredweight determined pursuant to Subparagraph (A)(4) of this Section, minus twenty and three-tenths cents (\$0.203), less 3.5 times the fat price per pound determined pursuant to Subparagraph (A)(1) of this Section, all multiplied by 0.24 and divided by 87.8, and then \$0.0031 per pound subtracted from the result.
  - (4) The Commodity Reference Price per hundredweight shall be the higher of either:
    - (a) The sum of the following three formulas:
      - (i) The price per hundredweight computed by the formula using the Cheddar cheese price determined pursuant to Subparagraph (A)(6) of this Section, multiplied by a Cheddar cheese yield factor of nine and eight-tenths (9.8).
      - (ii) The price per hundredweight computed by the formula using the butter price determined pursuant to Subparagraph (A)(5) of this Section, less ten cents (\$0.10), all multiplied by a whey butter yield factor of twenty-seven-hundredths (0.27).
      - (iii) The price per hundredweight computed by the formula using the dry whey price determined pursuant to Subparagraph (A)(7) of this Section multiplied by a dry whey yield of 5.8, all less a dry whey adjuster of eighty-five cents (\$0.85).
    - (b) The sum of the following two formulas:
      - (i) The price per hundredweight computed by the formula using the butter price determined pursuant to Subparagraph (A)(5) of this Section, multiplied by a butter yield factor of 1.2, and the result multiplied by 3.5.
      - (ii) The price per hundredweight computed by the formula using the nonfat dry milk price determined pursuant to Subparagraph (A)(8) of this Section, multiplied by a nonfat dry milk yield factor of 0.99, and the result multiplied by 8.7.

- (5) The butter price used in calculations pursuant to Paragraph (A) shall be the simple average of the daily closing Grade AA butter prices at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the second previous month and concluding the 10th day of the previous month. In the event that Chicago Mercantile Exchange Grade AA butter prices are not available to calculate the butter price fifteen days prior to the effective date of the Class 1 pricing period concerned, then used in its place shall be the butter price used in the previous month's calculation.
  - (6) The Cheddar cheese price used in calculations pursuant to Paragraph (A) shall be the simple average of the daily closing 40 pound block Cheddar cheese prices at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the second previous month and concluding the 10th day of the previous month. In the event that Chicago Mercantile Exchange 40 pound block Cheddar prices are not available to calculate the Cheddar cheese price fifteen days prior to the effective date of the Class 1 pricing period concerned, then used in its place shall be the Cheddar cheese price used in the previous month's calculation.
  - (7) The dry whey prices used in calculations pursuant to Paragraph (A) shall be the **weighted average of the two most recent weekly U.S. average National Agricultural Statistics Service (NASS) dry whey survey prices reported by the U.S. Department of Agriculture**, *simple average of the Dry Whey—West Mostly prices as published in Dairy Market News* available on the 10th day of the previous month.
  - (8) The nonfat dry milk price used in calculations pursuant to Paragraph (A) shall be the weighted average of the two most recent weekly **U.S. average NASS nonfat dry milk survey** prices **reported by the U.S. Department of Agriculture**, available on the 10th day of the previous month. *The weekly reports are used to calculate the weighted average price per pound for all Grade A and extra grade nonfat dry milk for human consumption sold f.o.b. California manufacturing plants for the seven day period ending on Friday as reported by the California Department of Food and Agriculture.*
  - (9) For any month in which the Secretary implements the collection of security charges provided for in Chapter 2.5, Part 3, Division 21 of the Food and Agricultural Code, the minimum Class 1 prices shall be increased by the following amounts:
    - (a) For milk fat, five and seven-tenths mils (\$0.0057) per pound.
    - (b) For milk solids-not-fat, two and three-tenths mils (\$0.0023) per pound.
    - (c) For fluid carrier, one-tenth mil (\$0.0001) per pound.
- (B) The minimum bimonthly prices for components used for Class 2 shall be determined at the beginning of each even month, using the following formulas and procedures:
- (1) For all milk fat, not less than the Average Class 4a fat price.
  - (2) For all milk solids-not-fat, not less than the Average Class 4a solids-not-fat price plus four and ninety hundredths cents (\$0.0490) per pound.
  - (3) For any month in which the Secretary implements the collection of security charges provided for in Chapter 2.5, Part 3, Division 21 of the Food and Agricultural Code, the minimum Class 2 prices shall be increased by the following amounts:
    - (a) For milk fat, seven and one-tenth mils (\$0.0071) per pound.
    - (b) For milk solids-not-fat, two and nine-tenths mils (\$0.0029) per pound.
  - (4) The time periods for the Average Class 4a fat price used in Subparagraph (B)(1) and the Average Class 4a solids-not-fat price used in Subparagraph (B)(2) of this Section shall be those in Subparagraph (B)(5) of this Section.
  - (5) For February-March Class 2 and 3 pricing period, the average of preceding December-January Class 4a component prices per pound.  
For April-May Class 2 and 3 pricing period, the average of preceding February-March Class 4a component prices per pound.  
For June-July Class 2 and 3 pricing period, average of preceding April-May Class 4a

component prices per pound.

For August-September Class 2 and 3 pricing period, average of preceding June-July Class 4a component prices per pound.

For October-November Class 2 and 3 pricing period, average of preceding August-September Class 4a component prices per pound.

For December-January Class 2 and 3 pricing period, average of preceding October-November Class 4a component prices per pound.

(C) The minimum bimonthly prices for components used for Class 3 shall be determined at the beginning of each even month, using the following formulas and procedures:

- (1) For all milk fat, not less than the Average Class 4a fat price.
- (2) For all milk solids-not-fat, not less than the Average Class 4a solids-not-fat price plus four and thirty-three hundredths cents (\$0.0433) per pound.
- (3) For any month in which the Secretary implements the collection of security charges provided for in Chapter 2.5, Part 3, Division 21 of the Food and Agricultural Code, the minimum Class 3 prices shall be increased by the following amounts:
  - (a) For milk fat, seven and one-tenth mills (\$0.0071) per pound.
  - (b) For milk solids-not-fat, two and nine-tenths mills (\$0.0029) per pound.
- (4) The time periods for the Average Class 4a fat price used in Subparagraph (C)(1) and the Average Class 4a solids-not-fat price used in Subparagraph (C)(2) of this Section shall be those in Subparagraph (B)(5) of this Section.

(D) The minimum prices to be paid for components used for Class 4a shall be computed as follows:

- (1) For all milk fat, not less than the price per pound computed by the formula using the butter price, less an f.o.b. California price adjuster of three and nine hundredths cents (\$0.0309), less a manufacturing cost allowance of fifteen and six tenths cents (\$0.156), and the result multiplied by a yield factor of one and two-tenths (1.2).
- (2) For all milk solids-not-fat, not less than the price per pound computed by the formula using the nonfat dry milk price, less a manufacturing cost allowance of sixteen and ninety-eight hundredths cents (\$0.1698), multiplied by a yield factor of one (1.0).
- (3) The butter prices used in calculations pursuant to this Paragraph shall be the simple average of the Grade AA butter price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.
- (4) The nonfat dry milk prices used in calculations pursuant to this Paragraph shall be the **U.S. average NASS nonfat dry milk survey price reported by the U.S. Department of Agriculture for the month.**
- (5) In the event that the Chicago Mercantile Exchange Grade AA butter price is not available to calculate the current Class 4a fat price, pursuant to Subparagraph (D)(1), then used in its place shall be the Chicago Mercantile Exchange Grade AA butter price used in the prior month's calculation of the Class 4a fat price. All other Paragraphs that use the Class 4a fat price shall operate as if the price had been established pursuant to Subparagraph (D)(1).
- (6) *In the event that the California weighted average nonfat dry milk price is not available to calculate the current Class 4a solids not fat component price, pursuant to Subparagraph (D)(2), then used in its place shall be the California weighted average nonfat dry milk price used in the prior month's calculation of the Class 4a solids not fat price. All other Paragraphs that use the Class 4a solids not fat price shall operate as if the solids not fat price had been established pursuant to Subparagraph (D)(2).*

(E) The minimum prices to be paid for components used for Class 4b shall be computed as follows:

- (1) The Cheese hundredweight price shall be the price per hundredweight computed by the sum of the following:
  - (a) The price per hundredweight computed by the formula using the Cheddar cheese price, less an f.o.b. California price adjuster of two and fifty-two hundredths cents

(\$0.0252), less a Cheddar cheese manufacturing cost allowance of nineteen and eighty-eight hundredths cents (\$0.1988), all multiplied by a yield factor of ten and two-tenths (10.2).

- (b) The price per hundredweight computed by the formula using the butter price, less a manufacturing cost allowance of fifteen and six tenths cents (\$0.156), less ten cents (\$0.10), all multiplied by a yield factor of twenty-seven-hundredths (0.27).
  - (c) The constant whey factor of twenty-five cents per hundredweight (\$0.25), **plus the higher of: (i) the weighted average of the monthly U.S. average NASS dry whey survey price reported by the U.S. Department of Agriculture, less thirty-five cents (\$0.35), all multiplied by a yield factor of 5.8, divided by 2; or (ii) zero.**
- (2) For all milk fat, not less than the price per pound computed pursuant to Subparagraph (D)(1) of this Section.
  - (3) For all milk solids-not-fat, not less than the price per pound computed by the formula using the Cheese hundredweight price established pursuant to Subparagraph (E)(1) less the product of three and seventy-two hundredths (3.72) multiplied by the Class 4b fat price established pursuant to Subparagraph (E)(2), all divided by eight and eighty hundredths (8.80).
  - (4) The Cheddar cheese prices used in calculations pursuant this Paragraph shall be the simple average of the 40 pound block Cheddar cheese price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.
  - (5) The butter prices used in calculations pursuant this Paragraph shall be the simple average of the Grade AA butter price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.
  - (6) In the event the Chicago Mercantile Exchange 40 pound block Cheddar cheese price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the cheese price used in the prior month's calculation of the Cheese hundredweight price.
  - (7) In the event that the Chicago Mercantile Exchange Grade AA butter price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the Grade AA butter price used in the prior month's calculation of the Cheese hundredweight price.
- (F) The minimum prices to be paid pursuant to Paragraph (A) of this section shall be computed by the Dairy Marketing Branch and furnished to handlers not less than ten days prior to the effective date of each price change.
  - (G) The minimum prices to be paid pursuant to Paragraphs (B), (C), (D), and (E) of this section will be computed by the Dairy Marketing Branch and furnished to handlers each month.
  - (H) The minimum price for components used for Class 1, as set forth in Paragraph (A) of this Section, shall be modified only for the period April and May, 1997 and shall be:
    - (1) The fat component price shall be \$1.0004 per pound.
    - (2) The solids-not-fat component prices shall be \$0.9575 per pound.
    - (3) The fluid carrier component price shall be \$0.0283 per pound.