MEETING

STATE OF CALIFORNIA

CALIFORNIA DEPARTMENT OF FOOD & AGRICULTURE

AN EMERGENCY CONSOLIDATED PUBLIC HEARING TO CONSIDER AMENDMENTS TO THE STABILIZATION AND MARKETING PLANS FOR MARKET MILK FOR THE NORTHERN AND SOUTHERN CALIFORNIA MARKETING AREAS

AUDITORIUM

CALIFORNIA DEPARTMENT OF FOOD & AGRICULTURE

1220 N STREET

SACRAMENTO, CALIFORNIA

MONDAY, NOVEMBER 9, 2009

8:34 A.M.

Reported By:
Peter Petty

APPEARANCES

DEPARTMENT OF FOOD & AGRICULTURE

Dee Anne Holloway, EEO Program Analyst, Hearing Officer

David Ikari, Dairy Marketing Branch, Panel Member

Hyrum Eastman, Dairy Marketing Branch, Panel Member

Candace Gates, Dairy Marketing Branch, Panel Member

Annie AcMoody, Dairy Marketing Branch, Panel Member

Michael Francesconi, Supervising Auditor, Dairy Marketing Branch

PETITIONERS

William C. Van Dam, the Alliance of Western Milk Producers

Tiffany LaMendola, Western United Dairymen

Michael Marsh, Western United Dairymen

WITNESSES

John Kaczor, Milk Producers Council

Geoffrey Vanden Heuvel, Milk Producers Council

William Schiek, Dairy Institute of California

Lynne McBride, California Dairy Campaign

Joaquin Contente, California Dairy Campaign

Scott Magneson, California Dairy Campaign

Linda Lopes, California Dairy Women Association

Eric Erba, California Dairies, Inc.

John Jeter, Hilmar Cheese Co., Inc.

John Hitchell, The Kroger Co.

Peter Hoekstra, Ganske, Mulder & Co.

APPEARANCES (CONT.)

WITNESSES

Tom Wegner, Land O'Lakes, Inc.

Dennis Brimhall, Super Store Industries

Greg Dryer, Saputo Cheese, USA, Inc.

John Bedrosian, Unified Grocers

Scott Hofferber, Farmdale Creamery, Inc.

Mike McCully, Kraft Foods

Patricia Stroup, Nestle USA

John Rossi, Hay Dealer in Manteca

David Gilbert, Al Gilbert Co.

Sue Taylor,, Leprino Foods Co.

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P R O C E E D I N G S

HEARING OFFICER HOLLOWAY: Hello, good morning everybody. If I can get your attention, I would like to mention a few little details to make sure this hearing runs as smoothly as possible.

First, I would appreciate if you could please turn off your phones so they don't go off during the hearing.

Also, if you're going to come up and testify, as I know a number of you will, the place that you will testify is over here by the microphone right here.

THE REPORTER: Right here, right here.

HEARING OFFICER HOLLOWAY: Oh, over here. Okay.

If you have something you would like considered as an exhibit, please bring it up to me first, before you sit down to speak, so I can mark it as an exhibit.

Most you probably know where the restrooms are. If not, they're outside this room, you just need to make a left and they will be on the right.

We will probably break for lunch at around 12:30, depending on the flow of the testimony.

The room has been vacated before five o'clock, so depending on testimony we will end the day a little before that. If there were more testimony to be presented, the hearing would resume tomorrow morning at 8:30 a.m. in this room.

This hearing will now come to order. The California Department of Food and Agriculture has called this public hearing at the Department's auditorium, 1220 N Street, Sacramento, California on this day, Monday, November 9th, 2009 beginning at 8:30 a.m.

My name is Dee Anne Holloway; I am an employee with the California Department of Food and Agriculture. I have been designated as the Hearing Officer for today's proceedings and I have no personal interest in the outcome of this hearing.

I will not be personally involved in any decision that may result from this hearing.

On October 5, 2009 the Department received a petition from The Alliance of Western Milk Producers requesting an emergency public hearing to consider permanent amendments to the class 1, 2 and 3 pricing of formulas of the stabilization and marketing plans for market milk for the Northern and Southern California marketing areas.

On October 16, 2009 the Department received a petition from Western United Dairymen requesting a public hearing on an emergency basis to consider temporary amendments to the class 1, 2, 3, 4a and 4b pricing formulas of the stabilization and marketing plans for market milk for the Northern and Southern California marketing areas.

The Department announced the call of a hearing on

October 19, 2009, on an emergency basis, to consider the petitioners proposed permanent and temporary changes to components of the current class 1, 2, 3, 4a and 4b pricing formulas.

Further, this hearing will also consider any other aspect of the class 1, 2, 3, 4a and 4b pricing formulas that are raised by alternative proposals received by the October 28, 2009 deadline.

This hearing will also consider the factual basis, evidence, and the legal authority upon which to make any and/or all of the proposed amendments to the plans.

The Department has received five alternative proposals in response to the call of the hearing. The alternative proposals are from California Dairy Women Association, Dairy Institute, Milk Producers Council, California Dairy Campaign, and California Dairies, Incorporated.

The two petitioners will each have up to 45 minutes each to submit testimony and relative material to support their proposal; which then will be followed by any questions from the panel.

The five parties who submitted alternative proposals will each be provided 30 minutes to give testimony and evidence, followed by questions from the panel.

Anyone else wishing to testifying must sign in on the hearing roster located at the back of the room, and will be allowed 20 minutes to give testimony and evidence.

Witnesses will be called in the order they sign up. The timeclock to my right has been established to assist you when testifying.

Please note that only those individuals who have testified under oath during the conduct of the hearing may request a post-hearing brief period to amplify, explain, or even withdraw their testimony.

Only those individuals who have requested a post-hearing brief period may file a post-hearing brief with the Department.

I will analyze the situation and let you know later when those will be due.

As a courtesy to the panel, the department staff and the public, please speak directly to the issues presented by the petitions and avoid personalizing any type of disagreements.

Such conduct does not assist the panel in any way whatsoever.

The hearing panel has been selected by the Department to hear testimony, receive evidence, question witnesses, and make recommendations to the Secretary.

Please note that the questioning of witnesses by anyone other than the members of the panel is not permitted.

The panel is composed of members of the Department's Dairy Marketing Branch which include David Ikari, which is the Branch Chief, to my left; Candace Gates, Research Manager; Hyrum Eastman, which the Agricultural Economist to my left; and Annie AcMoody, which is the Agricultural Economist.

I am not a member of the panel and I will not be taking any part in any discussions relative to the hearing.

The recording of the hearing will be handled by the firm of Peters Shorthand Reporting Corporation, which is located in Sacramento. A transcript of today's hearing will be available for review at the Marketing Branch headquarters, located in Sacramento, at 560 J Street, Suite 150.

Testimony and evidence pertinent to the call of the hearing will now be received.

At this time Mike Francesconi, Supervising Auditor in the Dairy Marketing Branch, will introduce the Department's exhibits.

The audience may ask questions of Mr. Francesconi only as it relates to the exhibits.

Mr. Francesconi, will you please state your full name and spell your name for the record?

MR. FRANCESCONI: Okay. My full name is Michael Francesconi. It's M-i-c-h-a-e-l F-r-a-n-c-e-s-c-o-n-i.

HEARING OFFICER HOLLOWAY: Oh, do you swear or affirm to tell the truth?

MR. FRANCESCONI: I do.

HEARING OFFICER HOLLOWAY: Thank you. You may proceed.

PANEL MEMBER FRANCESCONI: Thank you. Madam Hearing Officer, my name is Mike Francesconi, I'm a Supervising Auditor with the Dairy Marketing Branch of the California Department of Food and Agriculture.

My purpose here this morning is to introduce the Department's composite hearings numbered 1 through 44. Relative to these exhibits, previous issues of Exhibits 8 through 44 are also hereby entered by reference.

The exhibits entered here today have been available for review at the Office of the Dairy Marketing Branch since the close of business of October 26th, 2009. An abridged copy of the exhibits is available for inspection at the back of the room.

A copy of the exhibit list is also available at the back of the room.

Additionally, I'm entering the Department's response to a request for information from Milk Producers Council as Exhibit 45.

And I'll bring these all up when I'm done entering here.

I'm also entering a Department's response to a request for information from Dairy Institute and Scott Magneson of California Dairy Campaign as Exhibit 46.

I'm also entering a document release by the Department comparing Chicago Mercantile Exchange prices and audited California cheese and butter sales dated November 2009, as Exhibit 47.

I'll also enter a document, a letter of support from Western Milling Quality Feeds, dated November 6th, as Exhibit 48.

Another document, a letter of support from Security Milk Producers Association, dated November 5th, 2009 as Exhibit 49.

I'll also enter a last document, a letter of support, from Assembly Member of the 17th District, Cathleen Galgiani, dated November 6th, 2009 as Exhibit 50.

(Exhibits 1 through 50 were identified
for the record.)

I ask at this time that the composite exhibits be received. I also request the opportunity to provide a post-hearing brief, Madam Hearing Officer, and this concludes my testimony.

HEARING OFFICER HOLLOWAY: Okay, your request to file a post-hearing brief is granted.

PANEL MEMBER FRANCESCONI: I'll bring these up here for you.

HEARING OFFICER HOLLOWAY: Okay, thank you.

Are there any questions for the Department's witnesses regarding the Department's exhibits?

MR. KACZOR: The question I have has to do with, I believe, Exhibit 25, which are questions and answers relative to the auditing procedure used by the Department of Food and Agriculture on the weekly and monthly sale, reports of sales of non-pack dry milk.

HEARING OFFICER HOLLOWAY: Excuse me, may I please have you introduce yourself and spell your name for the record?

MR. KACZOR: Thank you very much. My name is John Kaczor. The last name is spelled K-a-c-z-o-r. I'm representing Milk Producers Council.

HEARING OFFICER HOLLOWAY: Thank you, go right ahead.

MR. KACZOR: I'm not quite clear as to whom I should address these questions; they do relate to the questions that were submitted for clarification of auditing procedures and that were answered in part of the Department's exhibits.

The first general question I have is the last time this subject came up in relevant conditions was two years ago and where questions were raised regarding what auditing procedures were followed by the Department, and a number of follow-up questions were asked by Milk Producers Council this year and were answered.

The first general question is has there been any changes in the procedures used by the Department over that two-year period?

PANEL MEMBER FRANCESCONI: Well, I can speak personally, for myself as a hearing witness, plus the person in charge of the audits. I've been doing it for three years now and so we have changed not so much procedures of the audit, but more of documentation.

MR. KACZOR: Well, thank you. One specific question that was raised two years ago had to do with whether or not the Department looked at general ledgers and related documents; and the answer that was given two years ago was "the Department examines the sales invoices and the detailed summary sheets of sales. The Department does not review the general ledger, plant inventory, or other financial records of the plants that produce powder."

A similar question was asked by Milk Producers Council this year and specifically was "without a review of the general ledgers or other financial records, how does CDFA verify that there is no financial dealing between a seller and a broker or buyer related to sales of nonfat dry milk that could affect the completeness and accuracy of the report submitted by the seller to CDFA?"

The answer that was given is "by reviewing all invoices and identifying sales customers to ensure compliance. The Department has a long-standing policy that only sales involving objective third parties are included. Any sales between companies that have a business relationship with each other are excluded. Company sales between or among its members or business affiliates are also excluded."

Another question was "without a review being made of general ledgers, inventories, or other financial records of the plants or other reporting agencies how does CDFA verify that all sales that should be reported are reported?"

And the answer given "all plants that produce nonfat dry milk submit a monthly production report to the Department, to the Dairy Marketing Branch Statistics Unit. The sales volume of nonfat dry milk for each plant is measured against nonfat dry milk produced as reported to the Statistics Unit. The Dairy Market staff audit the reported sales against the plant's monthly production and inventory to determine the sales are in alignment."

Now, the question is were inventories looked at -- are inventories looked at now and were not two years ago; is that a change that was made?

PANEL MEMBER FRANCESCONI: Inventories have always been looked at, but I've implemented procedure of tracking it and documenting it. It probably has been in the past, but it was not -- I don't have any records to refer back to prior to three years ago.

MR. KACZOR: Okay. With respect to the question of verification of payments, does the Department of Food and Agriculture verify payments that are made or do they not?

PANEL MEMBER FRANCESCONI: I'd like to address that one in a post-hearing brief, if you don't mind.

MR. KACZOR: I appreciate that. And does the Department look at general ledgers or do they not?

PANEL MEMBER FRANCESCONI: They do not. We do not do financial audits, we do compliance audits.

MR. KACZOR: So is it fair to say then that the Department does not have the ability to determine if payments have been made or if adjustments to the payments may have been made, whether it's to a final user or to a broker?

PANEL MEMBER FRANCESCONI: I'll address that in a post-hearing brief, too.

MR. KACZOR: Okay, thank you very much.

HEARING OFFICER HOLLOWAY: Okay. I'm not hearing any objections or comments, the Department's exhibits are now entered into the record, Exhibit 45 through 50.

Thank you very much, Mr. Francesconi.

PANEL MEMBER FRANCESCONI: Thank you.

HEARING OFFICER HOLLOWAY: Uh-hum. At this time I'd like to call the petitioners, Alliance of Western Milk Producers. You will have a total of 45 minutes to submit your testimony. You'll notice that we have a timeclock running over here to my right.

Thank you, sir, good morning.

PANEL MEMBER IKARI: Thank you. Madam Hearing Officer, just a point of clarification. I think you -- did you enter Exhibits 1 through 45 and then 45 through 50?

HEARING OFFICER HOLLOWAY: Yes, I'm sorry, all inclusive, Exhibits 1 through 50.

PANEL MEMBER IKARI: Thank you.

(Exhibits 1 through 50 were received in evidence.)

HEARING OFFICER HOLLOWAY: Okay, please state your full name and spell your first and last name, and please state your affiliation for the record?

MR. VAN DAM: Good morning, my name is William C. Van Dam, W-i-l-l-i-a-m C., the letter "C", V-a-n and then a separate word D-a-m. I am the CEO and Executive Vice President of The Alliance of Western Milk Producers.

HEARING OFFICER HOLLOWAY: Thank you. Do you affirm to tell the truth?

MR. VAN DAM: Yes, I do.

HEARING OFFICER HOLLOWAY: Okay. The written statements here, would you like to have that entered into the record at this time?

MR. VAN DAM: Yes, I would, including the tables at the end as part of the testimony.

HEARING OFFICER HOLLOWAY: Okay, that's marked as Exhibit 51.

(Exhibit 51 was identified for the record and received in evidence.)

HEARING OFFICER HOLLOWAY: Go right ahead, please.

MR. VAN DAM: Good morning. I am William C. Van Dam, Executive Vice President of The Alliance of Western Milk Producers. My office is at 1000 G Street, Suite 230, Sacramento, California.

The Alliance member organizations are California Dairies, Inc and Dairy Farmers of America, Western Council. Combined, the members of these two cooperatives produce approximately 55 percent of the milk produced in California.

I would like to thank the Secretary for responding to our petition by calling this hearing so quickly.

The first topic here is why call an emergency hearing?

The decision to petition this emergency hearing was made at our September 21, 2009 Board of Directors meeting. The single most important piece of new information available at that time was the August 2009 milk production data. I used an arrow to highlight that data point on the graph, on Graph A on this page. It was alarming to see that milk production in this State had decreased from July and this showed that the July observation was not an aberration. The final data point on Graph A is the September number, which further verifies the negative trends in production.

It is very important that you understand and appreciate that this decrease if far below the production bases established separately by the three large cooperatives plus Hilmar.

The production base limit is estimated, on the chart below, as the average daily production for 2007 and is shown as a straight line at just over 111 million pounds of milk a day.

I, and surely many others, have operated under the firm belief that California producers will always produce a volume of milk that would be pressing up against their production bases, if there were such a thing in the past.

With that thought in mind, please look again at Graph A and note how far below the expected production base line that the last three months have been, and especially notice how sharply production has dropped. In both July and August milk production was more than 6.6 million pounds per day less than the expected production base total. The

September number is an astounding 9.1 million pounds less than expected.

Until these recent months, the production base limits appeared to be the cause of milk supply no longer growing.

However, as of June 2009 the drop off clearly departed from the production base baseline. Clearly, the production bases are no longer the factor that is constraining production.

There are other factors that are not just limiting production but are reducing production. This is totally unprecedented in the dairy history of California, at least for the 40 years that I remember.

The numbers show us that something significant has changed. I believe it is partially, if not completely, explained by the comments given by Corry Gallagher during a presentation to the State Board of Agriculture on October 28th, 2009, just a couple of weeks ago.

Mr. Gallagher works for the Bank of America, but made his presentation in his role as Chairman of the California Banking Association AG Lending Committee.

Here is the content of his key slide, three messages. Number one, "California Ag Lenders have sufficient funds to make farm loans in 2009 and beyond."

And then I've emphasized the next comment and as part of his point one, "cash flow drives the ability to repay."

Point number two is actually a friendly sounding one, it says "California Ag Lenders want farm loans and will compete to get your business."

The key to this whole thing is in point three. Point three says "it is not business as usual for the banking industry or for the dairy business; credit risk increases rates. Losses have averaged nearly $100 per cow per month for the last 10 months. Cow values have dropped. Risk continues until global demand improves, supplies are reduced and milk prices go above break even."

The levels of losses experienced by our dairymen this year have stunned us all and have especially shocked those who provide the financing for our dairymen. Losses were far higher than ever before because costs, most notably feed costs, have moved up sharply and stayed above their historical levels, while the support system in place has not changed at all, with the exception of the MILC program which is of limited value to the average California dairyman.

The view of the financial community toward dairy financing will never be the same again. Money will not be available for expansion from current levels of production, let alone new facility expansion, unless the business plan presented to the bank considers all factors, market risk included, and can demonstrate reasonable assurances of profitability.

There has been much turmoil in our industry over the past year; it is part of what happens during periods of stress. The calls to do something become increasingly frequent and more strident.

Fortunately, it does appear that significant price relief is here. Now it is time to get all parts of our industry pulling together again. Step one to restoring confidence in the California Dairy industry is to illustrate that the governmental agencies involved are willing to work with the industry to help it adapt to our changing times.

Restoring normal price relationships is an important part of rebuilding confidence in our system; not just with producers, but also all of those whose livelihood is tied to providing services to the dairy industry. And I might add that includes the banks.

It is also true that the only way to get this new information through a hearing process and to get the process completed by January 1, of 2010, was to call for an emergency hearing.

The plight of the producer in 2009; figure 9, on page 19 of the background material prepared by the CDFA staff for this hearing clearly illustrates what has happened to producer profitability in the first two quarters of 2009.

The comparison to the year of 2006, which was also a poor year for dairymen, shows a similar pattern to 2009, but because costs were at a more traditional level the losses, while painful, were not fatal. Several others witnesses this morning and today will be speaking directly to the plight of the producers in 2009 so I will not dwell on it for the moment.

A review of last year's hearing result; one year and 11 days ago at a hearing in this room, The Alliance and several other producer organizations jointly proposed a $1 surcharge on the Class 1, 2 and 3 prices for a period of six months. Had that surcharge been in place in 2009 it would have generated $44 million for producers.

However, instead of a helpful surcharge CDFA, after considering the evidence, decided on a permanent reduction of Class 1 prices of 35 cents per hundred weight and a decrease in Class 1 and 3 prices of 26 cents per hundred weight.

Tables 1, 2 and 3, attached to this testimony, point out that the lost income for January through September of 2009 was $15.2 million for Class 1, $3.8 million for Class 2, and $4 million for Class 3. That's a total of $23 million. Annualized that is $30.7 million of lost premium income to producers. And I might add in a year that would have been incredibly helpful.

This $30 million reduction in producer income, while not voluntarily given by producers, can be given an investment. Call it market development.

I think it is appropriate to take a moment to see how our investment worked out.

Class 1 sales in California for the first nine months of 2009 are down 2.2 percent. Keep in mind that Class 1 prices in the first nine months of 2008 averaged $20.72 per hundred weight. In 2009 the average has been $12.76 per hundred weight. That is a drop of $7.96 per hundred weight, which does include the 35 cent formula change; the rest of it which is price changes because of the overall conditions.

Overall, the Class 1 price that producers received dropped 38.4 percent, but the Class 1 usage is down 2.2 percent. It is difficult to find any silver lining in this cloud, it was a badly timed experiment that did not work and it cost the producers dearly.

Class 2 pooled utilization in California for the first nine months of 2009 are up. Fat utilization was up 13 percent. This is fairly impressive until you notice that the increase driving these numbers began in July of 2008, six months before the reduction in Class 2 fat price and thus the growth had nothing at all to do with the price adjustment.

The gain on the solids-not-fat side was 2.7 percent, which represents 2.7 million pounds of solids, not fat, which is helpful in terms of milk usage. But the amount of "investment" by producers of $1.5 million was equal to 54 cents per pound of solids-not-fat gain. One can hardly believe that that was a worthwhile investment.

Class 3 pooled utilization of fat was down 5.5 percent for the first nine months of 2009 compared to the same period in 2008. The decrease in income to producers for Class 3 fat was just over $3 million based on the volumes pooled in 2009. It seems that that was given away for no useful purpose at all.

Class 3 solids-not-fat usage on the other hand was up a bit with a 2 percent growth, which was an additional usage of 1.4 million pounds of solids-not-fat. That, however, works out to an investment by producers of 76 cents per pound of solids-not-fat gained.

An interesting side observation about frozen products is that Table 12 of the Dairy Information Bulletin indicates manufacturing increases of 8.2 percent, while pool utilization figures for the same period show a perplexing decrease of 5.5 percent for fat and a gain of only 2 percent for solids-not-fat.

It's hard to explain how that happened, but there probably is an explanation.

I would like to point out and stress that both Class 2 and Class 3 prices, because of the operation of the price farm list, were 37 percent less in the first nine months of 2009 than they were in 2008. The decrease was $6.35 per hundred weight, which includes the 26 cent adjustment which was the result of last year's hearing.

The values for the various classes of milk have been carefully and fully debated over the past seven decades. Classified pricing is a basic principle of all regulated milk pricing systems. Any changes in these prices should be carefully debated and discussed. The previously established premiums should be restored.

Class 1 price increase, 50 cents per hundred weight. Not surprisingly, we find that the difference between the Class 1 price in surrounding markets are now about equal to the reduction in the California Class 1 prices that were implemented as a result of the October 2008 hearing.

Although the data for 2009 is not yet complete, the indications through October are that the Class 1 prices in Northern California are averaging about 35 cents per hundred weight lower than the Pacific Northwest Order, and the Class 1 prices in Southern California are averaging about 55 cents per hundred weight lower than the Arizona order.

The California price can be increased by 50 cents per hundred weight without encouraging the movement of milk from Arizona into Southern California.

In Oregon, the 50 cents will move our prices to just a bit over the federal order price there, but I would judge that the 11 cent per hundred weight will not be enough to change milk movement patterns given the distances involved.

The Reno, Nevada comparisons, as you know, are meaningless since the Nevada Dairy Commission sets the Class 1 price in Northern Nevada to be equal to the Northern California price.

Class 1 and 3 increase, 26 cents per hundred weight. Our specific request for Class 2 and 3 is to restore the premiums that existed prior to the last year's hearing. We are asking that in both the Northern Marketing Area and the Southern Marketing Area the price for Class 2 and Class 3 solids, that's fat and solids-not-fat, be each increased by 2.13 cents. This does not fully recover the value lost in fat prices and adds a bit extra to the solids-not-fat side of the equation but, overall, does a reasonable job of allocating the values that should be added back to the formula. It also meets the requirement that the results of a consolidated hearing should result in either a common result or a common change. We're obviously going for the common change.

Conditions are different this year; our petition last year may have been a bit early in the cycle. Price trends were clear to us at the time, but they had not yet fully developed. The cost of production numbers, however, were not in the least ambiguous and it was abundantly clear that producers of California were headed for a disaster. Even the biggest pessimist, however, could not have predicted how bad it would be or how long it would last.

At the time of the hearing the circumstances in the California dairy industry and factors affecting California dairy policy decisions were much different than they are today. Since then farm milk prices have, indeed, dropped dramatically and after dwelling at support price level for several months have just now begun a slow recovery. The milk production costs, while now lower than they were a year ago, are still running far ahead of historic levels. In combination, these two factors have helped to lead to less milk produced in the State. In fact, milk production compared to the same month the previous year has now fallen for 12 straight months.

Both Graph A, presented earlier in this testimony, and Graph B below show that production in California is declining, but we would like you to focus on the last few months. The rate of decline is accelerating and this is before the last CWT round has had any impact on the numbers.

Consequently, any of the concerns regarding adequate plant processing capacity in California are over. In addition, California Dairies, Inc. will, within the next few months, be commissioning its seventh processing plant. There are also plant expansions at Leprino's Lemoore facility and Land O'Lakes, Inc.'s Tulare facility, which are completed or nearly completed. Combined, and combining all of those plants and the drop in production, this new capacity assures that lack of space in processing plants will not be an issue in the near future.

When the milk supply exceeded the plant capacities available in the state there were few viable marketing options for California producers. Although milk production base programs were applied to over 80 percent of the California milk by April 2008, it was still difficult for milk production to be handled in the State of California. Everyone learned how frightfully expensive it was to find a home for milk when the plants are all full.

This trend continued until slight decreases year over year were recorded in July and August. That's of 2009, yeah. And then a slight -- no, 2008. And then a slight increase of September.

Ironically, October 2008, the month of the last hearing, brought about the start of something that had not been experienced before, sustained decreases in California milk production. The milk supply has decreased every month since then. Alarmingly, this trend shows no sign of letting up, the milk production continues to fall off at an increasing rate, as shown in Graph B, which is above, not below.

Another matter cited in the Panel Report published by CDFA is the very troubling issue of homeless milk from California finding its way to out-of=-state plants at discounted prices. Any such milk is not subject to California price regulation and can be bottled and returned to compete with regulated California milk products. This scheme is clearly a thing of the past with the availability of adequate California processing capacity. The rather abrupt end of the homeless milk in California has had a dramatic effect on the viability of the Class 1 plant located in Yerington, Nevada. Clearly, the sustainability of the Yerington plant depended on an abundant supply of milk not subject to price regulations. Without cheap, unregulated milk the Yerington plant is unable to compete with California fluid milk processing plants.

And the last comment in this group that is changed, the milk demand for milk proteins is returning to normal. In this case I am defining normal as the demand growth in volume as opposed to the value growth over the past decade, but ignoring the 2008 bubble year. This year's export numbers are improving and are now on or near a path to show nice gains over 2007. The important point is that the prospects of adequate world demand for California produced milk protein has dramatically improved. And these changes have all occurred since the October 2008 hearing.

What has not changed? The biggest problem facing the dairy industry in this country continues to be the impact of the Energy Independence and Security Act of 2007. Unless a modification to the Renewable Fuel Standard established in this law is made by Ms. Jackson, Administrator of EPA, it will be mandated that over 35 percent of this year's corn crop will have to be used in the production of ethanol. It has been widely reported that there is a 13 billion bushel bumper crop of corn this year, that is a near record crop, yet the price of corn has hovered near 3.75 per bushel for the past several weeks.

I have attached a copy of the December 2009 Corn Futures graph at the end of this testimony and that includes data through last Friday.

Prices could come down a bit if the portion of the crop still on the stalk gets harvested and dried, but the prices will still be at least 50 percent higher and as much as 85 percent higher than their traditional levels.

Conclusion and summary; and finally it should be noted that 2009 has been without a doubt one of the most challenging and devastating years endured by dairy producers. The near financial ruin brought about by low milk prices and high production costs has caused many producers to exit the business, either through participation in CWT's herd buyout programs or by simply sending the cows to the auction yard and shuttering the dairy.

Nearly all the conditions that were used to justify the decision to reduce Class 1 prices have changed in less than one year. The producer side of our industry has been severely wounded financially and because of this the milk supply is not growing; indeed, it is shrinking.

Plant capacity is not an issue. All the homeless milk now has a home. We urge you to favorably consider our proposal to reverse the findings of last year's hearing and to correct the Class 1 differential between areas by adding 50 cents to the Class 1 formula and 26 cents to the Class 2 and 3 formulas.

Last year CDFA concluded that there was a different emergency than we had tried to address in our petition for a hearing. Our view was rejected and an opposing view was accepted.

This time, in the face of a different kind of emergency, we are asking only that regulated premiums be returned to levels that we had prior to 2009.

Comments on other proposals; our intent in petitioning for this hearing was to discuss the narrow topic of Class 1, 2 and 3 prices. The expansion of the hearing to all matters related to pricing regulations on all classes of milk was both a puzzling and surprising move on the part of CDFA, but it happened and thus we need to respond.

First and foremost we object to any changes in the Class 4a and 4b formulas that have the impact of reducing the cost justified make allowances that are in place. The proposed increases in the payment for these classes of milk are, even if temporary, a reduction in the make allowance.

There is a fundamental difference in the approach to pricing between the first three classes of milk and the manufacturing classes. Both types of prices are based on real economic factors, but for the first three classes the price is established prior to the processing and the sale of the product. In these cases the milk cost is known to the buyer prior to pricing the product. The processor in this case knows what he and, importantly, his competitors are paying for milk ahead of time. Increased prices in this case can be recovered from customers, the retail customers.

In the manufacturing classes the opposite is true; the milk price is announced after the product is made and sold.

the example of nonfat dry milk provides the best illustration. During a month milk is received at a plant and it is processed into nonfat dry milk, which is then sold to the trade or to CCC. The trade can be either domestic or export.

Each week during the month CDFA collects the data on volumes and price of all sales for nonfat dry milk for each week, and at the end of the month the data is compiled and the weighted average price is announced and from that the make allowance is deducted and the remaining value is the price paid to the producer.

In that calculation the only margin allowed for the plant making the nonfat dry milk is the make allowance. If forced to pay more for the milk, the plant cannot recover that price from the market place. The Catch-22 embedded in this type of formula is that even if the seller, knowing that he had to pay more and somehow being able to get that added amount from the customer, would still receive no benefit since that increased price would, through the operation of the CWAP formula, end up increasing his milk cost by the same amount. He would still get only the make allowance except, in this case, the make allowance has in effect been reduced by the value of the added milk price.

Much effort continues to go into trying to develop a new milk valuation system but so far no one has worked out a better solution. Make allowances are fundamental to the operation of our system here in California and they are critical for the maintenance of adequate plant capacity to process milk produced in this State.

As I mentioned earlier in my testimony, now is the time for building confidence in our system, not a time for capricious actions which are often quoted as one of the reasons that California is not a favorable place for plant investments.

It is no secret that the vast majority of the nonfat dry milk capacity is owned by cooperatives of this State. The dairymen members of those organizations have invested hundreds of millions of dollars in their plants. Any arbitrary allocation of an up-charge of any size will have the direct result of taking money from those who have made the investment in facilities and giving it to those who have not made such an investment.

We also find it difficult to accept the conditional surcharges onto milk prices. Frankly, it is surprising to see the Dairy Institute proposing such an increase, no matter how unlikely it may be that the conditions will be met. Once a concept like this is started, it will be very difficult to keep up with the new innovative schemes that come out of the fertile minds active in our industry.

The idea of using NASS price reports in place of

CWAP price was considered and rejected in a hearing that was entirely devoted to considering the pricing to be used in the nonfat dry milk formula. The results of this hearing was well considered and well decided. Any change should be considered in a hearing limited to that and directly related issues.

While the suggestion to change the Class 4b formula whey pricing provisions is one that we find quite interesting, we cannot imagine this being acceptable to the cheese plant operators in this State. The issue of the whey valuation has been fully discussed in both a hearing specific to this issue and a series of meetings of a CDFA appointed committee of producers and processors. This, too, is a topic that if revisited at all should be handled at a hearing called to consider only that issue, and directly related issues.

The addition of cost-of-production to the pricing formulas of milk does not work well in an industry that is set up to serve real market demand. We understand the frustration experienced by producers over this last year. Thankfully, markets are beginning to respond and better days are ahead.

Our views on the importance of the proper make allowances are well known. We did not, however, call for an examination or a change in the make allowances in our petition. The reach of this hearing was extended by CDFA to all issues, much to our surprise. The members of The Alliance will respond to the make allowance petition as they see fit.

Thank you.

HEARING OFFICER HOLLOWAY: Thank you. Do any of the panel members have any questions for the witness, Mr. William Van Dam?

PANEL MEMBER EASTMAN: I have a question, Mr. Van Dam.

HEARING OFFICER HOLLOWAY: Can you please state your name?

PANEL MEMBER EASTMAN: Hyrum Eastman.

On page 3 of your testimony, on I guess the second to the last paragraph, it mentions there's a -- the third sentence it says, "fortunately it does appear that significant price relief is here;" were you referring to -- what exactly were you referring to?

MR. VAN DAM: That the milk prices are recovering nicely right now.

PANEL MEMBER EASTMAN: Okay, thank you.

PANEL MEMBER IKARI: I have some questions. Mr. Van Dam, you testified about how the production situation in California has changed. Given those changes and the decreases in production, are your member co-ops still imposing penalties for their production of limits, their base plans that they had established?

MR. VAN DAM: As I understand their system, the penalties would be applied only to the milk that was over the production base and then only if there were extra costs of disposing of that milk. Clearly, there are no extra costs now.

PANEL MEMBER IKARI: So it's your understanding that the producers who are exceeding their production bases are not being charged a penalty?

MR. VAN DAM: I believe not. You can ask them specifically when they get on the stand later.

PANEL MEMBER IKARI: You mentioned in your testimony, on page 6, that DFA, Land O'Lakes, I think you -- Land O'Lakes and Leprino are expanding their plant capacity. What is your assessment of how California's reduced -- let me see, let me go back to -- okay, could you provide us an assessment of California milk supply relative to the needs of the State's processing plants given that expansion?

MR. VAN DAM: Well, it's an interesting question, but it's clear that's what's happening is the -- almost everybody is being supplied with the milk they need except the nonfat dry milk plants are running less product than they would have run otherwise.

PANEL MEMBER IKARI: Let me rephrase the question.

California's been experiencing a decrease of 3.5 percent production.

MR. VAN DAM: Okay.

PANEL MEMBER IKARI: My question is who's felt it the most, the manufacturing of butter, powder and cheese, Class 1, Class 2, Class 3?

MR. VAN DAM: Oh, the one -- obviously, the one that's been affected by it is the nonfat dry milk and the butter, they are the final residual products.

PANEL MEMBER IKARI: Can we surmise from your testimony that given the changes that the federal government has made through the $350 million legislation, $290 million of which is a payment to producers, a direct payment, $60 million going to the purchase of cheese, that your proposal, that The Alliance is sufficiently confident that your proposal will ensure that California will have sufficient milk supplies?

MR. VAN DAM: I'm not sure that I am raising the question that California does or doesn't have sufficient milk supplies. We have a lot of milk still produced here, we're still the number one dairy state.

What I'm pointing out to you, that in order to have a stable and functioning, hopefully profitable dairy industry, we need to have conditions that are stable, we need to have a steady hand of the government implications, and put us back on an even keel with where we were before that last hearing.

We weren't happy with that result, as you know. We did not think that that was needed, but we understood the pressures were great then, there was a lot of negative things going on. They're gone now and we just want to go back to square one plus 15 cents.

PANEL MEMBER IKARI: Given the potential negative consequences to butter, powder and cheddar cheese plants or cheese plants if California's milk production doesn't turn around, what is the economic rationale that they shouldn't be included in the paying higher revenues, at least on a temporary basis, in order to help the dairy farmer recover for the last nine months?

MR. VAN DAM: You're going to force me to go to some areas that I really don't want to go. But the way the system works and is designed and the way that we have confidence in it is that there is a make allowance there that will cover the investment you make in facilities.

Now, when facilities have less product going through them their costs go up; that is a risk that the plant runs and it will take quite a bit of time for that to flow through the formula.

But all of that equation is part of sending the correct economic decision to producers on whether to respond or not respond to it.

And so forcing the plants to suffer a loss, and if they're cooperatives, and it's the cooperative plants, the ones that are going to -- that have the biggest dryers by far, or the vast majority, they're going to take a big hit.

The only way they can exist is to charge back their producers enough to cover their loss in costs. So, therefore, those who have made the investment are going to get double punished, their going to have less milk going through their plants and their producers are going to get paid less. That is not a successful, confident system being set up.

As long as you've got regulation, it needs to be fair to everybody in the system, as fair as it can possibly be.

PANEL MEMBER IKARI: Is that the reason why you're posing the other proposals that would raise the Class 1, 2 and 3 prices significantly higher than your proposal?

MR. VAN DAM: We thought our proposal was adequate to restore the balance and not set up any negative issues out there in the market place.

But if they're -- as you know from our proposal last year, we were willing to take the risk for six months of a $1 increase on Class 1, 2 and 3, because of the problems that were going on in the dairy industry, well, the ones that we saw coming and, indeed, they did come, we saw coming in the industry, it was worth that risk to us. But you couldn't have done the same thing on the manufacturing side because then the losses would have been unfairly distributed.

PANEL MEMBER IKARI: Several years ago CMAB commissioned a study, an independent study by the McKinsey Company to evaluate various options and develop a long-term strategy that would ensure the long-term success of the California Dairy industry.

One of the concerns that that study found or reported is that ever greater volumes of the State's milk production is being marketed in the lowest value products. Doesn't increasing the Class 1, 2, 3 prices simply provide more fuel to increase that trend?

MR. VAN DAM: Well, the McKinsey study also had a very interesting sentence in it that said, unless of course the export market for milk proteins in the world develops to the point where it is a viable option to California.

That has been the option that has indeed developed in -- except for last year. Well, last year was wonderful, the prices were just staggeringly high, but that was an inflationary bubble that hardly made any sense. It's the long-term trend that counts for us and world prices are responding again. And I'm not sure that nonfat dry milk's going to be your lowest priced utilization.

Even in the past, I think it's three years I looked at, ten percent of the time powder was higher than -- butter and powder, 4a, was higher than 4b. It happens, we expect more of it.

But our milk is there, our plants are there, it better happen that way. But we are a part of the world now. We got hurt by the world, we're part of the world, so I don't see that the 1, 2 and 3 issues related to that at all; that will be decided on its own merits.

PANEL MEMBER IKARI: You're willing to -- in other words, you're willing to -- whatever the outcome of the world market with respect to powder will determine the fate, the future fate of the California dairy industry?

MR. VAN DAM: A future fate of a significant part of it. If it dies and goes away and the price isn't right, we will see the kind of decreases we're seeing right now because we will not be able to successfully supply that market and we'll stop doing it. California will have a smaller industry, go back to our cheese base and enough drying capacity to just get the swing supplies taken care of.

PANEL MEMBER IKARI: That study also identified another concern, that California dairy farm revenues are increasingly reaching a point where Class 1, 2 and 3 price levels simply won't be high enough to sustain California's long-term growth.

Does The Alliance proposal simply speed up the day of reckoning?

MR. VAN DAM: What's happening with Class 1 sales right now, they're approaching 20 percent. Kind of interesting, this isn't a direct answer, I hope, considering that it's been as low as 14 and a half percent, this looks like a pretty impressive gain. However, we had a lot of Class 4 milk, Class 4b milk step out of the pool, thus reducing the size of the pool and, therefore, there's no real growth in Class 1, it's just a percentage.

And my point is that the Class 1, 2 and 3 are not the prices that run this system. In total what have you got, 24 percent of the milk, something like that, of the three things. For a long, long time now California's success and growth has been tied to Class 4b and now we're onto 4a; they represent the vast majority of the milk produced in this State. And that has been the case and I think it will continue to be the case.

We just need to make sure that the system makes sense, that those, the Class 1, 2 and 3 markets get properly served. It is part of the deal in pooling that we will make sure that they get served in both, but when you're providing service, you expect the system to have something in it to make that service worth it.

PANEL MEMBER IKARI: I have on final question, that you touched on, but I'll -- the Department's always asked, has often asked, I should put it that way, and I'd like you to have the opportunity to respond to the question; if the logic is that Class 1 prices in California can be set equal to the prices in neighboring states, why doesn't that logic apply to the establishment of Class 4a and 4b, shouldn't that be set equal to the neighboring states?

MR. VAN DAM: Let's start with 4b. The customers, and California long ago passed the point where the cheese it was making was sold only to Californians. We produce vast amounts of cheese beyond that and it must be exported to somewhere else. The export in this case is to other states.

And with something like 75 to 80 percent of the people east of the Mississippi River we have to reach ever further to sell all our cheese. Obviously, that's more of a problem now because you've now got New Mexico, with Texas, and Idaho with increasing milk supplies between us and them. But that's why ours is and should continue, our prices in California need to be less than those prices there in order to get that delivery done to the far markets.

On the Class 4a products, they do move throughout the country also, surprising volumes of our powder are moved to Wisconsin where they're used to fortify cheese vats.

That's a big market for our powder, but we are now going into the world markets.

But the key there isn't a comparison in values between us and them, it is that our system has enough dollars in it to provide coverage of the investment required to have those plants.

If we want to be in the business, we have to be set up in a way that we can price it to compete in the world and get our costs covered in doing it. And the result of those two calculations will be taken from the price you get for your product, and that's what the producer gets, and that is the proper economic signal.

If that's what we can get for the product, that's the signal the dairymen get and we produce to it or we don't, depending on what that market is.

PANEL MEMBER IKARI: I guess inherent in my question is should California be motivated to get more sales of Class 1, 2 and 3 products in other states, just like we're trying to get more sales of Class 4a and 4b?

MR. VAN DAM: The problem with that is the sheer bulk of the product you're moving. It's not concentrated enough to be a competitive feature, and with the energy prices moving like they do sometimes it gets close to working and other times it won't work at all.

So it's a case of doing what you have to do, the bulk, the big bulky products, fluid milk is very bulky, keep it here, make it here, sell it here. You can't reach very far.

And we could bottle milk, for instance, here and move it to Florida. Florida's traditionally short on milk, but it's not always short on milk. So we would have huge Class 1 plants putting up bottled milk, trucking it to Florida four months a year. That isn't going to work.

PANEL MEMBER IKARI: What about just neighboring states though?

MR. VAN DAM: Well, they've got their milk supplies, too, and they will adjust to match that and they will stay -- the world doesn't operate in a vacuum, it's not static. They don't just sit there and take it.

In my testimony I commented what Nevada does. They set their price the same as ours, no matter what we do they will match it.

I believe in the cheese market, for instance, there's probably nothing we can do to price 4b milk low enough to beat the guys that are a thousand miles closer and are not or are lightly regulated. That's not the game for us anymore.

PANEL MEMBER IKARI: Thank you, Bill.

MR. VAN DAM: You're welcome.

PANEL MEMBER AC MOODY: I just have a quick clarifying question. You said that the differences between Class 1 prices in surrounding markets are now about equal to the reduction in California costs when prices are -- before --

MR. VAN DAM: Yes.

PANEL MEMBER AC MOODY: -- beginning. So I'm just curious, how do you come up with your 50 cents, like why the 15 cents difference?

MR. VAN DAM: Oh, how did we come up with the 50 cents.

PANEL MEMBER AC MOODY: Yeah, because we reduced it by 35 cents.

MR. VAN DAM: Oh, because we wanted 15 cents more. No, because the number -- the biggest market is the Arizona/Southern California, those are the closest to each other, and there was a 55 cent difference there and we thought what the heck, go for 50.

PANEL MEMBER AC MOODY: Thanks.

HEARING OFFICER HOLLOWAY: Okay.

MR. VAN DAM: Am I excused?

HEARING OFFICER HOLLOWAY: I think you are. Thank you very much for your testimony.

MR. VAN DAM: Thank you.

HEARING OFFICER HOLLOWAY: Okay, at this time I'd like to call the second Petitioner, Western United Dairymen.

You will also have a total of 45 minutes to submit your testimony.

Okay, please state your name and spell it for the record?

MS. LA MENDOLA: Tiffany LaMendola, T-i-f-f-a-n-y L-a-M-e-n-d-o-l-a.

MR. MARSH: Michael Marsh, M-i-c-h-a-e-l M-a-r-s-h.

HEARING OFFICER HOLLOWAY: All right, and would you please tell me who you are testifying on behalf; are you doing it as an organization or an individual?

MR. MARSH: We're testifying today on behalf of Western United Dairymen.

HEARING OFFICER HOLLOWAY: Okay. And do you both swear you'll tell the truth and nothing but the truth?

MR. MARSH: Yes.

MS. LA MENDOLA: Yes.

HEARING OFFICER HOLLOWAY: Thank you. Go right ahead.

MR. MARSH: Is this Bill's water, I don't want to get his germs?

HEARING OFFICER HOLLOWAY: No, I don't think so, it hasn't been opened. I think he finished his.

MR. MARSH: Oh, thank you.

Good morning. Ms. Hearing Officer, Members of the

Hearing Panel, my name is Michael Marsh; I'm the Chief Executive Officer of Western United Dairymen.

Our Association is the largest dairy producer trade association in the western United States, representing dairy producers harvesting approximately 60 percent of California's milk.

On October 16th our board had a meeting and approved part of the policy positions which we'll present today and on November 3rd, at a conference call with our board of directors, they adjusted those and those policy positions will also be expressed in our testimony here today.

We appreciate the Secretary's call of this emergency hearing. We also appreciate the recognition of the crisis the dairy producers are in.

Western United Dairymen has been at the forefront of trying to bring relief to California's dairy families as the world's economy fell off a cliff.

A look back at the past year is truly eyeopening as to the many challenges the California dairy farm families faced.

In August 2008, as economic pressures were driving producers' cost production to record levels and demand contraction in the market place was becoming evidence, Western United Dairymen joined with our colleagues at The

Alliance of Western Milk Producers and the California Dairy Women's Association in seeking temporary emergency relief for California farmers.

We petitioned the Secretary for a pricing change to help us through what we hoped to be a short-term rough spot.

At the same time Western United Dairymen called on National Milk Producers Federation to use available resources to trim the nation's dairy herd. Our board felt that we had to slow supply as quickly as we could in light of the flood of economic data suggesting that necessity. We also called on the Bush Administration to unleash the Dairy Expert Incentive Program that had lied dormant and unused since 2004. Our board felt that enhancing international demand with this subsidy would slow the buildup of significant domestic inventories.

Processors attacked our petition at the hearing. Some producers actually opposed our call for emergency temporary relief, while other producers didn't even show up to testify. The Secretary determined that a price cut for dairy farmers was in order, rather than the temporary relief we sought.

National Milk noted their ongoing efforts and suggested additional producer support for their CWT program was needed. The Bush Administration refused to initiate export assistance, even as government inventories swelled.

In December of 2008 Western United Dairymen sponsored an industry session to flesh out sentiment regarding how best to address economic issues facing the California dairy industry. The meeting attracted about 300 dairy producers and processors and dozens of notions were surfaced.

The overbase price, which in December of 2007 had been dizzyingly above $19, had plummeted by over $6.50 in December 2008 as the global economic downturn became manifest.

Our analyses indicated the situation would get worse in the months ahead. On January 1, 2009 the Secretary's price cut went into effect of dropping the Class 1 price by an additional 35 cents per hundred weight, and the Class 2 and Class 3 prices by 26 cents per hundred weight.

The Class 1 price announcement in January, for February 2009 pricing, revealed an additional decline of $6.15 per hundred weight. Horrific.

Cows could not be shut off quickly enough to match the falling demand for milk. Export markets, which had consumed almost 11 percent of U.S. production in 2008 foundered on the recession's rocky shore. At the same time, the European Union unleashed massive export subsidies into the world's dairy markets, rendering unsubsidized U.S. dairy products and exports not competitive in the global market place.

Western United Dairymen continued to press for producer relief. Letters to CWT calling for action became matters of course. National Milk indicated a need for a line of credit and a two-year commitment for a revamped CWT program. Preliminary intra-industry discussions were held regarding how to best secure loan guarantees to finance herd retirements. Western United Dairymen estimated that 300,000 cows needed to be removed from the U.S. dairy herd as quickly as possible. In response, the National Cattlemen's Beef Association demanded that Congress provide no relief at all to struggling dairy families.

Additional please were made to the Obama Administration for assistance, as they were just coming into their transition. Western United developed the data and talking points for a meeting with the new Secretary of Agriculture at USDA and members of the House Ag Committee to explain the crisis that was happening to dairy producers. The existing dairy producer safety nets were proving completely ineffective at dealing with the significantly diminished demand in the market.

Secretary Vilsack agreed that help was called for and immediately announced the donation of all USDA inventories of nonfat dry milk to domestic and international feeding programs. Vilsack also committed support for using the Dairy Export Incentive Program so that the U.S. could respond in some fashion to the massive EU subsidies dumped on the market in January.

Beginning in February 2009, Western United Dairymen hosted a series of meetings to further explore the dairy issues raised at the December 2008 meeting. National and international experts in dairy marketing, manufacturing and policy were attracted to these meetings. Issues of competitiveness, supply management, marketing orders, global markets and opportunities were analyzed, discussed and debated. Task forces of economists and industry processor and producer leaders were appointed to delve deeper into the topics presented.

In the middle of February 2009, Western United Dairymen received word that an attorney had called Humboldt Creamery and informed them that errors contained in the -- of errors contained in the cooperative's financial statements. The attorney also noted that the creamery's CEO had resigned. Further unneeded stress for dairy producers in the State of California.

The California legislature took a few shots at dairy producers, too. Legislation was introduced to eliminate the pooling system in California. Further, a hearing was held to do away with CDFA completely. The vegan group, Humane Society of the United States, got the chairman of the Senate Ag Committee to sponsor legislation banning the docking of cow's tails in California. HSUS condemned this as a customary practice in the State, apparently choosing to ignore research indicating tail docking to be extremely rare within California. This activity was taking place as dairy producers were losing between $100 and $150 per cow per month.

In March 2009, CWT finally announced that they had reached their goal of two-thirds of the U.S. milk supply agreeing to participate in the program and on April 1 announced a herd retirement destined to retire over 100,000 cows. In the meantime, heavier than normal culling and California processor base programs had continued to reduce California's milk production.

Western United Dairymen continued to press in Washington, DC for assistance for California's dairy families. Western United advised National Milk that another herd retirement ought to be initiated as soon as the first one was wrapped up. Secretary Vilsack was pressed repeatedly on using the area Export Incentive Program. Western United Dairymen organized a letter writing campaign to the Secretary, the U.S. Trade Representative, and the Secretary of State. Western United Dairymen's lobbyists pressed further with the letters of support from the California congressional delegation. At the same time, different groups with varied interests started to try to engage in the discussion. Keeping eyes focused on the ball of providing producers short term relief became more difficult as a confusing array of largely ineffective proposals began to surface from around the country.

The California Dairy Industry Task Force met twice with CDFA. The task force expressed concerns that the department effectively enforce milk pooling and pricing regulations aggressively. The task force also expressed frustration and concern that CDFA's apparent inaction in timely enforcing regulations was creating chaos within the industry.

Finally, on May 22nd, 2009 the Secretary at USDA announced a full allocation of DEIP funding through the fiscal period ending June 30th. Western United Dairymen encouraged domestic processors to use the program and export dairy productions. After a slow start, export activity picked up markedly as U.S. products re-entered the global market armed with our own export subsidies to compete against the massive ones put in place by the Europeans. The demand for and the evident success of the DEIP made it easy for the Secretary to heed our calls to reauthorize the DEIP funding for the next fiscal period on July 3, 2009.

On July 1st, Western United organized a bus to the Assembly Ag Committee hearing considering SB 362. The bill had been amended from its original call to eliminate pooling to expanding exemptions for selected individual producers. The bill was amended the night before to exempt purveyors of raw milk from the pool; an unconscionable positive result for a raw milk handler already adjusted guilty of violating California's pooling regulations and owing hundreds of thousands of dollars to the other producers in the State. This new exemption would have allowed this scofflaw to skirt the regulations collecting additional ill gotten gains from the unregulated sale of his milk that would assist him then in repaying the monies he already owed to the other dairy producers in the State. Absolutely incredible.

The Western United Dairymen organized dairy producers expressed their outrage over the bill at the hearing. The Assembly Ag Committee shared in that outrage and defeated SB 362. The author's staff pleaded for reconsideration from the committee and the chair, unfortunately, acquiesced.

Following a request made to Secretary Vilsack to increase the support price, by National Milk, the California dairy industry task force made a similar recommendation and request. However, recognizing that the market was starting to show a few signs of life, the task force requested that the Secretary enhance the support prices at a higher level than National Milk Producers Federation had requested and suggested changes to cheese grading standards so that cheese might actually move to the government.

Also, on July 14th, 2009, Western United Dairymen President Ray Souza had been asked and agreed to testify about the ongoing dairy crisis before the House Ag Committee. At that hearing, Mr. Souza made the request that USDA move quickly to relieve the market of burdensome inventories of cheddar cheese that were overhanging the market and depressing producer prices. Due to the fact that the milk supply failed to slow quickly enough to meet the remaining demand in the marketplace, WUD analysis revealed that inventories of cheese in cold storage had grown to a level approximately 100 million pounds higher than the five-year average. Mr. Souza requested this cheese be acquired and immediately donated to the nation's food banks who were witnessing phenomenal demand due to the lengthening economic crisis. Hunger advocates cheered Western United's proposal and joined with us in the request.

On July 31st, Secretary Vilsack acceded to the California dairy industry task force and agreed to temporarily raise the support prices to the levels requested by the task force. Secretary Vilsack's staff also requested that Western United forward additional details about the proposed cheese buy presented by WUD at the hearing. The Secretary was pleased that such an innovative proposal had been broached.

The California overbase price, which had been $17.35 in July of 2009, had crashed to $9.60 in July 2009. Multiple generations of equity in California dairy operations had been completely wiped out. Banks, operating under ever more strict regulations following the international collapse in financial markets, became ever more parsimonious in their support for family farmers. Vendor receivables to dairy producers continued to get longer and longer. Some dairy families saw CWT as a way to get out of the business before all was lost. Unfortunately, others were not so lucky.

In August, U.S. Senator Bernie Sanders, Independent from Vermont, proposed an amendment to the Senate Ag Appropriations bill. The proposal was for $350 million in support for U.S. dairy producers. No such provision was included in the House version passed earlier. U.S. Senators Boxer and Feinstein asked for WUD's opinion on the amendment. We responded it could be an opportunity for producer relief provided that it not be paid in the form of a direct payment that would discriminate against California dairy producers and other farm families in the western United States.

After receiving assurances from Mr. Sanders that this would not occur, the California senators agreed to support the amendment, providing the 59th and the 60th votes necessary for cloture. The bill then moved to a Conference committee of House and Senate negotiators.

National Milk Producers Federation chimed in their support for Western United's cheese buy proposal. National Milk's economists developed an analysis regarding different scenarios for the expenditure of the $350 million included in the Sanders amendment. Their analysis revealed several things. First, should the $350 million be directed towards additional price supports, the $350 million would return only $185 million in producer benefit. Secondly, if the $350 million were dedicated to a direct payment to producers, U.S. producers would realize only $335 million in benefit.

However, their analysis disclosed that if the $350 million was dedicated to the cheese purchase and donation strategy proposed by Western United Dairymen, U.S. dairy families would realize a $1.3 billion return on that investment.

Western United's lobbyist pressed this point with conferees. Unfortunately, David Obey, a democrat out of Wisconsin, who is the chairman of the House Appropriations Committee, chose to ignore the economic arguments. Mr. Obey felt that his Wisconsin producers would be better served by receiving a direct payment check from the federal treasury ahead of his own efforts to win a reelection race back home. Obey argued for payments that would discriminate against California dairy families, as well as other dairy producers in the western United States.

Negotiators compromised on a scheme to split the money into $60 million for a cheese buy and $290 million for direct payments. A triumph of pork over policy. Noting Mr. Obey's desire for discriminatory payments, Western United Dairymen again discussed the matter with U.S. Senators Boxer and Feinstein. Mrs. Boxer agreed to place a hold on the bill, a rare maneuver, until she could secure assurances in the form of a colloquy read on the Senate floor between herself, Mr. Sanders and Senator Herb Kohl from Wisconsin that discriminatory direct payments were not the intention of the U.S. Senate with regard to the funds. Mrs. Boxer also demanded and received a meeting with Secretary Vilsack, gaining his assurance that the Department would not utilize a discriminatory method for disseminating the funds. Senator Boxer released her hold on the bill after receiving those assurances.

USDA is now charged with distribution of the funds. Even in a best case scenario, the average California producer will receive a direct payment of $34,000 versus

$4,327 under the discriminatory scheme pushed by Mr. Obey. Still, this payment is only a drop in the bucket compared to the massive losses suffered and experienced by California dairy families.

Congressmen Jim Costa and Dennis Cardoza invited Secretary Vilsack to come to California to see the devastation on the ground. On August 26th, the Secretary met with producers up and down the valley. At the luncheon in Modesto that afternoon, Western United President Ray Souza again pressed the Secretary regarding the cheese buy. Again, Secretary Vilsack indicated support for the idea but complained that the significant additional demand for food donations had taxed USDA's available resources.

Western United Dairymen further explored this idea on a private tour of the Durrer Dairy in Modesto with the Secretary and Congressman Cardoza.

In October the U.S. Senate again called upon Western United's expertise. President Ray souza was again asked to testify about the continuing dairy depression. He again touted the need for funds to complete the previously requested cheese buy. He also requested that the recent adjustments to the price support be extended through the end of the Dairy Export Incentive Program fiscal year to assist in facilitating contracts for exporting U.S. dairy products.

Western United Dairymen's board of directors routinely considered during this timeframe perhaps even asking CDFA for help. Numerous concerns were expressed based upon our last attempt where we had asked for temporary emergency relief from the Secretary and had received a price cut for our effort.

Further, Western United Dairymen formed a producer committee to analyze in detail the many pricing and supply management proposals being developed around the country.

Unbeknownst to WUD, similar discussions were also taking place at The Alliance of Western Milk Producers. I received a copy of The Alliance's petition after it was filed with CDFA and it was downloaded from the CDFA website. Our board of directors felt we should do something similar.

In listening to our producers month after month about the losses they were incurring on their dairies and witnessing firsthand the economic devastation that the global economic downturn had generated within our membership and our neighbors, Western United Dairymen's board acted.

They saw the producers, including themselves, were in a huge financial hole. They questioned whether The Alliance proposal provided enough relief quickly enough. The California pool, which had generated $7.3 billion in milk sales in 2007 and $6.9 billion in 2008 was trending toward only $4.42 billion in 2009. A loss in revenue of over two and a half billion dollars in one year.

At the same time, the Board discussed competitive concerns with regard to manufacturing production in other states, as well as the potential for renewed interstate milk shipment activities in Classes 1, 2 and 3 that may be created by permanent changes to the prices.

Western United Dairymen's board acted and approved submission of a petition to CDFA on an emergency basis. Western United's petition asked for an additional 50 cents on all classes of milk. The board felt that a temporary increase would help producers with an infusion of about $100 million over six months would also stymie competitive pressures from out of state.

Our staff and board members immediately heard concerns expressed by the State's manufacturing cooperatives. Complaints about the impact of such relief, should a hearing be allowed and Western United Dairymen's request for relief granted, expressed that the cooperatives could be financially harmed. Indications were made that the cooperatives have had a difficult year as well and that the temporary relief Western United Dairymen had requested would be difficult for the cooperatives' bottom lines.

Hearing the cooperatives' concerns expressed to our board through their members to our own, Western United Dairymen's board met by teleconference on November 3rd to review these concerns and develop positions on the alternative proposals submitted. The board of directors voted to support the proposal submitted by the Alliance of Western Milk Producers, seek assurances -- and also seek assurances from California Dairies, Incorporated that they not press forward with their proposed request for make allowance and f.o.b. adjuster increases and take no position on any of the other proposals submitted.

Thus, Western United Dairymen no longer supports our petitioned for relief. Some questions arise as a result of this action. Was it our intent by filing our original petition an attempt to harm the State's manufacturing cooperatives? Absolutely not, such a suggestion would be absurd.

Were we too ambitious in seeking so much relief for producers? Dairy families have been devastated and their numbers decimated by this economic calamity. Equity that it has taken generations to nurture has simply evaporated.

Perhaps a better question might be whether we can ever fill the financial hole that's been created in this past year for California's dairy families.

We appreciate the call of this hearing and are hopeful that the Secretary will grant producers some relief.

Ms. LaMendola will continue our testimony.

MS. LA MENDOLA: Okay, my name is Tiffany

LaMendola, I'm the Director of Economic Analysis for Western United Dairymen.

Western United Dairymen recognizes the extreme economic pain that all factions of the dairy industry have been experiencing. In particular, the ruinous financial situation that has faced dairy families over the past year has been devastating. The erosion in capital and equity experienced by the large majority of our members will take years to rebuild. And, for many, they simply could not sustain their operations under the severe conditions. Thankfully, markets have recently shown some recovery, but even as prices rise the recovery will take time.

We thank the department for the call of this hearing on an emergency basis and recognize the quick turnaround on the part of CDFA staff.

The Alliance of Western Milk Producers petition; Western United supports the proposal put forth by The Alliance to increase Class 1 prices by 50 cents per hundred weight and Classes 2 and 3 prices by 26 per hundred weight on a permanent basis. To avoid duplicating efforts by The Alliance to support the requested increases on Class 1, 2 and 3, we'll keep our discussion brief,. In short, we recognize that nearly every condition that the Department cited as justification for reducing Class 1, 2 and 3 prices effective January 2009 have reversed course.

First, major California milk supply reduction; surplus milk production is no longer. California has posted year-over-year reductions in supply for 14 out of the past 15 months. As of September 2009, California milk production was down 6.4 percent when compared to September of 2008. This is occurring at the same time other states, particularly in the Midwest, have continued to grow production. This is also contrary to the historical four percent yearly growth rate witnessed in California.

Production declines posted in the spring of 2008 can be almost entirely linked to production caps that were implemented by almost all California cooperative and independent manufacturers. These production caps put the brakes on production in the State. However, the massive year-over-year declines posted throughout the remainder of 2009 can be attributed to the significant price-cost squeeze felt by California dairy families as milk prices plummeted and production costs soured. California producers were forced to respond by culling cows and, for some, submitting bids through the CWT program. In fact, as of September, the milk cow herd in California is down 73,000 cows from a year ago levels.

It's also worth noting that at the same time federal aid through programs, such as the Milk Income Loss Contract Program, discriminated against the average

California producers who reached the production cap in one to two months, while smaller dairies in other areas of the nation continued to benefit from payments on their entire production. This is likely a contributor to the differing milk supply responses that have been witnessed throughout the U.S.

The chart included shows that current concerns may very well be centered on a milk deficit in California. Again, a situation nearly unheard of in a state accustomed to continual growth.

Second, surplus milk production is no longer available to supply out-of-state processors. We are not aware of this occurring to any great extent in attempts to find a home for milk or milk leaving at a discounted rate. And if it is, it surely doesn't make sense given the need for additional milk in the State.

Northern Nevada's Class 1 price was re-aligned with Northern California Class 1 prices as of February 2009. The $1 per hundred weight advantage in Northern California that was in place during 2008 no longer exists. The advantage once afforded to the Yerington, Nevada plant has diminished almost entirely. Furthermore, California contracts previously supplied by this Nevada plant have been captured by California bottlers.

The numbers I looked at showed California Class 1 sales are up. California has posted an increase in Class 1 sales throughout the year with a .1 percent year-over-year gain January through August 2009 and a .9 percent gain in the period September through August 2009.

The spread between Class 1 and overbase prices has declined. The spread between California statewide average Class 1 prices, based on utilization, and the overbase price, February through September 2009, has averaged $2.07 per hundred weight. Even with january 2009 included, which posted an unusually high spread; the average is $2.64 per hundred weight. The panel report from the last Class 1 hearing noted an average level of $2.38 per hundred weight as a desired spread. Clearly, the current level is within and in most cases below an acceptable range.

The modest proposed increase on Class 1, 2 and 3 should not leave California at a major competitive disadvantage. The change would restore prices back to levels in place prior to the last hearing, which lowered Class 1, 2 and 3 prices for all of 2009.

Dairy Institute of California Alternative Proposal. We commend the Dairy Institute for recognizing the dire economic conditions facing California dairy families. We also recognize that given the recent market improvement it's unlikely that the $13 per hundred weight trigger will be activated. Beyond that, the board took no further action on their alternative proposal.

California Dairy Women's Association, California Dairy Campaign Alternative and the Milk Producer Council Alternative Proposals; Western United board of directors took no position on these proposals.

In closing, we urge the Department to adopt The Alliance proposal. Dairy producers are in need of financial assistance.

We thank you for the opportunity to testify and respectfully request the opportunity to file a post-hearing brief.

HEARING OFFICER HOLLOWAY: Thank you. I would like the record to reflect that this written testimony is marked as Exhibit 52.

(Exhibit 52 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: And I'd like to ask any Panel Members if they have any questions of both witnesses, William -- or I'm sorry, Michael Marsh or Tiffany LaMendola?

PANEL MEMBER EASTMAN: I have a question.

MR. MARSH: Yeah.

PANEL MEMBER EASTMAN: Initially, the proposed -- excuse me, what's coming out my mouth isn't what was formulated in my head here. Let me start over.

Originally, your proposal was to increase the class prices by 50 cents a hundred weight on a temporary basis, for about six months or so and then, so based on your testimony, now you're supporting The Alliance proposal which will have a reduced effect, the magnitude of the price increase is different.

So the question I have is based on maybe the previous analysis or thought process that you had when you first recommended the 50-cent-a-hundred weight change compared to now, supporting the Alliance proposal which is a smaller magnitude type change, do you think the smaller change will still have the desired effect you need? Was there some sort of change in the numbers, the financial situation, or maybe an analysis that sparked this? How do you view this new support for their proposal, how will that affect your members or the State?

MR. MARSH: The answer to your question, Mr. Eastman, is no, it will not have the same effect. And clearly what we were looking at was very short-term relief of an immediate nature and that's why we looked initially at having it placed upon all classes of milk.

At the same time our board of directors, many of whom ship to manufacturing cooperatives within the State, heard from their neighbors and also heard from some of the cooperatives, themselves, that indicated that perhaps that would place California in a negative position with regard to competition from out of state.

And our board of directors considered that in changing their position from where it was to where we ended up today.

We recognize that this -- at the same time our board was also very concerned with the alternative proposal submitted by California Dairies, Incorporated requesting additional make allowance increases and changes to the f.o.b. adjusters. And so we're very hopeful that they will not support that position here today, at the hearing.

Because clearly, if you put 11 cents in producers' pockets with the change and by adopting The Alliance's proposal and then take away 14 cents with, you know, essentially you put producers in a negative position from where they had been without the hearing even taking place.

So we recognize that it's not as much money. We also recognize with the permanent change hopefully over time we'll be able to recoup that.

But frankly, the hole the dairy producers are in today, in the State of California, will not be solved by 11 cents and clearly would not have been solved by the 50 cents, either, that we were proposing. It was simply trying to get some relief to dairy farmers as quickly as we could.

And again, we appreciate the Secretary recognizing the dire situation that the dairy families in the State of

California are in.

PANEL MEMBER EASTMAN: So in essence, then, that 50 cents would have been too much in terms of competitive advantage, too much pain so to speak for maybe some of the cooperatives that have plants, exactly.

MR. MARSH: That's what our board -- that's what our board heard.

PANEL MEMBER EASTMAN: Okay, thank you.

MR. MARSH: You're welcome.

PANEL MEMBER IKARI: I have a couple questions. I asked Bill Van Dam a question about penalties. Are you aware whether or not your members are paying penalties for producing milk above the production basis that may have been established in 2008?

MR. MARSH: Yeah, I have heard of that and did hear of that occurring within the past year. However, I think that Bill's probably hit the nail right on the head with his comments that if, since they aren't having to ship the milk out, there's no penalty associated with that with the co-op. Well, it simply wouldn't make much sense for the co-op then to go ahead and penalize the producer.

But, you know, frankly, Mr. Ikari, when you have one of the dairy producers up here that belongs to one of those co-ops, I think that would be a good question to ask them because I really don't know.

We are -- we don't get regular reports on the ongoing activities within the co-ops, themselves, except anecdotally through our members, who are on our board of directors.

PANEL MEMBER IKARI: Will you be asking for a post-hearing brief?

MR. MARSH: Yes.

PANEL MEMBER IKARI: I wonder if your post-hearing brief if you can comment on the pros and cons of past Department decisions that temporarily raised all class prices?

MR. MARSH: Yes, we can do that.

PANEL MEMBER IKARI: The last question I have is you were in the audience during the testimony of Bill Van Dam. He cited some reasons for not making changes in 4a, 4b, I'm curious in what your position is with respect to the comments he made?

He seemed to indicate that he would prefer to have separate hearings to consider those kind of changes.

MR. MARSH: As I recall, Bill mentioned with regard, for instance, to the CWAP change versus the NASS, as also to the dry whey proposal, that those -- well, I think he's right, they've been very exhaustively discussed in previous hearings and probably are deserving more of their own hearing, themselves.

And our board did not take that position, so I'm not suggesting that's what our board did, I'm just relating my own opinion in that regard.

And with regard to our board's position, we also took no position with regard to any of the other proposals.

PANEL MEMBER IKARI: But perhaps again, in filing your post-hearing brief, your board could give us a little more clarification or amplification of why they decided to take a neutral position with respect to those other proposals.

MR. MARSH: Yes, we can do that.

PANEL MEMBER IKARI: Thank you,.

MR. MARSH: You bet.

PANEL MEMBER IKARI: Oh, one final question. A number of times in your testimony you talked about massive federal -- no, European subsidies in the export markets.

MR. MARSH: Huge.

PANEL MEMBER IKARI: And I wondered if you could quantify that in any way in your post-hearing brief?

MR. MARSH: Absolutely. They became effective January 1st and I believe, and we'll expand on this in our testimony, but became effective January 1st, 2009. And the Europeans have expended almost $2 billion in export subsidies to date, to the best of my recollection.

HEARING OFFICER HOLLOWAY: Okay, I don't think there's any further questions. Thank you very much for your testimony.

MR. MARSH: Thank you.

HEARING OFFICER HOLLOWAY: All right, now I would like to call up the organizations who submitted alternative proposals. Each of these will be granted a 30-minute period to testify.

First, I would like to call Milk Producers Council.

Good morning.

MR. VANDEN HEUVEL: Good morning.

HEARING OFFICER HOLLOWAY: Will you please state your full name and spell it for the record?

MR. VANDEN HEUVEL: Geoffrey, G-e-o-f-f-r-e-y, Vanden Heuvel, V-a-n-d-e-n H-e-u-v-e-l.

And John?

MR. KACZOR: And my name is John Kaczor, last name is spelled K-a-c-z-o-r.

HEARING OFFICER HOLLOWAY: Thank you. Do you both swear or affirm to tell the truth?

MR. VANDEN HEUVEL: Yes.

MR. KACZOR: Yes.

HEARING OFFICER HOLLOWAY: Thank you very much. Go right ahead.

Oh, before we start, this written testimony will be marked as Exhibit 53.

(Exhibit 53 was marked for identification and received in evidence.)

MR. VANDEN HEUVEL: Thank you, Madam Hearing Officer.

First of all, before I get started, I was hoping that Tom Gosserd would be on the panel. I understand that Tom will be retiring at the end of December. He's a tremendous member of the Department, and the dairy industry, and we wish him well.

I don't know if he's in the audience today, I checked and I guess he's working today, but not down here.

So for the record I want to express appreciation on behalf of the industry to Tom for his work. I don't know that we'll have another opportunity to do that.

Madam Hearing Officer and Members of the Panel, my name is Geoffrey Vanden Heuvel, I'm a dairy farmer with operations in San Bernardino and Riverside Counties.

I'm testifying today on behalf of Milk Producers Council, a dairy producer trade association with about 75 members, who are located primarily in Southern and Central California.

The MPC Board, at a meeting on October 26th, 2009, adopted the position I am testifying to today.

The dairy industry in California is truly at a crossroads. For many years milk production in California has increased at a steady pace. California dairy farmers got into the expansion mode in a big way back in the early 1980s. That growth coincided with the large increases in the federal support price that was part of the 1977 Federal Farm Bill. That farm bill mandated that the U.S. Secretary of Agriculture set the support price at 80 percent of parity. The practice result of that policy was to raise the support price from 8.26 per hundred weight in 1997 to 13.49 in 1981.

Milk production in California exploded and we soon found ourselves in a situation where there was inadequate manufacturing plant capacity to handle all the milk that was being produced.

CDFA's response back then was to grant generous make allowances to California manufacturing plants as an incentive to spur the expansion of manufacturing plant capacity in the State. This policy was effective in bringing a lot of new capacity online.

In the past decade or so our manufacturing sector has matured and grown. As a result, the percentage of milk in California utilized as manufacturing also grew, increasing the cost of the make allowance to producers in the pool. CDFA did trim down some of the extreme generosity of the make allowances, but for the most part efforts by producers to further tighten margins for the plants were rejected by CDFA hearing panels.

Today the situation is entirely different. California producers have collectively lost hundreds of millions of dollars in equity as the cash cost of milk production has exceeded the prices received by producers over the past 12 months. Milk production is dropping at rates that seemed impossible to contemplate just a short time ago. And the long term viability of many of California's dairy farming operations is in real doubt. This change in circumstances requires that CDFA evaluate its policies with regards to how it balances the interests of producers, processors and the consuming public. With that in mind, Milk Producers Council offers up our alternative proposals.

First, use the NASS nonfat dry milk price in the Class 4a and Class 1 formulas. The first proposal deals with a product value that is used by the Class 4a solids-not-fat formula. For as long as we can remember, the Class 4a SNF formula has utilized the California Weighted Average Price, CWAP, for nonfat dry milk in some form as the product value which drives the formula. Milk Producers Council has been troubled for several years about the validity of the CWAP. While this survey 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 the understanding of MPC that the vast majority, in excess of 95 percent of the powder that makes up the CWAP, comes from two cooperatives that jointly market their powder through a single marketing agency in common. The structure of the current 4a formula essentially insulates these handlers, who are in reality really acting as a single handler, 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 subject to.

What has been created is an insulated economic environment for these cooperatives that act in concert. The make allowances are fixed and static and this entity controls the product value price that drives the formula. It is a comfortable place which moots any significant pressure to move up the value chain to capture more revenue from the sale of Class 4a SNF products.

MPC is proposing that the product value in the Class 4a SNF formula be the National Agricultural Statistics Service, or NASS, nonfat dry milk survey prices reported by the U.S. Department of Agriculture for the relevant month.

The reason we are proposing the NASS nonfat survey price is that it is imperative for the integrity of the

Class 4a formula that the product value used in the formula includes a significant amount of product that is priced independent of the control of the firm who has to pay for the milk based on the Class 4a formula.

The Class 4a butterfat price formula and the Class 4b cheese price formula both use the Chicago Mercantile, CME, prices to establish a product price.. The CME is a wide open exchange where anyone can participate. This means that no one party can control what happens there. This has the result of all parties needing to work aggressively to make sure that they are getting at least the market price, as determined in an open process, in order to maintain their margins.

The CME is a very valid market price to use to determine the butter and cheese product values. There does exist a CME nonfat dry milk price that we could use, but since that price is relatively new and the industry has not embraced that price yet as a market mover in the same way that the CME butter and cheese prices are used, we would not at this point propose using the CME nonfat dry milk price in the Class 4a formula.

The NASS price includes the California powder marketing by the single firm but, importantly, it is not exclusively powder from that firm. This fact will help keep the California powder firm motivated to make sure they are competitively pricing their powder in order to maintain their margins.

Another reason to switch to the NASS nonfat dry milk price series for the California Class 4a SNF formula is because of the difference in reporting long-term contract prices in the series.

In 2007 a huge variance emerged between the CWAP and the NASS price for nonfat dry milk. As a result of that variance, California producers were shorted millions of dollars of legitimate revenue because of the inadequacies of the CWAP.

According to research done by John Kaczor, from Milk Producers Council, California producers missed out on more than $200 million in legitimate revenue in just nine months because of this simple variance. And we have the attachment where that is documented.

In August 2007, CDFA held a hearing and made only modest changes, 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, which is included on the next page, included in my testimony, California producers never recovered the losses; the CWAP fell in lock step with the NASS price when the market prices moved lower and eventually crashed in 2008.

It's very vividly shown in the chart that you have there at the top of the next page.

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 California producers are experiencing a CWAP that is lagging behind the NASS powder price.

Milk Producers Council is very concerned that California producers, who are in desperate need of income, will be deprived of legitimate market 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. We are vulnerable to see a repeat of 2007, with a CWAP price lagging behind the NASS price, with no hope of recovering that money on the way down.

No doubt California powder makers will vigorously oppose this change. The first thing they will say is that they will no longer be willing to sell powder on long-term contracts. They will imply that this is bad for California producers.

But think about this argument; what the powder makers are really saying is that unless CDFA continues to put all the price risk of long-term contracts on producers, who have absolutely no say in what the price and terms of those contracts are, they won't do them.

As representatives of the powerless producers we object, the risks are too great and the rewards are too nebulous.

Powder makers will also say that they are owned by producers and, therefore, have every motivation to maximize producer income. But we need look no further than to the alternative proposal submitted by one of these cooperatives, for this hearing, to question that claim.

California Dairies have submitted a proposal that would, if adopted, drop the Class 4a formula price by 38 cents per hundredweight. They justify this based on their opinion that because CDFA's manufacturing cost survey shows an increase in manufacturing costs, they should be able to buy their milk cheaper.

It's pretty clear that this cooperative puts a high priority on maintaining their manufacturing plants' insulation from pressure to move up the value chain.

The fact of the matter is that the California dairy industry can no longer afford to have a powder manufacturing sector that is 100 percent protected on the price side of its business equation. It is now time to adjust CDFA policy to reflect the new reality. We are going to need your, CDFA, help to create the proper motivation for our cooperatives that make powder to move up the value chain. As long as they are comfortable and you signal that you will keep them comfortable by continuing to allow them to control the product value through the CWAP, they will not have the incentive or motivation to do a better job of marketing California's milk supply.

Now, I have been pretty tough on CDI and Dairy America's management, which we view as pretty much one in the same, but I want to temper that because I think it's the system that's the problem. I have no doubt that these folks want to get the highest price for powder that they can get, but they're stuck between the producer, who wants them to get more money, and the buyer who every day is beating on them to get a lower price.

When you look at it, where they sit the producer can't go anywhere. Producers in California don't switch creameries, there really isn't any competition, you're committed to a creamery. So the producers have no recourse.

The system is fully insulated, so even though they want to get more money for the powder the buyers resist every day, and whatever they end up selling the powder for, their margins for their organization are protected because the CWAP protects them and they make up the CWAP.

We cannot -- it was very interesting to watch my colleague, from Western United, who work hard every day for producers, and came up with a proposal, and while they were as polite as they could, they got massive pressure from the cooperative to back off. And they aren't going to take a position on this because that same pressure exists.

We have a situation where we have a large entity in this State that has a huge amount of power and is willing to use it. Your job, as a department, is to be the cop. You have a law that you have to implement, you have policies that have to implement, you're not a democracy taking votes. There will not be an industry consensus on this issue.

But things have changed and we need every penny of revenue that we can generate, I, the market, and our processors have to be motivated to go get every penny. And just saying they're for producers is insufficient motivation and we've got some track record that it's insufficient motivation to get them to do everything that they can.

All right. So the California Class 1 formula also uses the CWAP and so we've also added, as part of our alternative, that we use the NASS powder, nonfat dry milk to the extent that it's involved in the Class 1 formula.

All right, the next proposal, whey solids value in the Class 4b and Class 1 formulas.

The second proposal is to adjust the calculation of whey solids value in the Class 4b and Class 1 formulas.

From 2003 to 2007 California's Class 4b formula included a variable dry whey factor that moved up and down as the Dairy Market News announced dry whey price moved. However, after a hearing in late 2007, CDFA replaced the variable dry whey factor that had been in the Class 4b formula with a static, 25 cents per hundredweight factor.

Over the past year, as dairy commodity prices have hovered at the bottom of the price cycle, the fixed 25-cent value has functioned as a reasonable stop gap measure. However, the market for dry whey has begun to show strength again in recent months, and Milk Producers Council is concerned that if the value of dry whey continues to rise significantly, California producers will be deprived of the legitimate value that is being earned on Class 4b milk.

California producers will also fall significantly behind producers in the rest of the country as the Federal Milk Marketing Order Class III formula continues to have a variable dry whey factor.

What we are proposing is to stay with the fixed 25 cent value and then when NASS dry whey value -- when the NASS dry whey value exceeds 35 cents a pound, one-half of the additional value be added to the Class 4b formula, with one-half remaining for the processor.

One of the challenges in pricing the whey solids stream in the California order is the lack of good manufacturing cost data for making dry whey. The second fundamental problem is that while the vast majority of whey solids are further processed by California commodity cheese plants, there is not a consistent whey product that is produced. This reality necessitates a different approach to establishing a value for the whey solids stream.

We are proposing using the NASS dry whey price for both the 4b and Class 1 formulas because it has both achieved a level of acceptance in the industry as a valid measure of dry whey values, as well as functioning as the surrogate value for the whey solids stream. Our proposal allows the fixed 25-cent per hundredweight in the Class -- our proposal allows the fixed 25-cent per hundredweight in the Class 4b formula to cover any producer value from dry whey prices under 35 cents per pound, and we are only adding one-half of the increase in dry whey values above 35 cents a pound to both compensate processors for the risks associated with a dry whey price that falls below the cost of processing, as well as to reward and to incentivize processors to maximize the value of the whey solids stream. We believe this proposal is both very necessary, and very balanced, and fair in its approaches to producers and processors.

This is a crucial time for the dairy industry in California. The financial damage that has been done to the producer sector over the past year is truly incalculable.

The losses are massive and deep.

We bring this at an emergency hearing because we know that the price of whey is moving up, as we see powder prices moving up. Even if we say we'll deal with this later, it will take us four to six months to even get a hearing, if you announce one after the findings of this hearing, just to get the machinery. There are millions of dollars of lost value that could come into producers, that would be earned on 4b milk over the next six to eight months, that would be lost if you don't take action out of this hearing.

And one of the complaints that we hear of just a straight raising the price in an emergency manner, on the manufacturing sector, is we don't know that, we can't recover it.

Well, we're offering up our market-based revenue generators, but you have to take action today. As we hear about the dry whey price moving up, it's of no value to the 4b price because of the fixed nature of the 25 cents.

That was a good outcome when the Department did it. You have the opportunity to make this change, we've leaned over backwards to have an approach that addresses the 4b side, the concerns that we have had from processors, and so on, about sharing and the other bad manufacturing data or lack of, and so forth.

All right, my final point. It's very instructive to remind ourselves at this time of the law that directs CDFA policies with regards to dairy regulation. Section 62062 says in part "In establishing the prices, the director shall take into consideration any relevant economic factors, including but not limited to the follow: (A) The reasonableness and economic soundness of market milk prices for all classes, giving consideration to the combined income from those classes in relation to the cost of producing and marketing market milk for all purposes, including manufacturing purposes. In determining the costs, the director shall consider the cost of management and a reasonable return on necessary capital investment; (b) That prices established pursuant to this section shall insure an adequate and continuous supply, in relation to demand, of pure, fresh, wholesome market milk for all purposes, including manufacturing purposes, at prices to consumers which, when considered with relevant economic criteria are fair and reasonable."

The prices California producers have received in 2009 have come no where near to being sufficient to ensure an adequate and continuous supply of milk for the consuming public. CDFA has been given the authority and the responsibility to address this issue. Milk Producers Council has offered up these two specific alternatives because of deficiencies in the current Class 4a and 4b formulas. In both formulas, market price increases in powder and dry whey, which should be shared with producers, will not be fully realized unless the changes we have requested are granted.

We can be sure that if you do not accept our proposals, they will come back at a later time because the gap between what the current California formulas will produce in a regulated price versus the price established in the Federal Milk Marketing Order areas will be obviously lacking and California producers will clamor for change, but potentially millions of dollars of sorely needed market-based revenue will be missed because we delayed. Now is the time to make this change. The future of hundreds of California dairy farm families, and all the employees, and allied industries that serve them hangs in the balance. We trust that you will do the right thing.

As for the rest of the proposals, we fully support the Alliance's position with regards to increases in Class 1, 2 and 3. We appreciate the realization of the Dairy Institute, the California Dairy Campaign, and the California Dairy Women that producers need relief, but we disagree with the specifics of their proposals. We were prepared to support the temporary price increase requested by Western United and we are appalled and oppose, as unwarranted and untimely, the proposal by California Dairies to reduce producer prices at this time.

We thank the Department for holding the hearing today. In no small way, the future of the California dairy industry is dependent on a good decision. We believe we have provided solid proposals for change and we look forward to a positive result.

We would be happy to answer any questions you might have. And we would respectfully request a post-hearing brief and suggest a very quick, short time frame for that, maybe even Friday as a deadline, so the Department can get a hearing result out soon.

HEARING OFFICER HOLLOWAY: All right, thank you. Your post-hearing brief is granted.

Do any of the panel members have any questions they would like to address?

PANEL MEMBER EASTMAN: I have a question. Mr. Vanden Heuvel, you mentioned with regards to your adjustment in the whey factor, you told that that would add a market, signal a market value to the factor, itself; correct, that it be market-based?

MR. VANDEN HEUVEL: Yeah, it would only trigger in and change the current if the price of dry whey actually got up over 35 cents, which I don't think it's hit yet.

PANEL MEMBER EASTMAN: Right. So the question I have is I would assume processors on the other side, probably 4b cheese makers that whose cheese milk is dependent on that could argue that maybe that wouldn't be market-based, the fact that there's a fixed whey value in there is a fixed value that's not market-based.

And your proposal wouldn't let the whey value go below 25 cents, you would always have that value in there.

How would you -- if someone were to make that point on the other side, how would you argue that there is a market-based characteristic to the factor?

MR. VANDEN HEUVEL: Yeah, I think I get your question. I think it's in the nature of the whey stream and how to value it. We really wrestled with this as an industry, and I was a part of that committee that wrestled with it. I don't think you're going to get unanimity in the industry on how to handle it, okay, I mean everybody's going to argue.

But I actually think -- well, let's start with the fact that currently, I mean, theoretically, the price on the other commodities could go negative also; right?

I mean, if somehow or another the price of nonfat dry milk dropped to 15 cents a pound, you know, you've got a 17-cent make allowance, and if the value of it -- well, we'd get nothing. We'd actually, probably, have to take any value we might have got out of the butter. It's so absurd, we don't even consider it and so there's not a necessity to put in a fixed value for butter, pricing of butterfat, cheese, pricing its role in the 4b formula, and nonfat dry milk's role in the 4a formula.

But because whey, it's market value is very close to its cost of manufacturing, you run this possibility that it could go negative. And we don't have good data. What data we did develop historically about the cost of processing dry whey was always substantially higher than the manufacturing cost data when you had a much larger group of plants that you could survey, as expressed, say, when the federal order dealt with this issue. They had many more plants, they had a lot better data, a lot more dataset, a bigger dataset, and so they had a make allowance that was, you know, I think it's less than 20 cents a pound.

Whereas our data finally, at the end, got pretty absurd, over 30 cents, you know, is that accurate or not?

You know, what we're doing here is not exactly what -- you know, we're not all making dry whey, we're making other products.

So I thought the Department's way of handling it was to say -- was a valid one. There's a value to the whey stream. And what we heard a lot from cheese makers was -- and when we heard from them the loudest, I mean, you know, they're always trying to buy milk as cheap as they can. But when we heard, when the pain got the largest was when the price of dry whey exploded and the other whey products didn't keep up and they ended up, you know, really caught in a vice.

And we wrestled with this on that whey committee, how to come up with some alternative. And actually, this is very similar to one of the alternatives that was developed in the whey committee, which was a fixed value, and then a sharing once the market price of whey got up over a certain level, and a pretty generous level. I mean, at 35 cents -- at 35-cent whey in the federal orders, I think you're going to be looking at almost 80-cent, a dollar a hundredweight worth of value that will be added to the Federal Order Class III at 35-cent NASS dry weight. We're suggesting 25.

So there's going to be a built in dollar a hundredweight, or 75 cent a hundredweight advantage. And then in the Federal Order Class III every penny that the dry whey would move up above that, the full 5.8 cents would come into the Federal Order Class reformula, and we're suggesting cutting it in half.

We're trying to lean over backwards to get a deal. So I am hopeful that someone out there in the cheese industry will support this. And I haven't given up hope, we'll sit here until the end of the hearing and see if they can put their long-term interests ahead of their short-term opportunity. And their short-term opportunity is to oppose it, but they're long-term one, we're very close to killing the goose that's laying the golden eggs. We need money really bad, this is a good deal, take it.

PANEL MEMBER EASTMAN: So it sounds like what you're saying is, in your testimony, what you just said right now, so you agree it appears it's really hard to price the whey factor, the whey stream, it's hard to determine cost, et cetera.

MR. VANDEN HEUVEL: Absolutely.

PANEL MEMBER EASTMAN: So this is your best shot, your best attempt to obtain the value that you feel producers would need then.

MR. VANDEN HEUVEL: Well, it's not just the value producers who need. But I have often thought, I mean this is an area and we've already seen quite a bit of innovation on the whey solid, we need to leave some money on the table to incentivize whey makers to get as much value as they can out of it. And by splitting it 50/50 over a pretty high threshold, you know, there's a lot of money in it for them to keep pushing that -- to keep pushing that whey price up and that's ultimately in our interest.

PANEL MEMBER EASTMAN: Okay, thank you.

PANEL MEMBER IKARI: Given the history of the whey factor and the emergency nature of this hearing, Jeff, would you consider implementing your whey proposal on a temporary basis?

MR. VANDEN HEUVEL: You know, I hate to say this, but beggars can't be choosers. And, you know, I think that temporary, hey, we need revenue and this is a way to get it. And the thing -- I'll tell you -- I'll tell you, the thing that would just break my heart, Dave, is we see the whey prices moving up, the Federal Order of Class IIIs moving up because it's got it and there we sit, and we don't have it, and this is money that's there, it's being earned out of market, but because of a failure to adopt it at this hearing we're missing out on that opportunity, you know we'd be back.

So yeah, temporary, with a commitment to have a full-blown hearing at some point in the future, you know, if that's the way the Department wants to handle it, you know, we would respect that.

PANEL MEMBER IKARI: You've testified that powder processors, or at least major powder processors are insulated, but isn't it conceivable that if they did such a poor job of marketing powder that if you have an independent and at some point if they got significantly high enough price above what the co-op is getting, that the CWAP price will be above what the co-op has derived? I mean, if they just sit on their butt and do nothing, and somebody out there is getting a price that's, say, 20, 30 cents higher, then the CWAP price will be actually higher.

So why is that in the interest for the co-op just to sit there and take the lowest price?

MR. VANDEN HEUVEL: They got a -- they got a closed shop, Dave.

PANEL MEMBER IKARI: Well, if the Department established the minimum price based on the CWAP price, they will actually lose money.

MR. VANDEN HEUVEL: No, there isn't anybody else making powder expect them.

PANEL MEMBER IKARI: There isn't?

MR. VANDEN HEUVEL: There's one firm that has the capacity to do it, they don't do much and they're very small.

They got the whole thing sewed up and you have the data to back that up. You get the reports, you have the data. If we're wrong, you'll know it. You take your monthly reports and who's reporting in volume, and our contention is that virtually a hundred percent, 95 plus is coming from this single entity.

PANEL MEMBER IKARI: You're saying 99 percent, 99 percent of --

MR. VANDEN HEUVEL: Well, what I testified to is that our understanding is 95 plus and --

PANEL MEMBER IKARI: But even at 95 percent, if they sat there on their butt and did nothing, that one firm, that five percent, if they were aggressive and got a significantly higher price it can result, conceivably can result in a CWAP price that's higher than the co-op price and they will lose money.

MR. VANDEN HEUVEL: Dave, it would take 20 cents a pound to get one penny change between the CWAP and that price.

PANEL MEMBER IKARI: And you're saying it's not conceivable.

MR. VANDEN HEUVEL: It is absolutely inconceivable.

PANEL MEMBER IKARI: Okay. Another question, you were talking about in 2007, isn't it true that it was NASS whose rules on survey -- by the way, NASS does a survey, California doesn't do a survey. But isn't it true it was NASS rules that were violated?

MR. VANDEN HEUVEL: It was NASS rules that were violated in terms --

PANEL MEMBER IKARI: And isn't it true that no California rules were violated in the reporting of the CWAP price and the auditing of the CWAP numbers?

MR. VANDEN HEUVEL: We are not making the contention that there was any --

PANEL MEMBER IKARI: Well, I just want to clarify the record.

MR. VANDEN HEUVEL: And I appreciate your clarification. Our beef is not that you're not collecting the numbers accurately, our problem is that the embedded incentives that are imbedded in the way we do business here, and remember the California weighted average price does have a long history, it's gone -- I've been actively involved in this for almost 30 years and I think it goes all the way back at least before that.

But at one time we had eight, ten different companies that were selling powder; today we have one.

PANEL MEMBER IKARI: Mr. Kaczor was asked a number of questions. John, I will ask you the question, is NASS auditing the numbers that they are reporting? Do you know what their procedures are and do you know how they compare with the Department's?

MR. KACZOR: The hearing that was held two years ago, almost, you know, really simultaneous with the --

PANEL MEMBER IKARI: Are you talking about the Department of Food and Agriculture's hearing or USDA's hearing?

MR. KACZOR: USDA's hearing.

PANEL MEMBER IKARI: Okay.

MR. KACZOR: The USDA held a hearing that began before and finished after CDFA's hearing two years ago.

PANEL MEMBER IKARI: And what was the net result?

MR. KACZOR: The net result was that they maintained their 30-day limitation on the reporting of the sales. They made a number of other relatively minor changes. One significant change that they, from their point of view made, was to establish an audit procedure, that they said they had an audit procedure at the time that apparently was deficient, that the AMS took it upon themselves to establish an updated, more detailed procedure for visiting the major manufacturers on a monthly basis, I believe, the smaller plants on a less frequent basis.

PANEL MEMBER IKARI: Do you know if it's implemented?

MR. KACZOR: I'm told that it is, yes. I've spoken with and corresponded with the chief economist of AMS and he said it is.

PANEL MEMBER IKARI: And do you know how that procedure compares with the Department's? Whether it's tighter, looser, the same?

MR. KACZOR: With respect to the Department's procedure, I think we're all completely satisfied that there is a verification and a verification of the relationship between the weekly and monthly reports submitted by the plants with respect to the amount of product that is reported to be sold and the prices. But I see a significant gap between the follow-through --

PANEL MEMBER IKARI: Does USDA do a financial audit, do they review the general ledger of the companies involved?

MR. KACZOR: I do not believe they do, no.

PANEL MEMBER IKARI: That's all the questions I have.

PANEL MEMBER GATES: I just have a couple questions. Jeff, on page 2 of your testimony you were speaking in 2007, a huge variance emerged between the CWAP and the NASS price and as a result a huge -- of that variance, California producers were shorted millions of dollars of legitimate revenue because of the inadequacy of the CWAP.

Could you expand on that a little bit more, I'm confused between if our policies and procedures were being followed what was the loss there?

MR. VANDEN HEUVEL: The loss was the fact that you were reporting -- your rules allow for, obviously, long-term contracts to be reported and the NASS rules do not.

PANEL MEMBER GATES: So where's the loss then, if our procedures were that we were not --

MR. VANDEN HEUVEL: Our contention is that, and we contended it at the time, that these long-term contracts should not be -- should not be used in the calculation of our 4a prices.

PANEL MEMBER GATES: So it's your opinion then --

MR. VANDEN HEUVEL: That's right and --

PANEL MEMBER GATES: -- it was not an actual loss?

MR. VANDEN HEUVEL: Well, it's all in the matter of characterization. The powder sold for more, the current powder price was higher. And if you remember at the time, the assurance to us in that hearing -- I mean, we were watching prices move up in other series and having impacts on other -- on the Federal Order prices, for example, and our prices were lagging. We were upset about that, we pushed you hard, we held a hearing and decided essentially to not change your policy.

We were told in that hearing, essentially, you'll get it on the downside. These long-term contracts will extend, the price will extend and so theoretically, then, the current NASS price would drop and our price would stay higher.

And what you see on the chart is that that didn't happen. And so we didn't get it on the upside and we didn't get it on the downside and that is the basis of our claim that this was legitimate revenue, I mean the market prices were moving up, but we never benefitted from them.

PANEL MEMBER IKARI: I think what Mr. Vanden

Heuvel is saying is if the Department had disallowed long-term contracts that the CWAP price would have been higher.

MR. VANDEN HEUVEL: Thank you for saying what I would have said, had I thought of it.

(Laughter.)

PANEL MEMBER IKARI: So it --

MR. VANDEN HEUVEL: It's a policy issue.

PANEL MEMBER GATES: Okay, second question. On page, the back of page 4, I guess I'm trying to understand why the co-ops, who are owned by producers, would not have the incentive to sell powder at a higher price if they could get it, I'm missing that point.

MR. VANDEN HEUVEL: Well, okay, it's in trying to understand the relationship. I mean, I believe they want to. Okay, this is not -- they want to. But they got buyers who every day are pushing them.

PANEL MEMBER GATES: The market price.

MR. VANDEN HEUVEL: Yeah, I mean the market -- well, it's not that -- it's a matter that -- look, necessity is the mother of invention. I mean, why does it go up when it goes up? Finally, it has to, I mean the pressure is just there.

And when you look at the pressure on the other side, really, the management whose job it is to sell this stuff, it's not the dairymen who are selling it, even though the dairymen are the owners, it's the management's job to sell it.

PANEL MEMBER GATES: To report.

MR. VANDEN HEUVEL: Well, it's the managers who are selling the powder; right? I mean, the dairy farmers aren't selling the powder, it's the people they've hired to sell this powder for them, for their cooperative. And they're being evaluated based on how is the cooperative doing, that's how they're going to report back to their producers.

PANEL MEMBER GATES: Okay.

MR. VANDEN HEUVEL: Okay. Are you with me so far, okay?

PANEL MEMBER GATES: Yeah.

MR. VANDEN HEUVEL: Okay. Well, the buyer, every day they're interacting with trying to push the price down. The producer, even though he's an owner, he can't go anywhere, he's stuck and they know that.

And in terms of the performance of the organization that they'll have to report to the producer, the way we've structured the 4a formula is, essentially, whatever they can get out of that buyer their margin in their co-op is protected because they can control that product price.

And we got to put more pressure, the Department has to put more pressure on the upside of this formula. They will respond, I guarantee you. You do this, they'll get the NASS price because they are not willing to put the margin of the co-op at risk.

But they will -- they can do it now because they can get away with it. I mean, it's not that they -- I don't want to impugn their motives, they want to do a good job. But we can't afford to not -- we cannot afford for them not to have a maximum amount of pressure on them.

Because we're going to -- we are arguing right now about the future of this industry five and ten years from now. The devastation that we have, we have got to get every penny that's out there, that's available and value into producers' pockets today to try to save it.

PANEL MEMBER GATES: And you're saying the powder co-ops don't believe that?

MR. VANDEN HEUVEL: Well, they just -- look at their -- can you believe they petitioned to drop producer prices 38 cents a hundredweight in this hearing, at this time?

Now, if that isn't an indication of how strong they are about protecting the margins of their plant, I don't know what is.

PANEL MEMBER GATES: Okay, thank you.

PANEL MEMBER AC MOODY: I'm -- I'm sorry.

HEARING OFFICER HOLLOWAY: Go ahead.

PANEL MEMBER AC MOODY: Okay, I just have a quick question. On the graph on page 3 about where you're showing where, you know, the price was lagging and you didn't get the price on the upside and then it tracked well when the price went down; did you see that trend happening in the recent past or was this just like a one-time trend you've noticed?

MR. VANDEN HEUVEL: Well, I mean, you know, we're in unchartered waters. This is what was the history surrounding the last time we've visited with this issue. What's very, very troubling to us is what's happened in the last three weeks, where we're starting to see that NASS move and, you know, four to six cents a pound. That's nine cents per penny, that's 50 cents a hundredweight. That's what we're talking about right now and we're seeing -- we're seeing this trend and we're going oh, no, is this 2007 all over again?

That's why we're here and that's why we're as passionate as we are. This is dead serious right now, this is critical. That 50 cents -- you know, Western's approach was to raise to 50. Maybe that wasn't the right approach, but my goodness, if there's 50 cents that's in the market, we need to get that into producers' pockets.

PANEL MEMBER AC MOODY: Thank you.

HEARING OFFICER HOLLOWAY: All right, I believe that's it on the panel's questions. Thank you very much for your testimony.

We are going to break right now for about ten minutes and come back at 11:10.

(Off the record.

HEARING OFFICER HOLLOWAY: Oh, I can use the gavel. I've always wanted to do that.

Come to order.

Next in line for testimony is Dairy Institute. Okay, and I have two documents, right, and I'm going to do the first document of your testimony will be marked as Exhibit 54 and the next exhibit, which is the appendix, will be Exhibit 55.

(Exhibits 54 and 55 were marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Can you please state your name for the record?

MR. SCHIEK: Yes, my name is William Schick, that's S-c-h-i-e-k.

HEARING OFFICER HOLLOWAY: Just to break it up a little bit, I was hoping everybody was coming in at this point to sit down.

I want to also announce that if you would like to just do something, present it for e-mail or fax instead of coming up for testimony, I'm going to give you an e-mail address here. It's cgates, c, as in Candace Gates, g-a-t-e-s @cdfa.ca.gov.

And the fax number is 916-351-6697. Again -- oh, I'm sorry, thank you. The fax number again, 916-341-6697. 341-6697. And you can go ahead and just fax something, your comments, and/or e-mail.

All right, do you swear to tell the truth and nothing but the truth?

MR. SCHIEK: I do.

HEARING OFFICER HOLLOWAY: Thank you very much, go right ahead.

MR. SCHIEK: Okay. Madam Hearing Officer and Members of the Hearing Panel, my name is William Schiek; I'm an economist for Dairy Institute of California and I'm testifying on the Institute's behalf.

Dairy Institute is a trade association that represents 40 dairy companies, which process approximately 75 percent of the fluid milk cultured in frozen dairy products and over 85 percent of the cheese products, and even a small percentage of the butter and nonfat milk powder processed and manufactured in the State.

Member firms operate in both marketing areas of the State and the position presented at this hearing was adopted by a split vote of the board of directors of Dairy

Institute.

Dairy Institute appreciates the opportunity to testify at this emergency hearing, in support of our alternative proposal and to provide temporary and a modest adjustment to California's formulas for setting all class prices.

We also thank the Department for the opportunity to comment on the petitions submitted by The Alliance of Western Milk Producers and Western United Dairymen, as well as the other alternative proposals submitted and considered at this hearing today.

At issue in this hearing is what changes, if any, are needed to the State's milk pricing formulas. In establishing pricing formulas, the Secretary is directed by the Legislature to weigh the factors found within statute. Among other things, the Legislature requires that the State's dairy policy should serve the public interest, foster intelligent production and orderly marketing of milk, endeavor to provide for uniform prices to competing handlers and provide an adequate supply of milk for all purposes.

With regard to milk pricing formulas, the statute calls for Class 1 prices that are in reasonable relationship to Class 1 prices in surrounding states and class prices that are in reasonable relationship to each other, and pricing standards that conform to current economic conditions.

The Secretary is also directed to consider any other relevant economic factors when setting prices and must consider how to set prices so that all of the declared intentions of the Legislature are met as closely as possible.

There is no question that producers are now facing challenging times in the face of extreme volatility of both milk revenues and input costs. During the past year milk prices have been considerably below average milk production costs. This situation has led to severe financial losses and erosion of equity for many producers.

Unfortunately, the financial difficulties were made worse for some producers by the fact that they contracted for feed at very high prices, but failed to take advantage of the milk pricing opportunities that were available at the time.

Also, California's growing reliance on Class 4a prices resulted in lower pay prices to California producers in 2008 when compared to those in other western states.

While the losses to California producers in the past 12 months have been significant, it is important to remember that they followed a period of record high prices and returns. See figure A-1, and that's the first page of the appendix document.

According to CDFA data, over the entire period from January 2006 through June 2009 the producer sector earned about $852 million based on the adjusted mailbox price less cost of production. And this data came from CDFA Hearing Exhibit, Revised Table 6, with some corrections I made. I think there were some errors and based on the footnotes I made the corrections.

This revenue amounts to an average gain per year of $243 and a half million or 134.34 per cow annually. A number of that is no doubt small comfort to producers who have experienced real financial hardship in the last year.

Our purpose in raising this information is to point out that over the longer term there are profits to be made in the dairy industry and to encourage the widespread use of risk management tools as a means of achieving these profits.

We commend Western United Dairymen for organizing the upcoming risk management seminars on December 15th and 16th and encourage as many producers as possible to attend them.

In 2007 and 2008 prices rose because of growth in international demand and shortages in the international supply chain that were caused by milk production declines in Australia and New Zealand. As prices rose, U.S. producers expanded output to take advantage of higher earnings opportunities and domestic dairy product manufacturers rushed to meet the enhanced demand for U.S. dairy products in a global market.

The seeds of the dairy market crash were not in the global financial meltdown, as many seem to believe, but in the very high prices for milk and dairy products that producers were enjoying throughout most of 2007 and 2008.

As commodity prices rose, demand from international buyers fell and total global volumes of traded product decreased. As milk production in Oceania rebounded, demand for U.SD. product dropped as buyers returned to their traditional suppliers. The financial crises of last fall further compounded the situation as trade financing became more difficult. Uncertainly led global consumers to be somewhat more cautious about purchasing dairy products and a strong dollar made U.S. products relatively more expensive to international customers. While U.S. exports took a hit, they did not fall to zero, but rather back to the rising trend line they have been on since the beginning of this decade.

According to estimates by the National Milk Producers Federation, the U.S. exported over 10.8 percent of the milk solids it produced in 2008. However, in 2009 we are still on track to export around 8.5 percent, more than any prior year -- more than any year prior to 2006.

The key point here is that shocks in the global market were largely responsible for the large price run-up in '07 and '08 and these high prices precipitated the fall in global demand that led U.S. prices lower. However, now the rebound in global markets is largely what is leading us out of the price trough and toward price levels at which dairymen can make a profit.

Even after the fall off of exports in '09, the U.S. is still selling a significant amount of product abroad and volumes are expected to grow in the future.

Prices are determined at the margin and, like it or not, our domestic prices are largely being determined by global supply and demand balances. What we need to remember is that it is these sales into the global market that are determining our price. Unless we can find another home for eight to ten percent of U.S. milk solids that we export, we cannot afford to adopt policies that make us less competitive in global markets. Otherwise, product that was being sold abroad will come back into our domestic market and reduce domestic prices.

The Secretary must consider the impact of proposed pricing changes on the ability of California processors to compete and sell product both nationally and globally.

Another point that needs to be made is that while prices have fallen at the farm, they have also fallen at retail. Some seem to suggest that prices at retail have remained high while farm level prices have fallen and, by inference, that the processing/manufacturing side of the industry must be reaping huge profits. However, in reality, prices for dairy products had followed prices at the farm level very closely, although manufactured products do so with a lag.

Processors and manufacturers simply do not have the margins to support unilateral revenue transfers to products, while meeting competition from states where such policies are not employed. While producers costs have remained higher than their revenues in recent months, it is important to note that milk prices are not and should not be determined by milk production costs alone, but by supply and demand in the marketplace.

When market prices are low, they signal the need for less milk production and fewer dairy products in the marketplace. Likewise, when milk prices are high, producers receive a signal that more milk is needed. That is simply how the market works. Increasing regulated prices above what the market is telling us milk is worth sends confusing signals to producers, processors, and dairy product buyers. The policy risks driving market prices lower again as buyers respond to higher prices by curtailing purchases and producers respond by expanding output.

Regulated prices should be minimum prices that serve to stabilize and underlay the market. Minimum prices should be set at levels that still allow the market to set the actual prices at which milk and dairy products trade so that supplies are correctly allocated to their highest and best use. Regulated prices that are set too high interfere with market signals.

Currently, production is down in California from where it was last year. However, reduced production is not necessarily an indication that regulated prices should be raised. Reportedly, market-based over-order premiums have been increasing to ensure that milk moves to where it is needed and this development is precisely what should happen in a properly structured market.

Actions by individual states to deal with low prices that result from the natural working of supply and demand in the market risk being ineffective at best or, more likely, harmful to the industry. State mandated regulated price increases do not create new money, but transfer it from processors to producers. There is no way for a state to increase its regulated prices without making the state's processing industry less competitive. In so doing, the state risks losing dairy product sales and processing or manufacturing investment.

If California increases its regulated prices and other states do not, California processors will lose sales and overall demand for California milk will fall. There is no way to raise California regulated minimum prices without doing some damage to the processing side of the industry and hurting producer interests in the long run.

If California's government is going to intervene in markets by providing financial assistance to producers, such assistance should come in a form that does not disadvantage in-state plants in comparison to out-of-state ones. Also, when multiple forms of assistance are coming from different sources, state government runs the additional risk of putting too much stimulus in producer sector which, again, could stall the market price recovery currently underway.

Already in 2009 there have been a number of national programs aimed at helping producers. And Mr. Marsh, from Western United Dairymen talked about all of these, but they include the Dairy Export Incentive Program, increases in the Commodity Credit Corporation support prices, the allocation of $200 million in nonfat dry milk to food donation programs, and the Milk Income Loss Contract program, which have all provided monies for California dairymen this year.

Still to come is the new $60 million Dairy Product Donation program, as well as $290 million in the form of direct payment to producers. The rules are currently being worked out for these programs, but benefits will be coming to California producers. Given the varied assistance that is already moving to dairymen and given the fact that any increase in a regulated price will disadvantage California processors in relation to their competitors in surrounding states, any California sponsored relief to producers should be both short term and modest.

Government mandated increases to regulated prices cannot give lasting relief to producers and run the risk of hurting the industry's market opportunities. We maintain that the real solution to producers' financial nightmare is a rebound in the market price. Given the recent price movements, the contraction of the milk supply, and the length of time we have already been in this current price trough, there is every reason to believe we are moving to a higher-priced environment. In recent weeks, market prices have indeed rebounded strongly and those higher prices will be reflected in producers' milk checks in the coming months.

There are strong reasons to believe that this price rally will be sustained. The domestic economy is now expanding, which is positive for diary product demand going forward. Likewise, the global economy is rebounding, especially in Asia. Demand for dairy products from those regions is improving and along with it demand for U.S. dairy exports is improving as well.

Dairy commodity prices are rising internationally, especially in U.S. dollar terms, and that development is driving domestic dairy prices higher. Prior to the most recent dairy powder auction by New Zealand's Fonterra Cooperative, Oceania prices for butter were ranging, and my ranging I mean this is the mid point of the reported range in dairy market news from last -- from the October 30th report, Oceania's prices for butter were ranging around $1.42 per pound, while skim milk powder prices were around $1.34 per pound. Prices for cheddar cheese during the two weeks ending October 30th were in the range of $1.66 per pound. the recent Fonterra auction saw milk powder prices rising even farther. With the exception of butter, these price levels are above those currently seen in the U.S. and these higher world price levels can be expected to pull U.S. prices higher.

So, improved prices for producers are on the way. however, we caution the Secretary that trying to speed up that process by regulatory action could end up harming the price recovery that is underway by pushing potential buyers of the State's dairy products elsewhere.

In a hearing called on an emergency basis, such as this one, the rapid hearing timeframe does not allow for thoughtful, deliberative consideration of major changes to pricing formulas. Proposed structural changes need to be fully examined by industry, with opportunities to request additional analyses by the Department, and to question Department staff regarding the meaning of such analyses.

We therefore view proposal for permanent changes to the pricing formulas, as well as those proposing major changes to how the formulas are constructed, to be inappropriate for consideration at emergency hearings, regardless of the announced hearing call. Consideration of structural or permanent changes is reckless in the context of hearings like this one, as adoption of such changes could result in major negative and unintended consequences for the California dairy industry.

It is our view, therefore, that the Secretary should consider only temporary changes that do not involve major structural changes to the formula. To our knowledge, permanent changes to the formulas have never been implemented as a result of an emergency hearing. The Department should continue with its past practice in this regard.

Dairy Institute proposes that for the three-month period beginning January 2010 and continuing through March 2010, prices for all classes of milk be increased by 20 cents per hundredweight, subject to a market-price trigger based on the second prior month's Class 4a and 4b prices.

The 20-cent increase would only be implemented if both the Class 4a and 4b milk prices in the second prior month do not exceed $13 per hundredweight.

To further illustrate our proposal, if either the November 2009 Class 4b price or the November 2009 Class 4a price exceeds $13 per hundredweight, then the 20-cent increase we propose would not be implemented for the month of January, and so on for February and March, looking at the second prior month.

The amendments proposed here are offered to address the conditions cited by the petitioners. While Dairy Institute's member companies understand the financial hardships that California dairy producers have faced in 2009, they have concerns about the negative impact of the petitioners' proposed changes on the competitiveness of California processors. Dairy Institute's proposal seeks to strike a balance by offering some short-term assistance to producers in the event of a continuation of low dairy product prices, while seeking to minimize the competitive disruptions brought about by increased regulated prices.

And in the document are the proposed component price increases that accompany this proposal, I'm not going to read them here.

Dairy Institute's proposal is both modest in scope and temporary in duration. Therefore, it has less likelihood for negative unforeseen and unintended impacts on California's sales of dairy products. Our proposal's short-term duration limits negative impacts compared to the longer time frame proposed by Western United or California Dairy Women Association.

The market-based trigger mechanism, at $13 per hundredweight for 4a and 4b allows the market to respond, providing a price boost only if prices fall back from current levels. Again, the market is where price increases for producers must originate, and market prices are moving higher.

With regard to The Alliance of Western Milk Producers' proposal, The Alliance proposes a permanent increase to the Class 2 and 3 prices of 26 cents per hundredweight, and they also propose a permanent increase in the Class 1 price of 50 cents per hundredweight.

We oppose The Alliance proposal because permanent changes to the pricing formula should not be considered in an emergency hearing. Furthermore, their proposed increases to the prices are not supported by economic evidence.

At first glance, it appears that California Class 1 prices have fallen relative to federal prices since last year's hearing. However, closer inspection of the data indicates that the average difference in the Class 1 price levels between federal orders and California has changed simply because of the timing of price volatility, rather than from any structural changes in the underlying relationship.

And I'll point you to figure A-2 in the appendix, and that graph has two lines on it. One is the Northern California price less the Portland price, which is the one that jumps around a lot.

The second graph is the 12-month moving average of that first line.

And you can see how the 12-month moving average at the end of last year was showing that the California price was 19 cents per hundredweight below the Portland price and how for the 12 months ending with November, it now shows the Northern California price being 37 cents below the Portland price.

So it looks like, yes, there's been a movement that way. But when you look at the individual monthly data, you can see where there are a couple of months where we were way below federal prices. Now, the reason for that was the timing of the formulas and how they respond to the commodity markets. California prices, as you all know, are based largely on CME prices, while the federal prices are based on NASS and there is a considerable lag, especially in cheese prices, between the CME and NASS.

So when we have a huge price drop, like we had at the end of last year and moving into 2009, California's going to fall much farther and much faster, but that's sort of a one-month aberration, or a one- or two-month aberration because what we actually had is we fell in December, bounced back up in January and fell again in February, as the market kind of did one of those seasonal loops that it sometimes does.

So again, the point here is that there's not really an underlying change in the relationship between federal prices and California prices and, therefore, not a need for the Department to make changes to the formula.

According to the Secretary's determinations from the last hearing, California prices were adjusted after the October hearing to match corresponding changes in federal prices as a result of make allowance adjustments in that system. That is, the changes were implemented to maintain the competitive relationship that existed prior to the federal make allowance changes.

The federal orders have not reduced their make allowances since last year's hearing; therefore, there is no justification for the proposed permanent increases to Call 1, 2 and 3 prices.

Table A-1 of the appendix illustrates the price relationship between California and federal Class 1, 2 and 3 prices when market volatility is removed. It contains a calculation of the price relationship between the two systems when prices are held constant. The results indicate that the existing price relationship is appropriate from a competitive stand point, especially when considering the higher cost of doing business in California compared to surrounding states.

Referring to the Department's Hearing Exhibit, Table 3, The Alliance proposal clearly puts California at a competitive disadvantage with regard to fluid milk, with California being disadvantaged anywhere from 1.5 to 9.6 cents per gallon. California will lose fluid milk sales if the Alliance proposal is adopted. Also, the Panel should note that under the Alliance proposal Northern California ice cream makers would have been disadvantaged relative to their Oregon counterparts in three of the past five years.

If giving up sales of Class 1, 2 and 3 products in favor of increased Class 4a utilization is the policy goal the Department seeks, then the Alliance proposal deserves consideration. But if preserving California's sales of higher class products is deemed worthwhile, the Department would do well to reject the Alliance proposal and we urge the Secretary to do so.

Western United Dairymen has proposed a temporary increase on all classes of milk of 50 cents per hundredweight for six months. While it is good that the proposed change is temporary, the price increase is too large and lasts for too long. California processors would lose significant sales to out-of-state competitors when disadvantaged by such a large amount for such a significant length of time. Western United's proposal should not be adopted

California Dairies has proposed increasing the manufacturing allowances for Class 4a fat and solids-not-fat and an increase to the butter f.o.b. price adjuster. Any change in the make allowance needs more analysis by industry than can be given in an emergency hearing, especially given the higher start-up costs associated with new plants that have not been made part of the cost study in prior years.

CDFA has a policy of not including the higher start-up costs for new plants when setting make allowances in the past, and I refer you to the Golden Cheese case back in the mid-eighties. Given the fact that we have not had time for thoughtful consideration of all the appropriate issues, changes to the make allowances should not be considered at this hearing. However, if the Department is going to entertain make allowance changes, we point out that the cheese make allowance is in the greatest need of increase, since only four percent of the State's cheese volume is covered by the current make allowance.

California Dairy campaign; CDC introduces a variable make allowance that would equal the current base make allowance multiplied by the ratio of the Class 1 Commodity Reference Price to the most recent CDFA Statewide Total Cost of Milk Production. The CDC proposal also floors the commodity prices used in the manufacturing class formulas at the CCC purchase price. They would also floor the Class 1 price at the CDFA Statewide Cost of Milk Production. CDC has proposed this type of change before and to date the Department has never seriously considered a variable make allowance.

The idea of a make allowance based on the ratio of production costs to milk prices is not economically sound. Its implementation would create a disincentive for plants to purchase milk when prices are low and milk is generally most abundant. This proposal would not be helpful to producers and would make an already difficult financial situation for producers worse by leaving them with the possibility that their milk would not be purchased.

Nothing has changed since this type of proposal was last considered that would make it a valid policy choice today. Furthermore, it is proposed as a permanent change and should not be considered at this hearing. CCC floors in the Class 4a and 4b formulas were implemented briefly by a prior administration, but were overturned at the first opportunity by the current administration because they were economically unsound and detrimental to California Manufacturers' ability to compete. CDC's proposed changes to the pricing formulas should be rejected.

Milk Producers Council. MPC advocates replacing the California Weighted Average Price for Nonfat Dry Milk with the National Agriculture Statistics Service survey price in the Class 1 and Class 4a pricing formulas. In addition, MPC asks for the 4b formula -- or asks that in the Class 4b formula the 25-cent fixed whey factor remain in effect, but whenever the dry whey price exceeds 35 cents per pound an additional amount equal to 50 percent of the difference between the market dry whey price and 35 cents be added to the Class 4b price. Also, MPC proposes replacing the AMS Western Dry Whey Price with the NASS Dry Whey Price in the Class 1 and 4b pricing formulas.

As we stated earlier, structural changes to the price series and the whey factor should not be considered at an emergency hearing. The question of whether pricing formulas should reflect spot prices or contract prices is one that deserves some debate and consideration, but not in an emergency hearing.

With regard to MPC's proposed changes to the whey portion of the Class 4b formula, the Department-appointed Whey Review Committee spent eight months looking at the issue and could not agree on recommended changes to the current formula after careful deliberation. It would be inappropriate to consider such major changes in an emergency hearing. Furthermore, all the problems that the previous whey factor posed for small cheesemakers would still exist under the MPC proposal and would potentially drive additional small cheesemakers out of business. The MPC proposals should be rejected.

California Dairy Women, I'm going to skip over a description of their proposal, but I'm going to state that at a national and international level consumers will simply buy less when products are expensive. This is seen clearly by what happened to total global dairy product demand when prices shot upward in 2007, it feel by roughly five percent on a 12-month moving average basis, according to calculations by USDEC.

At the state level, California plants will simply be unable to compete with their counterparts in other states and will have a strong economic incentive not to buy California milk.

The state can set a high price for milk, but it cannot force plants to purchase that milk. The result of this policy, when milk production costs exceed market price levels, is that plants will buy considerably less milk, leaving much of the available supply unpurchased. Milk that is not purchased by a handler returns an effective price of zero dollars per hundredweight to the producer.

Therefore, while this proposal would appear to help producers by requiring that prices equal their production cost, the actual impact would be to lower revenue to California producers because plants would have no incentive to purchase the milk. This proposal should be rejected.

Supply and demand conditions, both domestically and globally, are moving the price of milk and dairy commodities higher, providing relief to producers. Price recovery is expected to continue in 2010 and the federal government as provided myriad assistance mechanisms for producers during 2009, with the largest effort total of $350 million being implemented in the near future.

Efforts by California to unilaterally raise the State's regulated milk prices will disadvantage California processors and manufacturers relative to their counterparts in other states and countries, likely resulting in fewer sales of California dairy products and diminished market opportunities for producers.

Dairy Institute's proposal is the only option proposed that is both modest enough in its price impact and short enough in duration to limit the negative damage that will result from unilateral State action to increase prices. If the Secretary feels he has no choice but to increase regulated prices, then the Dairy Institute proposal is the only one that should be considered.

However, we reiterate that true price relief and income relief for dairymen must come from the market and that relief is on its way, as evidenced by the rebounding market prices for dairy commodities.

And I'll just say, given where cheese prices traded today, we're looking at a 4b price on today's market of close to $14, so that's moved up considerably from where the lows were last spring.

We urge the Secretary not to take any action that would interfere with or forestall the ongoing market milk price recovery.

Thank you for the opportunity to testify and I'm willing to answer any questions you may have, and I respectfully request the opportunity to file a post-hearing brief.

HEARING OFFICER HOLLOWAY: Thank you. Your post-hearing brief request is granted.

And I'd like to ask the panel members, any questions? Go ahead.

PANEL MEMBER EASTMAN: I have a couple of questions. Typically speaking when we come to these hearings, usually producers and processors are on opposite sides of the fence. Usually, producers want higher prices and processors lower prices.

And so in your proposal, you're actually looking for a temporary increase. Now, at the beginning of your testimony you kind of state how lots of times regulated intervention by governments can thwart pricing signals and could have negative outcomes, so to speak.

So my first question is, when you decided to actually propose a temporary price increase, that seems to go against price signals and portions of your testimony; do you feel the price increase was warranted due to the financial hardships of producers or was that maybe implemented a trigger mechanism kind of accounts for some of that, I'm sort of curious how that occurred?

MR. SCHIEK: Yeah, let me try to give a little background on that. As I noted in my introduction, this proposal was adopted by a split vote of our board. Typically, we come in here with a unanimous vote of our board, we work out the issue so that we have a unified position to present at the hearing and pretty much one that every member can support.

In this case, I think there were a couple of things at work. One is our long-standing belief that market prices need to be allowed to work, to send the appropriate economic signals to the industry; that's to producers, buyers, manufacturers, everybody throughout the chain. And that policy or that belief in the market doesn't go away simply because we're in a really unique economic time. And many of our members feel very strongly that the market is responding, the market is going to be bringing relief to dairymen and that we should allow that to work, because that's really the best opportunity, the best hope for a better future.

On the other hand, people aren't blind to what's been going on in the past year, we know how bad it's been for a lot of dairymen. We know that producers have had a tough time, we know that people have gone out of business. We know that the losses have been severe.

So there was a desire, I think, to do something to help but, again, there's this worry that anything the Department does, because you're just one state trying to raise the regulated price, it's going to have a negative impact on the industry in some way. You know, dairy farmers will see a larger milk check from an increase in regulated price, but they're going to also start seeing fewer sales of Class 1, 2 and 3 products and more 4a, and that's going to work to lower price.

So we're trying to strike that balance and recognize that the market's where price relief needs to come from. But by putting a trigger mechanism in place what we're saying essentially is if this market recovery kind of fizzles and falls back down, then some relief is appropriate.

PANEL MEMBER EASTMAN: Great. I have a second question. How did you arrive at the 20 percent -- I mean, the 20-cent per hundredweight increase? Is there some number, magical number that allows you for three months to maintain some level of competitiveness with neighboring states; or how did that come to be?

MR. SCHIEK: Yeah, once again there's that balance between providing relief and not hurting sales and I don't think there's anything magic about the 20 cents, there's no economic formula that spit it out. It was a discussion amongst our policy committee and our board and that's the level they came up with is in that balancing act role.

PANEL MEMBER EASTMAN: Got you. And then just one more question, when it came to the trigger mechanism did you feel that if either one of the 4a/4b prices were to get above the trigger mechanism that the over-base price or the blend price that you'd get from the pool would be sufficiently close enough to the cost of production to sort of not require any help or was there some level, was there a reason why $13 a hundredweight on any one of those prices became the trigger?

MR. SCHIEK: Yeah, I think at some level $13 a hundredweight on 4a and 4b historically has been a price level that's fairly reasonable. But I think the real focus on that number was when we were putting that proposal together that's pretty much where the current market was and, therefore, the idea was the market is recovering, let's leave the room for the market to work rather than intervene at a higher level which could, you know, work back to the market to actually derail price recovery.

And I think I've mentioned some of those reasons why that might happen in my testimony.

So the idea was let's look at the current market, the current market's about there so we'll set the trigger level there and that way it only becomes effective if we go back the other direction and then it comes in to boost the price.

PANEL MEMBER EASTMAN: So in essence you could kind of say -- it seems like your testimony and a few others we've heard already today, we're in circumstances of great uncertainty, it's sort of hard to predict what's happening, we're in uncharted territory. So parts of your proposal weren't necessarily a surgical cut based on really specific analysis, rather than just some --

MR. SCHIEK: No.

PANEL MEMBER EASTMAN: -- high level type discussions?

MR. SCHIEK: No, not a surgical cut. Although, you know, when our board members get together to decide on a policy, they bring their judgment and experiences, people who are in the marketplace selling products, to that discussion. So I wouldn't call it an ad hoc number, per se, or it's not a made up number, it is a number that's based on judgment, based on acting in the market place.

PANEL MEMBER EASTMAN: Sure, makes sense. Thank you.

PANEL MEMBER IKARI: Just to follow up on those questions; do the processors consider the cost of production and where that might be for dairy farmers, as well as the nine months of price cost squeeze that the dairy farmers -- or I probably should characterize it as unprofitable production?

MR. SCHIEK: Yeah, I would say it was considered insomuch as producers have been facing big losses. But as I think I tried to point to in the testimony, we're not advocates of setting market prices at cost of production because that's not how underlying market prices are determined.

In the long run, yes, market price will tend toward cost of production because to get a supply of the marketplace you've got to be there. But in any cycle up and down they can diverge from time to time, and they diverge primarily because of imbalances in supply and demand.

So, you know, we weren't thinking, okay, we want to set a price that matches the cost of production, it was more based on providing some relief should market prices retreat from where they were at.

PANEL MEMBER IKARI: October 2009, Livestock, Dairy and Poultry Outlook described the current financial stress on the nation's dairy farmers as being of "crisis proportions."

It went on to report that "it may rank as at least the second, a close second to the worst dairy crisis in more than 35 years."

What's your -- what's the Dairy Institute's opinion on that?

MR. SCHIEK: There's no debate about the fact that it's been very bad for the producer community.

PANEL MEMBER IKARI: Do you think the California producers were about the same, worse, or better than say the national average?

MR. SCHIEK: I think California producers, as a lot of western producers who buy a lot of their feed, were probably hit harder than producers in traditional milk-producing areas because purchasing more feed, you had to actually pay out the cash to get the feed to feed your cows.

Producers in Wisconsin, upstate New York, Vermont, Pennsylvania, places like that, a lot of them grow their own feed. You know, economists would tell you that they should be charging themselves that same market price, but the reality is they don't, so they're cash flowing better than dairymen in the west.

With regard to California, for most of 2008, when milk production costs began to soar the class -- well, the cheese value of milk was considerably higher than the butter/powder value. Some other western states have a much higher proportion of their milk supply in cheese, than butter/powder. We're more split between the two and that also probably had a negative impact on producer income in California.

PANEL MEMBER IKARI: You mentioned in your testimony about the split vote of Dairy Institute members. I'm curious if you could characterize or summarize, was the vote, the split vote along, say, cheese processors on one side and by type of plant or operations?

MR. SCHIEK: Uh-hum.

PANEL MEMBER IKARI: Or was it across the board?

MR. SCHIEK: Well, you're going to hear from some of our members today so you'll be able to form your own impression, but I would say, I would characterize it as saying there were -- there was at least one cheese producer that voted for the proposal and there -- and at various points in the discussion there were bottlers who were opposed to it. So I don't know if I -- I think probably, in general, you would say that the manufacturers of dairy products that are sold in a national marketplace probably were more concerned about the negative impact on their ability to compete because they know they're going to be up against a Wisconsin cheesemaker. And Wisconsin cheesemakers are expanding right now.

PANEL MEMBER IKARI: Was there consideration while the deliberations were going on that if the present trend of production declines continue, it seems to me that they will be the worse ones impacted, we will have an over-capacity and plants, especially the Class 4a and 4b plants searching for milk.

So in the long run, if that happens, won't they be paying premiums to keep milk in their plants?

MR. SCHIEK: I think they will be and they are, and I think most of them will tell you that they would rather see payment -- for a situation like we've been through, they would rather see premium structures keep their plants wet than have the regulated price move up.

PANEL MEMBER IKARI: Is that --

MR. SCHIEK: Because the regulated price moves up, when market conditions change, the regulated price doesn't automatically move back down.

So the idea here is that what's the role of the regulated minimum price versus what's the role of premiums in the marketplace. And I think they understand when milk is short they're going to be paying more for milk through higher premiums, and that's going to flow back to producers through their cooperatives.

But I think the other thing they understand is that as supply is tight and they don't have as much milk to flow through their plants and their production of dairy products is down, dairy product prices are going to start moving higher. That's going to provide more revenue for producers. That's going to raise producer incomes, that's going to bring the milk supply back.

And I think that it's that faith that the market will correct these problems is what most of our members believe.

PANEL MEMBER IKARI: You did mention about over-order premiums and you just mentioned it again, are the over-order premiums being paid more by cheese processors than fluid or higher value products?

MR. SCHIEK: I don't have a real specific knowledge, I've just heard general discussions in the industry. But my sense is it's being paid across the board, cheese, soft products, frozen products, and Class 1.

PANEL MEMBER IKARI: Your opposition to the Western United proposal, the original proposal that's now --

they've switched their position. But was it more based on -- is your opposition based on the amount or the timeframe, or both?

MR. SCHIEK: I'd say both. Fifty cents a hundredweight is five cents a pound on cheese, going to lose a lot of cheese sales if you've got that kind of cost disadvantage. And, you know, temporary is one thing, but six months is a long time.

PANEL MEMBER IKARI: So if it was 20 cents for three months, is that something that is more palatable to the processors?

MR. SCHIEK: I would say more palatable only because it's less time and more modest. I think you'll hear from some who will say, you know, we don't support that.

PANEL MEMBER IKARI: Am I wrong in making the assumption or is your analysis different, that if our production does not respond that it's the manufacturing plants, the butter, powder and cheese plants that will be hurt the most?

MR. SCHIEK: I would say they will be the ones who are going to be looking harder for milk supplies, yeah, without a doubt.

But on the other hand, quite frankly it's probably going to fall more heavily on butter/powder because I think the cheese plants -- if the market is short of cheese, market prices are going to move higher, they're going to have to, you know, get milk into their plants.

PANEL MEMBER IKARI: Thank you.

HEARING OFFICER HOLLOWAY: Okay, we have no more questions at this time. Thank you so much for your testimony.

Okay, now I will be calling up the California Dairy Campaign.

We have one document here which we will mark as Exhibit 56.

(Exhibit 56 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: You can go ahead and introduce yourself, please state your name and spell it for the record.

MS. MC BRIDE: My name is Lynne McBride, L-y-n-n-e M-c-B-r-i-d-e.

MR. CONTENTE: Joaquin Contente, J-o-a-q-u-i-n C-o-n-t-e-n-t-e.

MR. MAGNESON: Scott Magneson, M-a-g-n-e-s-o-n.

HEARING OFFICER HOLLOWAY: Thank you.

Do you all swear to tell the truth and nothing but the truth?

MR. CONTENTE: I do.

MS. MC BRIDE: Yes, I do.

MR. MAGNESON: Yes.

HEARING OFFICER HOLLOWAY: Thank you very much, you may proceed.

MS. MC BRIDE: Madam Hearing Officer and Members of the Panel, my name is Lynne McBride; I currently serve as Director of Government Relations for the California Dairy Campaign and Executive Director of the California Farmers Union.

The California Dairy Campaign is a member organization of California Farmers Union, which represents more than 1,500 farmer and rancher members statewide.

CFU is a state chapter of the National Farmers Union, which represents 250,000 farmers and ranchers nationwide.

The testimony Scott Magneson, Joaquin Contente, and I will present today is based on positions adopted by the CDC board of directors during its most recent, October 27th, 2009 board meeting.

Dairy operations throughout California continue to be in serious jeopardy due to record low producer prices. Many dairies have either filed or are in the process of filing for bankruptcy and many more are closer to bankruptcy each day. Many of the dairy operations near bankruptcy today have been in operation for several generations. They are family dairy farms that have weathered many economic storms, but the crisis they confront today is unparalleled in history.

From the third quarter of 2008 until the second quarter of 2009 dairy producers lost more than $1.4 billion dollars and producers continue to operate at a significant loss today. In addition, farm values decreased by more than $1.2 billion during that time and today farm value declines are estimated to have reached $2 billion statewide. Feed and other input prices remain high and producer prices continue to be well below the average cost of production.

The toll the dairy crisis has taken on dairy producers and related industries that supply and provide services to dairy producers will be felt for years to come. Even if dairy producer prices continue to improve, it will take five solid years of prices at $1 per hundredweight over production costs for producers to be able to convert their debts to assets. Given the volatility of dairy producer prices, it is unlikely even under the most optimist scenarios that producer prices will remain strong for that length of time.

Money is being made in the dairy industry, but producers are left out of the profit opportunity. Dean Foods Company, the largest U.S. milk supplier, reported last Monday that its third-quarter profit rose 32 percent and raised its full-year profit forecast. executive compensation at Dean Foods is up more than 50 percent from last year. According to Morningstar, Kraft Foods has a four star rating and executive compensation there is up by more than 60 percent. The gap between the farm and consumer dairy price is near an all time high. Many companies have prospered at the expense of dairy producers, who are unable to pay their bills and are accumulating debt at unprecedented levels. Under the current system, plants are able to cover their production costs, while producers to not have that ability. The gap between the farm and retail dairy price is near an all time high, which shows that consumers do not benefit from the current system either.

CDC and CFU members traveled to Washington, DC extensively in 2009, calling on the President and Congress to take action to end the dairy crisis caused by record low producer prices. One important step taken by USDA Secretary Vilsack was his decision to raise the support purchase price.

Since the beginning of 2009 CDC and CFU members have called on federal lawmakers to raise the support purchase price to a more reasonable level. CDC and CFU members met in person with Secretary Vilsack to urge him to take this important step, which he announced in July of this year.

Due to the current pricing system, California dairy producers do not benefit from this important safety net that was intended to aid producers in California and around the country. We call on CDFA to correct this inequity so that producers in California receive the higher of the prevailing market price or the USDA announced federal support purchase price.

Included in our testimony is a chart that documents the long-term losses that producers have accumulated over the years. During discussions of the current dairy crisis it is often suggested that producer income in previous years could make up for the current economic shortfall. But the data on the "average dairymen's" monthly incomes and losses proves that it will take many years of profitability to regain lost equity. Acceptance of the alternative proposal we have put forward would be a good first step toward correcting inequities in the system and improving the outlook for dairy producers in the future.

The alternative proposal submitted by CDC calls for CDFA to incorporate the producers' cost of production into the Class 1 price formula, utilizing the full cost of production including allowances from the Statewide Cost Comparison Summary.

We're also calling for CDFA to utilize the higher of the Commodity Reference Price or the cost of production to establish a price floor that will prevent the Class 1 price from dropping below the cost of production.

We're calling for an adjustment in the 4a and 4b price formula to establish a variable make allowance. The variable make allowance would increase or decrease the fixed base make allowance depending on the relationship between the cost of production and the end product values from the commodity reference price.

We're also calling for CDFA to include the higher of the commodity prices or the USDA support price in pricing formulas to prevent the minimum prices from dropping below the intended federal support level.

I'll just start with our proposed changes to the Class 1 formula.

This year, prices paid to dairy producers throughout the state covered a fraction of the average cost of the production and the outlook for the future is uncertain. According to CDFA data, nearly 100 percent of dairies in the North Valley were operating at a net loss during the first quarter of 2009. More than 80 percent of dairies in the North Valley began operating at a net loss during the last quarter of 2008,m the number operating at a net loss peaked during the first quarter of 2009 and continued to include well over 90 percent of the dairies in the second quarter of 2009.

Also included in our testimony is a graph that shows the relationship between the cost of production and net income over the last two quarters. The graph illustrates that depressed prices are affecting virtual all producers in the state and that the level of negative cash flow is in excess of $5 per hundredweight on most dairies. I should point out that the data for this chart is from the dairy feedback sheets and it includes some organic herds.

It is difficult, if not impossible, for producers to pay their feed and other input costs when producer prices are so far below production costs. As a result, low dairy producer prices are having a ripple effect on the rest of the state agricultural economy and all related businesses. At the same time that producer prices have dropped, input costs continue to remain high.

Under the current system, producers are not able to recoup their higher input costs from the market. It is the processors and retailers who have that ability, not the producers. To correct this inequity we are calling for the incorporation of the producers' cost of production in the Class 1 price formula. We call for a change in the Class 1 price formula to include the higher of the Commodity Reference Price or the cost of production, including allowances based on the Statewide Cost Comparison Summary.

The next thing I'm going to walk through, our proposal to establish a variable make allowance.

We believe the current make allowance system overall sends a false signal to processors to continue production regardless of market demand. The current fixed make allowance system provides a strong incentive for processors to run as much raw milk through a plant regardless of market conditions. The result from this system is that it puts the needs of the processor at odds with the needs of the dairy producer. Too much milk reduces the price to the dairy farmer and milk shortages decrease the amount of milk available to the processor.

We believe the make allowance system should be reformed so that it provides benefits to the producer and processor. We favor the establishment of a variable make allowance that would tie processor and producer prosperity together. A variable make allowance would increase significantly when milk prices are high, thereby giving an incentive to the processor to continue production because the return would be greater. However, when milk prices are low the make allowance would decrease and send a signal to the processor to limit production in order to allow demand to catch up with production. We believe a variable make allowance is a win-win proposal because it would enable producers and processors to make a higher return when milk prices rise.

Under the current pricing formulas, the plant make allowance is a fixed number; while the price received by the producer is highly volatile and until now has not included the dairyman's cost of production. A milk pricing system that is balanced requires that dairy product prices, producers' cost of production, and plants' cost all be given consideration when determining the value of milk. Each of these items sends signals to the other in a free market environment so that adequate price and production adjustments will occur.

Under a variable make allowance, when the supply of processed product is in line with demand, the make allowance is generous. As the market signals oversupply through lower prices, the make allowance would actually decrease, causing manufacturing to slow until once again supply and demand are in balance.

In California's milk pricing system there is insufficient marketplace balance between these factors, because the make allowance guarantees that the costs of the processing segment of the industry are covered. In fact, since the make allowance includes costs plus a profit for an efficient plant, over supply can actually be a benefit to proprietary processors because it lowers the raw product costs. This is less true for cooperatives whose members are dairy farmers affected by lower producer prices.

The California dairy pricing system has allowed plants to be profitable and expand processing of the lowest value dairy products regardless of true market demand because producers covered the plant costs. This has resulted in lower producer milk prices in our state. The generous make allowance level enables processors to use the additional margin to discount their product price to gain market share at the expense of producer pay prices and at the expense of other manufacturers in the rest of the United States. Plants are merely operating by the rules of the system. The CDC variable make allowance proposal is aimed at creating a true market-oriented system.

As long as the manufacturing allowance is fixed at the processor's cost plus a return on the investment, and is paid for by farmers, the processing segment of the industry will be unconcerned with market signals. We need a system that works with the marketplace at all levels; producer, process, wholesaler, retailer and consumer to provide an equitable, stable and viable economic environment for all segments of the dairy industry.

Our members support a variable make allowance based on the relationship between the commodity price and the producer's cost of production. It is unfair and market distorting to force the producer to continually cover the cost of processing, including a profit, when he has no similar compensation guarantee. It is far from certain if and when a producer is able to cover his production costs. Market signals should be sent to both the producing and processing sectors of the industry and our variable make allowance proposal achieves this important goal.

The CDC variable make allowance proposal incorporates the Commodity Reference Price, which is used to calculate the value of the milk in the market and compares that amount to the cost of production to show what percentage of producer costs are being covered by prevailing commodity prices. That same percentage is used to adjust the make allowance up or down from the base make allowance. When commodity prices are high, a hundred percent of the average producer cost of production and a hundred percent of the processor's average cost of production are covered. When commodity prices do not cover the cost of production to the producer, the make allowance would be adjusted downward accordingly.

Finally, I'll walk through our proposal to establish a price floor on the 4a and 4b price at the higher of the commodity prices or the federal support purchase price.

The federal support purchase price provides a much needed safety net for producers nationwide. California producers deserve to benefit from this important safety net that was passed as part of the last federal farm bill. CDC and CFU members traveled extensively to Washington, DC to urge lawmakers to pass strong dairy policy that included a safety net provision when prices dropped.

Although we believe producers should be paid from the marketplace, it was the intent of Congress and the President that all producers nationwide should be eligible for this important safety net. This summer USDA Secretary Vilsack recognized the importance of the support price to dairy producers and increased it for the first time in nearly three decades. His decision was intended to provide relief to producers throughout the country, including California. Under the CDC proposal, California producers would receive prices that are the higher of the prevailing market price or the USDA announced federal support purchase price.

Beyond the issues we have discussed today, we believe the current end-product pricing system in California should be fundamentally reformed. The producer price is based on the price paid at the Chicago Mercantile Exchange, which is a thinly traded market that is vulnerable to price manipulation. The current 4b formula should be modified to make it more market-oriented. The current 4b formula is based on the price of cheddar cheese, which is one of the least profitable cheeses sold in the marketplace today. We believe the 4b formula should be based on current market demand and prevailing market prices. Demand for mozzarella cheese and high moisture cheese represents half of the cheese market today. Producers should be able to reap the rewards of these products as processors have for some time now.

In terms of the other proposals put forward to CDFA, CDC and CFU support the proposals that have been submitted to CDFA that would increase producer prices. We believe the Dairy Institute's proposal should include a trigger that more closely reflects dairy producer production costs that are likely to remain $15 per hundredweight.

We oppose the petition put forward by California Dairies, Inc., calling for an increase in the 4a make allowance. Any increase in the fixed make allowance levels will make our system less market oriented than it is today.

In conclusion, we call upon CDFA to incorporate a cost of production factor in the Class 1 price, establish a variable make allowance that compares the producer cost of production with the commodity values, this relationship is then used to adjust a base make allowances for butter, nonfat dry milk and cheese on a monthly basis, and floor the butter, nonfat dry milk and cheese prices at the higher of the market price or the federal support purchase prices.

We believe acceptance of our petition will be a good first step towards improving producer prices and providing some much-needed relief. We look forward to working with CDFA to improve the outlook for dairy producers in this state.

The California Dairy Campaign and the California Farmers Union would like to thank the Department for the opportunity to present our alternative proposal today. We would also like to request the opportunity to submit a post-hearing brief. Thank you.

HEARING OFFICER HOLLOWAY: Okay, your post-hearing brief is granted.

We'd like to ask the Panel for any questions, go right ahead.

PANEL MEMBER IKARI: How's the California pricing system different than that used in the Federal Order, where producers don't -- or the prices don't take advantage of the support price?

MS. MC BRIDE: Scott, did you want to address that?

MR. MAGNESON: Well, it's not -- I mean, it's not different. We're recommending that it be different, I suppose.

PANEL MEMBER IKARI: Well, in the testimony, "California dairy producers do not benefit from this important safety net that was intended to aid producers in

California and around the country."

I want to know how isn't it different -- I mean, how --

MR. MAGNESON: Well, our pricing formula is different. I mean, the federal order prices are higher than ours and haven't dropped as low as ours have so --

PANEL MEMBER IKARI: But the question is on the price support, are you saying the price support does not do anything to California minimum prices?

MR. CONTENTE: Yeah, David, I think what we're referencing right there in that part of that testimony is the discussion about the flooring of the federal order minimum price. I think that's what that is in regard to. I'm not exactly sure where you're reading it, but if I --

PANEL MEMBER IKARI: Page 2, at the bottom of your testimony.

MR. CONTENTE: Yeah, yeah, I think that refers to a discussion of when we had -- remember, David, when we had the floor that was implemented back in 2003, that the Secretary Lyons put in, and then that brought the price to that minimum where it couldn't go below? I think that's what this is referring to so --

PANEL MEMBER IKARI: Well, this statement is much broader than that. It appears to me the statement means that whatever the federal government does on the price support it has no impact in California minimum prices. It doesn't say back in 2003, it's just a general statement and I'm curious how -- why it doesn't impact California prices.

MS. MC BRIDE: That was just the intent in the statement was to reference that we support having a price floor at the federal support price.

PANEL MEMBER IKARI: Well, it --

MR. MAGNESON: Well, I suppose what we're trying to avoid is since our prices are off the CME and a lot of the time the CME was trading it below the support price, we wanted to try to implement a floor in our price so that it wouldn't go below the support price, like it has in the past.

MR. CONTENTE: Yeah, David, if you read the very last sentence in that paragraph --

PANEL MEMBER IKARI: Whether or not you have a floor, but doesn't the support price still influence the California minimum prices established?

MR. CONTENTE: Yeah, but this hearing is in regard to producers in California, we're not talking about producers in the federal order. So I think the way that it was written it sounds like we're segregating the producers in California, but we're really not.

So if there was a floor put in it would actually -- it would actually cover all producers across the country.

PANEL MEMBER IKARI: Well, let me ask the basic question; does the support price, the U.S. support price have any benefit in California?

MR. CONTENTE: As it is today?

PANEL MEMBER IKARI: Yes.

MR. CONTENTE: Well, of course it's a soft floor, but it's not a hard floor. It can go below and it did go below the 9.90 level. And when cheese drops below the $1.13 level it's going below where the support purchase price is.

And if you go back to 2002, 2003, we saw prices that dropped down to below $9.

PANEL MEMBER IKARI: I will agree with you that there's nothing in the California system, nor is there in the federal order system, that prices can go below support, but that's not what the intent of the support price is. It didn't guarantee that price. It does influence the prices set in both systems.

MR. CONTENTE: Yeah, my interpretation is perhaps different than your interpretation then --

PANEL MEMBER IKARI: What is your interpretation?

MR. CONTENTE: My interpretation of the support price is the level that the government would indicate to create that safety net for the producers at that level, that's my interpretation of it.

PANEL MEMBER IKARI: Your interpretation is that support price, that all dairy farmers are supposed to receive that price?

MR. CONTENTE: That is the safety net mechanism provided, to have that bottom, that's my interpretation of it, that was the intent of it.

PANEL MEMBER IKARI: That it's a guarantee, that it's a guarantee?

MR. CONTENTE: That's the intent. It's just like all laws that even the speed limit on the highway is not necessarily exactly the way you'd it to be.

PANEL MEMBER IKARI: But if it's a target -- if it's a target, there's no guarantee associated with it.

MR. CONTENTE: Neither is the speed limit.

PANEL MEMBER IKARI: No, the speed limit is enforced.

MR. CONTENTE: Not always.

PANEL MEMBER IKARI: Oh, well. On page 5, let me move on, page 5 at the bottom you say "the current fixed make allowance provides a strong incentive for processors to run as much raw milk through a plant regardless of market conditions."

Yet, there's already testimony in 2008 plants put limits on the amount of milk they would process. We were shipping milk out of the state.

So how does that fit with this statement that you've read?

MR. CONTENTE: The plants at that time reached the maximum capacity of actual physical product that they could run through so thereby the bases were created to -- if you have the system that we have in California, and it disregards market conditions, where one segment of the industry is guaranteed, basically, their cost of production or at least the average cost of production for a certain portion of that product, eventually that system will want to self-implode because it disregards the market conditions that perhaps not all that product was needed.

And so then when we reached in 2008 and we had this tremendous surge in capacity of production, by the dairymen, and we didn't have the plant capacity, combined with the Corona plant being shut down, we got into a huge hiccup.

Wouldn't you agree, Dave?

PANEL MEMBER IKARI: So you're saying that, you're testifying that it was the physical limits and it had nothing to do with -- it was the physical limits of plants that limited our production.

MR. CONTENTE: But the system created the --

PANEL MEMBER IKARI: But if it's unlimited, then why wouldn't plants in California just expand? Because if they got a guaranteed profit, I might as well keep getting bigger. As long as the milk supply is bigger, I might as well get bigger.

MR. CONTENTE: They're doing that as we speak.

PANEL MEMBER IKARI: You also testified that the cost of the processing segment is covered. How does that square with the Department data that shows that the current make allowance only covers five percent of the volume of cheese processed and about half the amount of butter and powder processed?

Under your statement, we would have to be covering a hundred percent; wouldn't we? If I cover all the costs and they're all profitable, it seems like it would cover a hundred percent of the volume.

MR. MAGNESON: That's true, if all the costs that you collect are accurate.

PANEL MEMBER IKARI: So what's inaccurate; the data or your statement?

MR. MAGNESON: I don't know, I haven't seen it. I think the data is inaccurate, partly.

PANEL MEMBER IKARI: Does it concern you at all that your proposal and the Department analysis shows that we will cover zero percent of the volume of butter, powder and cheese?

MR. MAGNESON: You're talking about one year?

PANEL MEMBER IKARI: Yes.

MR. MAGNESON: Yeah. Yeah, that data didn't even look at it. I looked at a five-year average and it was the same. So some years they make way more. The whole intent --

PANEL MEMBER IKARI: Well, I'm talking about the volume of profit --

MR. MAGNESON: Yes, and you're looking at one year.

PANEL MEMBER IKARI: -- that will be covered.

MR. MAGNESON: And that was the year when our prices didn't match. So on a five-year average, under our proposal the variable make allowance was the same, as it would be as the current make allowance.

PANEL MEMBER IKARI: I don't think we did an analysis that showed five years, I think all we did is show an analysis --

MR. MAGNESON: I did.

MS. MC BRIDE: He did.

MR. MAGNESON: I did.

PANEL MEMBER IKARI: You did?

MR. MAGNESON: Yes.

PANEL MEMBER IKARI: Could you include that in the post-hearing brief then, I'd like to look at it.

MR. MAGNESON: Sure. Okay, yeah, over a five-year period the make allowance averaged the same on the butter --

on the cheese, and almost identical on the butter and powder plants.

PANEL MEMBER IKARI: You know, one of the things that's interesting about your proposal is the five-year that the Department did analysis, the average is ten cents a hundred, which is about the same as the Dairy Institute proposal.

MR. MAGNESON: I know, that was amazing.

PANEL MEMBER IKARI: Excuse me, not the Dairy Institute, I mean the Alliance.

MR. MAGNESON: But I think what our proposal does is it tries to incentify both the increase in commodity prices for the processors so that they can make -- they're not fixed to a locked income. When prices take off they would be making a -- I think the make allowance might have peaked at 30 cents, almost, when commodity prices were very high. So, I mean there's a huge incentive for them to move prices higher if they can because they're not locked into a fixed income.

PANEL MEMBER EASTMAN: I have a couple questions for you. On page 3 of your testimony there's a graph that's titled "Average California Dairy."

MR. MAGNESON: Uh-hum.

PANEL MEMBER EASTMAN: And I was curious, it doesn't really cite the source of the data. Is it possible for you to just provide where that came from, whether this is just California-specific data, is it data from maybe your member producers or --

MR. MAGNESON: The data's from the California Information Bulletin.

PANEL MEMBER EASTMAN: Okay.

MR. MAGNESON: And it uses the cost of production and the blend price out of that booklet. And then the rest -- and then the average income from producers is based on an average hurt size of production and that's listed on the graph.

PANEL MEMBER EASTMAN: Great. And then I have another question regarding the variable make allowance. The variable make allowance that you propose has two portions to it, it has a fixed number and then it has the ratio portion that has the cost of production, and then the market signal based on commodities.

The question I have is over time the variable portion would change as cost of production, and market or commodity prices change.

MR. MAGNESON: Uh-hum.

PANEL MEMBER EASTMAN: But that fixed portion is going to be sort of set.

MR. MAGNESON: Yes.

PANEL MEMBER EASTMAN: Do you envision that's the best starting point and that fixed portion would just stay constant over time? Do you think we would need to have hearings or do you suggest some sort of methodology or procedure where that portion would change; or does it need to change?

MR. MAGNESON: I think that's something that we'd probably look at depending on the conditions in the market, so probably we would have to. If it needed to be adjusted, I'm sure that would come up at other hearings, you know, to adjust that factor.

PANEL MEMBER EASTMAN: So do you adjust it sort of similar to the procedure where you'd followed in the past, because a fixed portion right now is based on usually --

MR. MAGNESON: The current, the current level.

PANEL MEMBER EASTMAN: -- current costs, and so over time you would just envision that there were would be hearings that would be called to adjust that portion then?

MR. MAGNESON: Yes, just similar to the hearings that we have now, supposing.

PANEL MEMBER EASTMAN: Thank you.

HEARING OFFICER HOLLOWAY: Okay, I believe that's all the questions. Thank you very much.

MR. MAGNESON: Thank you.

HEARING OFFICER HOLLOWAY: It's 12:30, do you want to break for lunch?

Okay, we're going to break for lunch. What time should we be back? Okay, we'll be back in an hour, at 1:30. Thank you very much.

(Thereupon the lunch recess was taken.)

--oOo--

AFTERNOON SESSION

HEARING OFFICER HOLLOWAY: The next in line for the alternative proposal is California Dairy Women Association.

Are they here? Oh, good. Okay.

I would like to state just for the record that anyone that has requested a post-hearing brief, it has been granted, and if I didn't say so, it is granted.

UNIDENTIFIED MALE SPEAKER: How about for those of us that didn't request it?

UNIDENTIFIED MALE SPEAKER: Out of luck.

HEARING OFFICER HOLLOWAY: Okay, so we've got a document here, which will be Exhibit Number 57.

(Exhibit 57 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: And can you please state your name for the record and spell it?

MS. LOPES: Linda Lopes, L-o-p-e-s.

HEARING OFFICER HOLLOWAY: Thank you very much. And do you swear to tell the truth and nothing but the truth?

MS. LOPES: Yes, I do.

HEARING OFFICER HOLLOWAY: Thank you very much, go right ahead.

MS. LOPES: Madam Hearing Officer and Members of the Hearing Panel, I am Linda Lopes, President of the California Dairy Women Association, and also a dairy producer from Turlock, California.

CDWA represents 150 dairy producers from Sonoma to Tehachapi. The CDWA is a unique group, most of our members are personally active and in charge of the financial business and of the daily dairy operation. We have become experts in balancing the checkbook and knowledgeable in the business's income and expenses. We know that we are not covering costs of production with the prices we have received the past year. We also do the grocery shopping and are aware of the retail sales for dairy products. In the past week, the price of a half-gallon of milk increased 30 cents. We know that we are not receiving our fair share of the market price.

This hearing was called as an emergency to increase all classes of milk and to consider the reasonableness and economic soundness of milk prices, giving consideration to combined income from those classes in relation to cost of production and marketing for all purposes, including manufacturing.

The cost of production figures calculated by CDFA for the third quarter of '09 was not available at this time. For that reason, we are using second quarter '09 figures.

I am here today not just for myself, but because I feel I must to represent the dairywomen and dairymen of the State of California. I would like to thank Mr. Van Dam and Mr. Marsh for petitioning for this hearing. No offense to any of you, but you are not living this. You are not going through what we, the dairymen, have been living the past 12 months. You are just hearing about it. Until you actually live it, you have no idea what this is like.

Many sleepless nights wondering where the money is going to come from to pay the bills, the employees, and the feed, wondering if the milk check will cover the bank payments; getting up in the middle of the night to check the computer to see if there's some press release or any kind of news that would give the dairymen some kind of price relief. Checking dairy.com every morning at 9:20 to see what the cheese and butter prices did that day. Hoping the figures were not red, signifying a drop in price. The days with a price increase would give hope for a turnaround.

I also have daily phone calls from other dairy ladies. Some ladies I have never met but call daily because they have heard about the CDWA and need someone to talk to. I have tried to give them hope, something to keep them going. Some are now out of business.

Some of the things that I thought would give us some price relief, like the CWT program and the DEIP program, did not have the positive effect I had hoped for.

The Chicago Mercantile Exchange did not respond to these programs. We feel CME will never respond adequately. The question is what's next?

We need a milk pricing system that reflects our cost of production. Hearing Officer and Panel Members, this is in your hands and you need to realize the seriousness of this hearing. The California dairy industry is in your hands.

The CDWA proposes to temporarily revise the formulas to reflect the California average milk production costs. Specifically, we petition for a temporary 12-month pricing formula that incorporates the average cost of production published by CDFA, with a 2009 production base into the Class 1, 2, 3, 4a and 4b pricing formula. Due to the fact that CDFA produces cost of production data quarterly, the cost of production portion of the Class 1, 2, 3, 4a and 4b price formula would be adjusted every three months.

The reason for such a recommendation is that for the past year, with production costs exceeding nearly 50 percent of prices set, all California dairies combined have lost historically unprecedented hundreds of millions of dollars, and more probably in the billions of dollars now, with little price relief in sight, while retail store dairy prices remain high.

With a temporary price revision reflecting average cost of production for 12 months, it would help to stabilize the California milk industry. The cost of production data by CDFA shows the average cost of production for the second quarter of '09 was $15.37. The overbase price for the same period of time averaged $9.75, which is a loss of $5.62 per hundredweight. A $5.62 loss per hundredweight, for a thousand-cow dairy, would be a loss of $93,666 a month, using a 20,000-pound herd average. For a quarter it is a loss of $374,666.66 and a loss of $374.66 per cow.

You may wonder how we are surviving this? The answer is massive debt load on top of eroded equity that took many years to build. According to CDFA figures, the total decrease in the California herd value is $1,277,500,000.

The Alliance and Western United Dairymen's proposals does not ask for a sufficient amount of a price increase. It is better than nothing, but not enough to sustain the California dairy industry and it continues to rely on the CME.

California Dairies, Incorporated, proposes an increase n manufacturing cost allowance due to evidence by the Department. CDI and the other processors need to finally realize that we are tied together. Both the producer and the processor must cover their costs. One cannot survive without the other. Because of these devastating times, we have lost many dairymen in California and will continue to if something doesn't change. Loss of dairymen mean less milk. Less milk means processors can't fill their contracts. We, the dairymen, and the creameries must work together. Dairymen also need a make allowance to stay in business.

The California dairy industry is, at this very moment, disintegrated before our own eyes. The number one in production is your state and you now have a choice as to whether you will take steps to salvage it or drive the final nail in the dairy industry's coffin.

What the industry is experiencing in this day and age is unjust and pure torture, torture without mercy, unacceptable. Dairymen are now receiving prices that were received in the 1970s, when cost of production was at a fraction of what it is today.

The Chicago Mercantile Exchange price discovery cannot maintain equity for dairy producers. There are many factors for this, including lack of competition and consolidation of buyers in a global economy. This market is thinly traded in relation to volume of product sold. Dairy producers need a price increase to meet our cost of production.

California milk producers are number one nationally for production and quality. We have invested millions of dollars in our businesses to do this. Many other support businesses, both small and large, depend upon the dairy industry to survive in their businesses, also. We all hear how bad the economy is in California, if the California dairy industry collapses, the economy of the State will be significantly affected. Dairy producers need a cost of production. Status quo is not an option going forward. To stop this crisis it will take an exerted effort by the dairy trade groups, the co-operatives, the proprietary companies, and the State of California.

You, the Hearing Officer and a Panel, represent the State of California. I appeal on behalf of our industry for you to make the necessary changes in our pricing system. I remind you this is just a temporary, 12-month plan to get us through this very difficult time. Dairy producers need a cost of production.

I expect you to come to a solution to save the California dairy industry. I am depending on you. Without a temporary, 12-month average cost of production, this industry will not survive.

HEARING OFFICER HOLLOWAY: Okay. Are there any questions from the Panel?

MS. LOPES: Thank you.

HEARING OFFICER HOLLOWAY: I guess not. Thank you very much.

The next alternative proposal is the California Dairies, Inc.

I have documentation that's being submitted, which will be marked as Exhibit 58. Thank you.

(Exhibit 58 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Good afternoon. Can you please state your name and spell it for the record?

MR. ERBA: Sure. My name is Eric Erba, E-r-i-c E-r-b-a.

HEARING OFFICER HOLLOWAY: Thank you. Do you affirm or swear to tell the truth?

MR. ERBA: I do.

HEARING OFFICER HOLLOWAY: Go right ahead, please.

MR. ERBA: Madam Hearing Officer and Members of the Panel, my name is Eric Erba, I am the Senior Vice President of Producer and Government Relations for California Dairies, Inc., whom I'm representing here today.

California Dairies is a full service milk processing cooperative owned by approximately 500 producer-owners located throughout the State of California and collectively producing over 17 billion pounds of milk per year, or 42 percent of the milk produced in California.

California Dairies supplies 45 of its milk directly to customers located in california. Additionally, our producer-owners have invested over $450 million in six large processing plants, which are projected to produce about 340 million pounds of butter and 750 million pounds of powdered milk in 2009.

On October 27, 2009 California Dairies's Board or Directors unanimously approved the position that I will be presenting today.

We thank the Department for calling this hearing and allowing us the opportunity to present our alternative proposal and to provide the Panel with an industry perspective that may be valuable during its deliberations.

In support of the petition from the Alliance of Western Milk Producers; we fully support the petition submitted by the Alliance of Western Milk Producers, which proposes to increase the minimum prices for Classes 1, 2 and 3 commencing in January 2010. The requested price increase would essentially restore the Class 1, 2 and 3 prices at the levels that existed prior to the Department's decision to reduce milk prices as of January 1, 2009. As such, the project effect is to increase the Class 1 by price by 50 cents per hundredweight and increase the Class 2 and 3 prices by 26 cents per hundredweight. The proposal is projected to increase pool prices by 11 cents per hundredweight.

We recognize that attempting to fully recover these losses, the losses sustained by producers for the last year, is problematic for both producers and processors in California. We have chosen not to pursue that agenda. Instead, we are supporting what we believe is a reasonable proposal that would provide dairy producers the higher milk price that can be justified by the changes in events over the last year.

As reviewed by Mr. Van Dam, in his testimony earlier this morning, many of the critical factors that prompted the Department to reduce minimum prices paid to producers have changed or have not come to be. The spread between the Class 1 price and the overbase price plummeted in 2009 and has average less than $2 per hundredweight in the last ten months.

Homeless milk, a topic that was discussed at great length by the Department in its Panel Report, is just a memory. The threat imposed to the California dairy industry by a Nevada Class 1 bottling plant faded away as the milk price fell and milk production followed. Cost of production, while improved from last year, remains at historically high levels. Concerns about adequate processing capacity in the State have vanished and, in the span of just a few months, that concern has been replaced by a new one; are we going to have adequate milk supplies for our needs? Milk production is down this year and continues to head downward. CDI can provide a first-hand perspective on milk production.

We can verify Mr. Van Dam's comments on the unprecedented drop-off in milk production. California Dairies' daily milk production hit its 2009 peak in April. We are 12 percent lower than that right now. We are 13 percent lower than our co-operative-wide production base. We are 7 percent lower than what we were just one year ago. For a full service co-operative, with customers throughout California and the western U.S., these statistics are unnerving. The marketing plan that was developed in 2009 is, needless to say, in shambles. In response to the question asked of our members on when milk production will return, the answer is invariably, "when the milk price comes back up."

A prelude to California Dairies' alternative proposal; much discussion among the industry participants has occurred since the Department issued its Notice of Public Hearing on October 19, 2009. The Call of the Hearing established broad parameters, much broader than was requested by the petition submitted by the Alliance, ostensibly in part because of the petition submitted by Western United Dairymen. In the hearing notice, the Department stated that it would consider "any other temporary or permanent changes to the Class 1, 2, 3, 4a and 4b formulas to address emergency conditions." California Dairies decided to submit an alternative proposal for cost-justified increases in the butter and nonfat dry milk manufacturing cost allowances and for cost-justified increases in the f.o.b. price adjuster for butter.

However, it was never the intention of California Dairies to propose changes to the Class 4a pricing formula, which California Dairies could have done immediately following the release of the manufacturing cost studies on October 1st. We chose not to do that.

Given the current status of the dairy industry, California Dairies would have preferred to wait until a later date to propose changes to the Class 4a pricing formula. However, two events, that is to say the submission of the petition by Western United Dairymen and the subsequent announcement by the Department to hold a hearing on an emergency basis to consider a wide variety of topics affecting any of the classes of milk, forced California Dairies to become directly involved in this hearing. On the latter point, we recognize that a hearing called on an emergency basis, with little lead time and no pre-hearing workshop, is not the most appropriate forum to propose changes in manufacturing cost allowances.

Western United Dairymen no longer supports its petition to increase the minimum prices on all classes of milk temporarily by 50 cents a hundredweight, and Ms. LaMendola and Mr. Marsh have articulated their position in their testimony today. We appreciate that they have reached the same conclusion that we have on Class 4a and 4b, these are market-clearing classes of milk and the California dairy industry cannot risk impacting these plants negatively with higher minimum prices. The 50 cents per hundredweight higher milk price that was proposed would put processing co-operatives, like California Dairies, at an immediate disadvantage in trying to sell products domestically and internationally.

California Dairies has the additional concern -- has additional concerns about the consequences of instituting higher prices for the manufacturing classes of mil, especially Class 4a. First, because nearly all the butter and powder processing facilities are owned by producers, a Class 4a price increase only functions to redistribute money from the producers who have made investments in processing facilities to those producers who have not. This is not the type of government oversight that will encourage producer-owned co-operatives, or any entity for that matter to invest in more processing capacity in the state.

Second, having just been through the loan renewal process, we understand all too well how closely lending institutions are scrutinizing processing plants for assurances of financial performance. California Dairies financial staff spent hundreds of hours meeting with potential lending institutions and preparing stacks of documents to obtain the financing necessary to run our business. The bank covenants associated with the loans were carefully crafted to be reasonably achievable. However, being mandated to pay higher minimum prices for milk than can be extracted from the market, even for a brief period, will result in our violating our newly created bank covenants. In the short term, violating bank covenants means the banks may request loan renegotiations with higher fees and higher loan rates.

In the longer term, the banks will remember the financial performance of a plant when it comes time to renew the loans. For processing plants that have performed below expectations, higher fees and higher loan rates when the loans are renewed are virtually assured. Both the short-term and long-term consequences are damaging to those producers who own processing facilities, but are not applicable to those who do not.

You may be wondering why I'm going through these points if Western United Dairymen is not supporting its petition for a temporary price increase on all classes of milk. It is simply a matter of timing and of procedure. the position taken today by Western United Dairymen notwithstanding, the fact is that the hearing notice opened this hearing to consider changes to the pricing formulas for all classes of milk, including 4a, and that remains unchanged. Consequently, California Dairies has no choice but to assure that its opposition to changes in the Class 4a pricing formula is reflected in the hearing record.

Unfortunately, the series of events that have taken place lead us to have to take the following conditional position; California Dairies opposes any changes to the Class 4a pricing formula, regardless if those changes would increase or decrease milk prices. If the Department considers changes to the Class 4a pricing formula that would ultimately increase the price, then we propose the Department also make cost-justified increases and manufacturing cost allowances for butter and nonfat dry milk, and for the f.o.b. price adjuster for butter.

Conditional proposal for Class 4a pricing formula; California Dairies proposes the following manufacturing cost allowance and f.o.b. price adjusters for Class 4a milk to be adopted, but only if the Department considers that the -- considers changes to the Class 4a pricing formula that would ultimately increase the Class 4a price, and that that price be determined by the CME AA butter marked price for butter less 4.74 cents, less 17.4 cents, all multiplied by yield factor 1.2. The solids-not-fat price is the California weighted average price less the make allowance of 19.65 cents, multiplied by yield factor of 1.

California Dairies' proposed changes are consistent with the objectives stated in previous hearings. The Class 4a formula should reflect the most currently available cost-justified changes. Simply, the manufacturing cost allowances should be consistent with the actual costs for processing, and the butter commodity price should be adjusted by a factor that reflects what California plants actually receive for the products they produce.

On the manufacturing cost allowance increases; the release of the Department's latest Manufacturing Cost Exhibit on October 1st, provides ample evidence to suggest that the manufacturing cost allowances for butter and nonfat dry milk should be increased.

California Dairies' proposal amends the butter and nonfat dry milk manufacturing cost allowances by the increase in the weighted average of the costs from 2007 to 2009. 2007 was the last time the manufacturing cost allowances were adjusted. That is to say, California Dairies' proposal would increase the manufacturing cost allowances for butter and for nonfat dry milk by the difference of the weighted average costs reported in the

2007 cost studies and of the weighted average costs reported in 2009 cost studies.

The Department's data verifies the cost to manufacture butter has increased by 1.8 cents per pound and the cost to manufacture nonfat dry milk has increased by 2.67 cents per pound. As such, we request that the butter manufacturing cost be increased from 15.6 cents to 17.4 cents per pound, and the manufacturing cost for nonfat dry milk be increased from 16.98 cents per pound to 19.65 cents per pound.

On the f.o.b. price adjust increase; at the time California Dairies submitted its alternative proposal, the Department had not yet released the most current comparison of the Chicago Mercantile Exchange butter prices and audited California butter sale prices. Consequently, California Dairies' alternative proposal suggested that an adjuster of 4.75 cents per pound would be appropriate. We arrived at that using our internal data, internal price and sales data.

The Department posted the results of the comparison just last week, which showed that the f.o.b. price adjuster for butter is indeed understated and should be increased significantly. Using the data collected over the 24-month period, which is consistent with past hearing decisions, the f.o.b. price adjuster for butter should be increased from 3.09 cents per pound to 4.74 cents per pound, an increase of 1.65 cents per pound.

California Dairies will accept the figure of 4.74 cents per pound, published by the Department, as a substitute that we derived using our own data.

To conclude this section of my testimony, it is regrettable that California Dairies cannot simply withdraw support for its alternative proposal. We would have preferred to take that course of action. However, the call of the hearing is not altered by the actions taken today by Western United Dairymen, and the proposals by any party that would increase the Class 4a price will still be considered at this hearing. As a consequence, California Dairies finds itself in the unfortunate position of having to put forth a conditional proposal to the Department. Allow me once again to state that if the Department considers changes to the Class 4a pricing formula that would ultimately increase in the price for Class 4a, then we propose the Department also make cost-justified increases in the manufacturing cost allowances for butter and nonfat dry milk, and for the f.o.b. price adjuster for butter.

On NASS versus CWAP; Milk Producers Council's alternative proposal recommends using the National Agricultural Statistics Service nonfat dry milk price series to replace the current California weighted average price series for nonfat dry milk. Two major explanations were offered for the recommendation and they appear to be the milk price level and milk price alignment with neighboring states. These are similar to the arguments that were raised at the August 28th, 2007 hearing that addressed the use of CWAP and reporting requirements for nonfat dry milk sales.

At the August 2007 hearing, there was a proposal to replace the CWAP with the Dairy Market News nonfat dry milk price series. In addition, the Department was asked to consider changes to specific reporting procedures regarding type and age of product included as reportable sales, and the duration of contracts allowed in the reporting process. In its Panel Report, the Department reviewed the specific reporting requirements for the NASS nonfat dry milk price series and compared them to the reporting requirements for CWAP. This comparison resulted in only two changes to the CWAP reporting procedures; excluding organic nonfat dry milk and limiting the reportable fixed contract sales to 150 days.

In the Panel Report the Department noted that, and I quote;

"In order to properly price milk produced and processed in California, economic factors that specifically affect California must be taken into consideration. Proper consideration of market conditions affecting the State of California requires economic data and factors specific to California, such as the actual values for nonfat dry milk received by California plants.

Exclusion of long-term contracts to a relatively short time period places additional risk on California nonfat dry milk manufacturers, making them more reluctant to commit to export sales.

Long-term price contracts are a strategic option whose maintenance allows the California dairy industry to compete successfully in world markets.

The long-term success of the California dairy industry will increasingly rely on these markets."

Substituting the NASS price series for the CWAP, as proposed by Milk Producers Council, would implement a set of reporting requirements that are contradictory to the Department's statements from the 2007 hearing. Moreover, the Department has already individually considered and rejected most of the aspects and features embodied in the NASS nonfat dry milk series. The explanations are covered in the findings from the August 2007 hearing and mirror the

Department's statements quoted above.

The Department's recent decision to continue using CWAP, with few modifications, instead of substituting another nonfat dry milk price series, appears to provide ample reason to deny the request by Milk Producers Council by itself.

However, let me provide a nonfat dry milk manufacturer's point of view on the proposal. There are two alternatives that the California dairy industry must grapple with, either it supports export sales of nonfat dry milk and those sales are reportable or it does not support exports of nonfat dry milk.

The first alternative is what we are doing today and the second alternative has potentially devastating consequences for the industry. If the dairy industry limits the reporting of fixed price contracts to 30 days or less, then no company will want to assume the risk of making nonfat dry milk for export. Thus, export opportunities for nonfat dry milk marketers will be reduced immediately.

The option at that point would be to either sell the nonfat dry milk to the Commodity Credit Corporation or lower the price offered to domestic buyers in order to keep product moving and inventories balanced. Either alternative is likely to result in lower prices to dairy producers.

There is no need to change the nonfat dry milk price series used in the California milk pricing formulas or even make adjustments to the CWAP reporting requirements. Since the Department considered a variety of changes to the CWAP in 2007, nothing materially has changed in the way that nonfat dry milk is produced or marketing.

California Dairies remains firmly opposed to adopting the NASS nonfat dry milk price series in place of the CWAP.

Concluding remarks; we have seen how sustained low milk prices have affected the dairy industry simply by looking at the impact on our own members. The membership at California Dairies is typically fairly stable year to year, but not in 2009. In the last year California Dairies has lost over 50 members and almost 2 million pounds a day of milk production.

These kinds of losses, plus the reduction of milk from our current members, has caused California Dairies to completely rethink how we can supply our customers and how to balance milk on a daily basis among our processing plants.

Who would have thought that the conditions in the dairy industry could change so much in just one year? When we reviewed the reasons used by the Department to justify the reductions in the Class 1, 2 and 3 prices, we are frankly amazed that how many of them have diminished importance or would not be relevant in the decision making process today. We fully support the petition submitted by the Alliance of Western Milk Producers, it is a reasonable proposal that will provide dairy producers with a higher milk price that can be justified based on the changes in events over the last year.

With respect to California Dairies' alternative proposal, California Dairies opposes any changes to the Class 4a pricing formula, regardless if those changes would increase or decrease milk prices. If the Department considers changes to the Class 4a pricing formula that would ultimately increase the price, then we propose that the Department also make cost-justified increases in the manufacturing cost allowances for butter and nonfat dry milk, and for the f.o.b. price adjuster for butter.

Thank you for your attention and I request the opportunity to file a post-hearing brief.

HEARING OFFICER HOLLOWAY: Your post-hearing brief is granted.

I'd like to ask the Panel if they have any questions?

PANEL MEMBER IKARI: I have a couple. Mr. Erba, I've asked several witnesses about penalties; is your co-op still assessing penalties if a producer exceeds their production dates?

MR. ERBA: The program that would allow us to do that is still in place. We are currently not assessing any members for over-production.

PANEL MEMBER IKARI: Are you aware of any co-op that is?

MR. ERBA: No, I'm not.

PANEL MEMBER IKARI: Are you confident that the actions, the proposal of the Alliance, along with the federal order changes in the CWT, and the movement in the market is sufficient to enable California dairy farmers to remain viable and provide the types of milk supplies we're going to need?

MR. ERBA: Am I confident? I guess my answer to that is, no, I'm not confident. I'm certainly hopeful. Just in our own co-op we've seen that we've hit the bottom of milk production, at least on a daily basis, and we're coming up.

We remain hopeful that the price levels that we're expecting to see for the rest of this year and into next year will continue, and that will take care of our milk production concerns.

Our biggest problem is with planning. And as I said in our testimony, our planning -- our plan for this year was completely in shambles, things happened we certainly did not expect and that's caused us to rethink how we're going to balance milk among our plants and we can do that. We have the opportunity to do that. That requires us to move milk around, but we're able to do that with plants located in strategic locations throughout California.

PANEL MEMBER IKARI: I've asked several witnesses, and I'd like to ask you the same question, if California's production does not come back and it continues to decline, will Class 4a and 4b manufacturers feel it the most?

MR. ERBA: Well, let me answer the first part of that, first. We are seeing milk production coming back already. We represent 43 percent of the milk production in this State, we've already hit the bottom on our daily basis of what milk production is, and we've already seen it come up since then.

It's not going to zoom back, like maybe what happened previous years, but by all accounts it looks like it's at least moving in the right direction.

As far as the effect on the manufacturing classes, I believe that other people have said this and I concur with it, that 4a is likely to be the one that gets hurt the most.

However, we do have opportunities without our own system to move milk around and put it where it's most profitable. If we can sell milk to other customers for more than we can receive by running it through our own plants, then that's what we'll do and we'll make adjustments in our own processing facilities accordingly.

PANEL MEMBER IKARI: I'm going to ask you a question on the CDI's position. You indicated that if the Department considers changes to the 4a pricing formula, that you propose the Department also make cost-justified increases.

Does that position extend to temporary adjustments on Class 4a?

MR. ERBA: Yes.

PANEL MEMBER IKARI: Okay, I have no further questions.

HEARING OFFICER HOLLOWAY: Okay, that's it. Thank you so much.

MR. ERBA: Thank you.

HEARING OFFICER HOLLOWAY: I'd like to also announce that post-hearing briefs will be due on November the 12th, 2009 by 4:00 p.m. You can either submit it to the Department's branch, which is located at 560 J Street, Suite 150, Sacramento, and the zip is 95814.

Also, the brief may be faxed to 916-341-6697. Or e-mailed and I'm going to give you Candace Gates' e-mail, which is cgates@cdfa.ca.gov.

PANEL MEMBER IKARI: Just a point of clarification, the post-hearing briefs are due to the Dairy Marketing Branch within the Department of Food and Ag.

HEARING OFFICER HOLLOWAY: Okay. Now, we have witness testimony and I have about nine people right here that would like to start doing witness testimony.

I do want to stress our time. We're willing to stay until six o'clock, if we can finish and wrap this up and do this hearing by today, instead of having it go over to the next day. So I'm hoping that maybe we can do that and also take a short break.

So without any further ado, let's just go ahead and I'll call the firth witness, which is Joan Jeter.

MR. JETER: John Jeter.

HEARING OFFICER HOLLOWAY: John. Sorry, John. That "h" looked like an "a".

This will be marked as Exhibit 59.

(Exhibit 59 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Go ahead, John, please state your name and --

MR. JETER: I'll spell it for you.

HEARING OFFICER HOLLOWAY: Okay.

MR. JETER: I will work on my handwriting, I do get comments on that.

My name's John Jeter, J-o-h-n J-e-t-e-r.

HEARING OFFICER HOLLOWAY: And do you affirm to tell the truth and nothing but the truth?

MR. JETER: Yes, I do.

HEARING OFFICER HOLLOWAY: Thank you, go right ahead.

MR. JETER: Thank you. My name is John Jeter and I'm President and CEO of Hilmar Cheese Company, a cheese and whey products manufacturer in California and Texas.

Our California operation processes approximately 12 million pounds of milk per day into American natural cheeses and value-added whey products.

We started a new plant in Dalhart, Texas two years ago, which also processes milk and American natural cheeses and value-added weigh products. We currently are in the process of expanding our Texas operation.

Hilmar Cheese Company in California procures milk from about 270 direct ship California dairy farms, several California co-operatives, and other proprietary handlers, which equates to approximately 12 percent of the milk in the State.

Founded upon the ideal of paying producers a competitive price for the value of their milk, Hilmar Cheese Company believes in low regulated prices and high market driven prices that allow both milk producers and processors the opportunity to remain viable.

Today I represent Hilmar Cheese Company with the following testimony.

After some of the highest prices ever, accompanied by very high costs, the past 12 months have indeed been a very difficult period for the dairy industry, in particular those at the farm level because they bear the brunt of the price risk. 2009 has been a gruesome year where essentially all dairymen lived off equity, unless they were very active in risk management and forward contracting in 2008 for the year 2009.

We are a market driven -- and this is our position. We are a market driven -- we are for market driven higher prices that reward those who are in the supply chain earning it. This is why Hilmar Cheese Company exists.

We oppose changes to the regulated price that perpetuate further income redistribution within the pool and give more money to those not directly contributing to the production of higher valued products. If the regulated price is low enough, market based adjustments or premiums can reflect the real appropriate value for the milk supply for given plants, as they should.

And in our case, what that has meant this year is we will have paid out over $20 million above the minimum regulated price through our normal milk payments. And in addition to that, we will have paid out over $25 million in cheese venture payments above our market basket prices. And those are just reflective of our situation and how our business operates.

And I think one person commented that cheese manufacturers try to pay as little as they can and, in our case, we pay as much as we can.

We therefore oppose all the proposals. We would encourage you to make no change in the regulated price because they all are essentially tinkering with the existing system. Making these changes simply says that the value of milk should be adjusted through the regulated price to meet short-term needs; and this is neither true nor good.

The current system needs to be transformed for the better in the long run. The industry has had many meetings looking at the need for major long run change, but almost no one in the producer community will even discussion real change.

We would therefore ask that the Department make none of the changes before you and encourage the leaders in the California dairy industry to address the need for real change.

The McKinsey report made the case for real change, stating that the current system encourages companies to act in their own self-interest to the detriment of the entire system. This is what has just happened in our industry and granting some of the proposals before you, from those acting in their own self-interest, would further damage the industry.

The current system encourages production of the lowest valued products by letting the people expanding production of those products receive the benefits created by others who invest in innovation.

Don't reward those who produce low value, low risk, poorly marketed products by lowering their milk price to pay for the new plant. Don't lower the 4a price.

Don't increase Class 1, 2 or 3 prices. Encourage those who service this market to charge market premiums for the milk used, if appropriate. With milk tighter, premiums should go up and they have gone up.

There does not need to be any increase in the classified regulated price. Premiums should be increased to reflect the increased value of the milk in the current tighter market. Premiums can then go to the people servicing this market, not to those who don't service it.

Increasing the classified regulated price will simply increase the amount of monies distributed through the pool. Not increasing the price will place the emphasis on charging market based premiums reflective of market conditions.

And don't increase the 4b price. The proposed 4b increase cannot be passed onto customer in a national market. California cheddar cheese production is decreasing and the proposed 4b increase will only accelerate the decrease in cheese production, as cheese processors feel increased regulatory risk in California.

Most California cheese processors have out-of-state operations where the regulatory risk, price or otherwise, is less.

And once again, the current tightness in milk has already been reflected in premiums charged.

Hilmar Cheese Company markets -- Hillmar Cheese Company's market basket price reflects -- excuse me, let me read it.

Hilmar Cheese Company's market basket price flexes with the market and contains whey factors as well. Any increase in the 4b price will only take money from our Grade A producers and give it to others who don't ship milk to us, thereby rewarding people who are not in our supply base, at the expense of those who are supplying us with the milk for the products we make.

If you increase the 4b price, the vast majority of our producers will receive less as a result.

Please don't make any changes to the existing regulated prices.

And I'd be happy to take any questions and I'd like to be able to submit a post-hearing brief.

HEARING OFFICER HOLLOWAY: All right, your post-hearing brief is granted.

Are there any questions from the panel?

PANEL MEMBER GATES: Just a quick one, Mr. Jeter, could you for the record just clarify what your market basket price is?

MR. JETER: That's our pay price to dairymen, so it has a cheese factor, a whey factor, and in our case it's a 34 percent market, and it has butter that is reflective of whey butter.

PANEL MEMBER GATES: Thanks.

PANEL MEMBER IKARI: Since you own plants both in California and outside of California, what's your assessment of how California dairy farmers fared compared to your Texas operations?

MR. JETER: Well, I think you asked that, the question I remember was of Bill Schiek, and him stating that California or the western producers tend to buy more of their feed.

Our texas producers, on the other hand, they tend to be newer so they probably carry relatively higher debt loads in some cases, they just have newer operations. So they were impact as well.

And what we've seen in Texas, of course, is just a slowing down of the growth there. Whereas when prices were very high, it was just very rapid growth.

And our Texas operation was designed to -- is designed for five million pounds a day. We were really designed to get it up to full blast in about four years and we hit full blast in, literally, about 16 months. And that was because milk was available that we didn't think was and, of course, the markets were extremely hot.

So we took production up and we've since ratcheted it back in probably the last nine months.

California's been greatly impacted and this is an extremely expensive place to do business. And it's just very, even onerous and difficult, yeah.

PANEL MEMBER IKARI: So is the production that your plant receives -- your plants received, have you had a bigger decrease in California versus your out-of-state operation?

MR. JETER: Now, the reason I'm hesitating, we -- we probably don't measure our production the way CDI, because our supply is changing. What we've noticed in California, early this year we were buying probably ten percent of our milk on the spot market and we take in about 250 loads of milk a day, so 25 loads a day were on sport market. And literally, that just means week to week. You know, on Thursday of every week we line up what we're going to take to fill up the plant and when there's a lot of milk that's a very appropriate way and actually services the industry, it finds homes for milk that needs homes.

And actually about July, late July, you know, it just dried up. So that milk really was very -- was relatively unavailable at that point, and so our whole procurement strategy -- now, in one sense, as the cheese markets -- and we had markets for that. We decreased our cheese production, so a load of milk a day to us is about a load of cheese a week in terms -- and so our cheese production, within about a 30-day period, decreased 25 loads per week. And really, I mean, we had market for that, but that just tightened up.

And frankly it was, you know, part of our effort, instead of going and procuring more expensive milk at that point we held off, and just to try and tighten up cheese markets as well. And we are still in a decreased production mode.

So where we've noticed it most in California is just the availability of spot milk and its cost, if we can get it.

PANEL MEMBER IKARI: Can you contrast that with what happened in Texas?

MR. JETER: We were buying spot milk in Texas, also, probably even to a greater extent, it might be 15 to 20 percent of our supply might be spot milk out there. That got a lot tighter, too.

But there's a difference out there, we can actually get the milk we want, when we want it, we just tend to pay more. And spot milk can be discounted out there, so out there it's legal to pay under the state or under, you know, the classified price, that's legal in a federal order to clear the market. I think you guys are aware of that.

But then when it's short, the price goes up. So we can pay from out there, when milk is long, from three under, to when milk -- I think this next week we're paying three over to fill the plant.

PANEL MEMBER IKARI: Against that background are you confident that you will have the milk supplies or that current economics will turn around and you will have the milk supplies you need in California to operate your plant efficiently?

MR. JETER: Well, you know, we're in -- and once --

PANEL MEMBER IKARI: I guess I should say absent any price intervention by the Department.

MR. JETER: Well, and that is an important issue to us, believe me, whether you guys intervene or don't.

We, in California, I mean in a sense our procurement, we've taken on probably 10 to 12 new dairies in the last 60 days and have -- in other words, all our dairymen are still on contracts, so we've -- we had a temporary releasing of contracts, in other words we let them ship over their contracts through the fall, which is unlikely to be done. We then went back and reviewed everybody's contract and increased them to the levels they wanted, so people were able to grow.

And then after -- so the idea was to take care of our own dairymen first, what they wanted to ship, and then to go back and be opportunistic about new people we wanted to do business with. And so we've essentially gone from buying a lot of spot milk to trying to buffer up our direct ship supply.

And, okay, to do that we have to be -- we have to be a buyer of choice. In other words, people have to want to do business with us. And so we try to create an environment where people want to do business with us.

And obviously, if we're good at what we do and go get money out of the marketplace, the idea is you share some of that with your dairymen and they want to do business with you, and that is the case. And so we have plenty of dairymen that want to do business with us.

And so my point is I think our strategy is, even in a decreasing milk supply, you know, we plan to get what we need to service the markets that we have.

Now, you're talking in an aggregate sense, but I'm talking in our business sense. The milk supply in

California has been very impacted, the current, you know, 12 months have been devastating.

And I mean, you've heard it, and I agree with Linda, I do not feel this. I understand it from afar and it's just an excruciatingly difficult period. So it is impacted, clearly.

And I don't know what's going to happen but markets are coming back, premiums have gone up. So, you know, those things are being reflected today and we think that's the way that this should work, rather than you guys intervening in the marketplace.

PANEL MEMBER IKARI: There was also previous testimony about plant expansion at CDI, at Land O'Lakes, Leprino and Saputo. Under that backdrop, might we get into more plant -- I mean, deficit reduction relative to the State's processing needs?

MR. JETER: By deficit production you mean more plant capacity in --

PANEL MEMBER IKARI: Increased competition for milk among manufacturers and processors?

MR. JETER: I think so, yeah. And I mean, I think that's good for dairymen in a sense. I mean, they've been in a situation where there weren't enough plants. I mean, there are other consequences to that but, I mean, it's probably refreshing to them to have people want their milk.

So I think that's a good thing in general. We plan to get the milk we need.

PANEL MEMBER IKARI: Finally, in your testimony you talk a lot about or there seems to be a theme that runs through your testimony about income redistribution within the pool. But in fact, doesn't the Class 1 and the higher differentials get redistributed to pool plants?

MR. JETER: Absolutely.

PANEL MEMBER IKARI: And your plant is a pool plant?

MR. JETER: Absolutely.

PANEL MEMBER IKARI: So aren't your producers benefiting from the higher value of milk?

MR. JETER: Well, those that have quota obviously are. Those that don't, no, they don't. In fact --

PANEL MEMBER IKARI: Isn't the pool price all -- you know, if there's increases in minimum prices, doesn't the non-quota as well as the quota producers benefit?

MR. JETER: Not ours. Essentially, the way our system works, we have this market basket price and then there's the minimum price, and those are not connected as far as we're concerned. The only connection is our market basket can't go below the minimum price. In other words, we owe the pool for the minimum price. So we're paying our market basket.

And if you guys raise this price, the minimum price, which should be below our market basket price, okay, then our costs did not change. In other words, we're going to just change the amount -- we're going to take what we pay and a greater proportion of what we pay is going to go into the pool, and to our dairymen, they get about 40 cents of that money that they were getting when you -- before you increased it, they were getting all that. You increase the price and so that money now goes into the pool and they only get 40 percent of it back.

PANEL MEMBER IKARI: But if the Department raised the 1, 2 and 3 price doesn't your producers benefit because there's more money in the pool?

MR. JETER: Theoretically, but our people will lose on an increase on the 4b.

PANEL MEMBER IKARI: Well, I mean if --

MR. JETER: I mean, we did the analysis and they lose. Now, it is because our premiums are not pegged to the 4b. If our premiums were pegged to the 4b, that would not be the case. We have a different pay system.

PANEL MEMBER IKARI: If you want to be totally market oriented, John, and Hilmar Cheese, you could become a non-pool plant and pay producers directly, and then the producers would make based solely on what cheese returns.

MR. JETER: That's what we do in Texas and it works extremely well.

PANEL MEMBER IKARI: But you're a pool plant in California.

MR. JETER: We're a pool plant because we have producers that have quota, and it's the system. So we offer a choice, they can either have a quota and be in the pool, not have a quota, be in the pool, or not be in the pool. So we offer them choice.

PANEL MEMBER IKARI: Thank you, John.

MR. JETER: Yeah.

HEARING OFFICER HOLLOWAY: Okay, that's it, thank you very much.

Okay, now we're going to call John Hitchell.

This will be Exhibit 60, thank you.

(Exhibit 60 was marked for identification and received in evidence.)

MR. HITCHELL: Thank you.

HEARING OFFICER HOLLOWAY: Please state your name and spell it for the record?

MR. HITCHELL: My name is John, J-o-h-n, Hitchell, H-i-t-c-h-e-l-l.

HEARING OFFICER HOLLOWAY: And you are representing?

MR. HITCHELL: The Kroger Company.

HEARING OFFICER HOLLOWAY: Okay. And you affirm that you'll tell the truth and nothing but the truth?

MR. HITCHELL: I do.

HEARING OFFICER HOLLOWAY: Thank you, go right ahead.

MR. HITCHELL: Okay. Madam Hearing Officer and Members of the Panel, my name is John Hitchell. I'm employed by The Kroger Company as the General Manager of Raw Milk Procurement in Cincinnati, Ohio. The Kroger Company owns and operates Compton Creamery in Compton, California and Riverside Creamery in Riverside, California. I'm appearing today to give testimony on the proposal by Dairy Institute of California.

The Kroger Company recognizes that in the past year the economic return for dairy farmers has been at an historical low. These economic conditions have led to a reduction in the supply of raw milk in the State of California.

The Kroger Company believes that a temporary increase in the cost of all classes of milk in California is justified to aid dairy farmers during this difficult time. The Kroger Company supports the proposal by the Dairy Institute of California of increasing all classes of milk 20 cents a hundredweight for three months. However, The Kroger Company would not require the price to be reduced if the 4a/4b price rose above the $13 a hundredweight while the temporary increase is in effect.

The Kroger Company believes that the three-month timeframe is adequate based on the current and expected increases in the cost of dairy commodities that will inevitably lead to higher prices for raw milk.

The Kroger Company opposes the proposal from the Alliance of Western Dairy Producers to permanently increase the current Class 1, 2 and 3 prices. The Kroger Company does not believe that consumers of these products in the State of California should bear the burden of a permanent increase in cost to correct a situation that is temporary in nature. And as stated above, the current and expected increases in the cost of commodities will raise the Class 1, 2 and 3 milk costs in the coming months.

The Kroger Company opposed the original proposal from Western United Dairymen and then since they have switched and supported the proposal of the Alliance of Western Dairy Producers, I won't need to read this one paragraph.

For the reasons stated above, The Kroger Company supports the adoption of the proposal of Dairy Institute of California without a $13 a hundredweight trigger price.

Thank you for your consideration, I'll be happy to answer any of your questions.

HEARING OFFICER HOLLOWAY: Are there any questions from the Panel?

PANEL MEMBER IKARI: Since you operate outside of the State of California, are you aware of any actions taken by other states to help address the economic crisis the dairy farmers are facing?

MR. HITCHELL: Not in the states that we operate at this time, no.

PANEL MEMBER IKARI: Thank you.

MR. HITCHELL: Thank you.

HEARING OFFICER HOLLOWAY: Okay, thank you very much.

MR. HITCHELL: Thank you.

HEARING OFFICER HOLLOWAY: I'd like to call up Pete Hoekstra.

Okay, this will be Exhibit Number 61.

(Exhibit 61 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Good afternoon.

MR. HOEKSTRA: My name is Pete Hoekstra, I represent Genske, Mulder & Company, an accounting firm in Modesto.

I spell my name P-e-t-e-r H-o-e-k-s-t-r-a.

HEARING OFFICER HOLLOWAY: Okay, and do you affirm to tell the truth and nothing but the truth?

MR. HOEKSTRA: Yes.

HEARING OFFICER HOLLOWAY: Thank you, go right ahead.

MR. HOEKSTRA: What I have come here to present, Madam Chairman, is just the state of the industry of the dairy producer. I have nothing to do with the pricing or anything, but I do feel that you should understand the plight of the producer.

I've been involved in the dairy industry since 1972 and I'm currently the managing partner of the Modesto office of Genske, Mulder & Company. We have produced cost studies for the last 25 years plus, and that's what you have in front of you today.

What I'd like to do is just go over a little bit of those cost studies and tell you what has happened in the past six months or in the past nine months.

I also talked to a Moore, Stephens, Frazer & Torbet, and they gave me permission to use their numbers, also, although I don't have them present, but I did get permission to use those.

We have had tremendous losses in the last six months in the dairy industry. And according to our cost studies and according to the cost studies of Frazer & Torbet, basically in the three areas in California, which we divide between Bakersfield -- or Southern California and Bakersfield, Bakersfield and Fresno, and Fresno north, the representative areas have lost $567 per cow. In the Central California it was $535 a cow. And in Northern California it was 529.

The average for six months was $535, which is an astronomical amount when you consider that the bank is willing to loan 65 percent of the cow and they value it at $1,300. So you get about $900.

I have started doing some of my nine months' financial statements and we're between $900 a cow loss, and we don't have them all done,, there's going to be some that are going to below that, but there's going to be some that are even going to be above that amount.

I guess what I'm saying is that the dairy industry in California, but also throughout the nation is really in a crisis and we have to try to address that crisis. I'm not saying raising milk prices, but if we do not address the crisis of a dairy family losing almost $12 billion in equity in the last six months nationally, 2.5 billion just in the State of California, we are going to have a disaster and we will be drinking milk from other countries and other states.

I have no doubt that we will have a shortage of milk.

One of the other statistics that I came out with, and you can take that from the cost studies, but in California the mailbox price that our clients got for their milk was $1,071 per cow for six months. Their feed costs for just feeding the cows and feeding the heifers was $1,283 a month for the six months.

They had a deficit of $182 per cow through six months, just to feed their animals, which makes it totally impossible.

All of our clients, in all of our offices in Southern California and in Northern California, the only dairy that we had that made a profit was an organic dairy. And if you look at these numbers, these numbers are numbers that are supplied to banks, so they're certified, they're reviewed by certified public accountants in my firm and in Frazer & Torbet's firm. These are real numbers and these are real numbers that banks rely on. It's pretty scary.

The projection for the third quarter, like I said, is probably going to go to $900 per cow. Our feed costs do remain high, whether they will come down again -- but, you know, our milk cost is coming up, but it's still a break even, it's probably going to be closer to $15 to $16 a hundredweight, so even if milk gets up to $13, $14, $15, which I hope it will by December, we probably will have a break even point.

But I can almost guarantee that through nine months all the dairies in California and pretty much throughout the nation are losing money and will continue to lose money through September.

I heard the testimony about the $270 million relief from the federal government. Somebody ought to do some math. $270 million divided by 9 million cows is $90. It will take care of one month out of 12, so it's not exactly a lifeboat, it's half of an oar.

The other thing, the last thing I'd like to talk about is the banking industry. The feed companies have pretty well reached their limit, and I don't see any feed companies here today, but I've talked to quite a few of them. Many of our dairymen are on COD, they have no longer can get credit from their feed companies. The feed companies have become second holders on land because they ask for collateral, if you want to continue to deliver feed.

The banks have notified many clients that they have 90 days or six months to find another bank, which is an impossibility in today's market.

I talked to two major lenders in this past week that have received many applications to have their dairies financed because their bank was kicking them out. They turned down 97 percent of those applications. And I don't know where this is going to go. I don't know how my dairymen pay my bill, let alone any other bill.

We have dairymen that are selling their mothers' homes. We have dairymen that are selling quota, we have dairymen that are selling heifers, they are selling everything that is out there that's just not tied down.

And the banks, basically, have no appetite to finance the dairy industry. And if you look at these cost studies, you really can't blame them. Why would you want to give somebody money that's losing $500 to $900 a cow?

Like I said, I've been doing this since 1972 and I went back on our cost studies, and in our cost studies there was only three years that I could find that there were any substantial losses whatsoever in the dairy industry. And the losses, I think the biggest loss was 40 cents a hundredweight, and that was in '82 and '84, and now we're looking at $5 a hundredweight, and it will be $5 a hundredweight through September. Hopefully, we'll soften up a little bit by December.

But I do feel that we will -- I know, Mr. Ikari, you keep talking about whether we will have enough milk, the dairy industry has been very resilient, dairymen have been very resilient, but they have never been pushed to a point where they started out the year with no debt on their cows and now are fully financed on their cows, and their feed.

So if people think that there is going to be more milk out there, they probably better start financing the dairies.

And just to show you that this is not a regional thing, in our cost studies we've done Idaho. Idaho lost $607 per cow through six months. Arizona lost $594 per cow. California was $535. The Texas Panhandle was $502. Washington State was $477. The lower midwest, which would be Colorado, Wisconsin, Kansas -- or Colorado, Kansas, Oklahoma, Nebraska, $465 a cow. The upper midwest, which would be Iowa, South Dakota, Wisconsin and so forth, was $402 a cow. And New Mexico was $400 per cow.

The average in all regions was $482 per cow.

What I did notice when we were looking at these cost studies is that the midwest, especially the upper midwest, lagged about two months behind California and the western states but, believe me, they are feeling the same pain that we are feeling, also, it's just that it came a little bit later.

I want to thank you for the opportunity.

HEARING OFFICER HOLLOWAY: Okay, thank you.

Are there any questions?

PANEL MEMBER IKARI: I just have a couple of questions to clarify. Now, this document contains both your studies, as well as the Frazer & Torbet?

MR. HOEKSTRA: No, Frazer & Torbet, I have their study right here, but I didn't have a chance to make a copy.

I called Sharon Davis before I came down here and asked her if I could use it. But her cost study shows the same numbers. If I look at Frazer & Torbet for Southern California, it was $511 a cow.

PANEL MEMBER IKARI: Could you supply that in a post-hearing brief? If you get permission?

MR. HOEKSTRA: Yeah, I got to get permission.

PANEL MEMBER IKARI: Yes.

MR. HOEKSTRA: But if she'll give me permission, I can provide that for you.

HEARING OFFICER HOLLOWAY: You can just fax it.

MR. HOEKSTRA: Yes.

HEARING OFFICER HOLLOWAY: Thank you.

PANEL MEMBER IKARI: Of the studies, it would be interesting also to know how many dairy farmers are included in the various areas that you guys are doing?

MR. HOEKSTRA: I think I can come up with that. But I can tell you this, in talking with Sharon Davis, basically theirs includes about 165,000 cows, 3.4 billion pounds of milk annually. That's in Frazer & Torbet's cost study.

Our cost study is going to probably be double that amount of milk being produced in California.

PANEL MEMBER IKARI: Well, I noticed that the average number of cows is 1,500, 2,200, 1,600, 1,700.

MR. HOEKSTRA: Right.

PANEL MEMBER IKARI: So if the statewide average is a thousand, these tend to be a little bit larger than the average.

MR. HOEKSTRA: The statewide average, yeah, we do have larger. But I have 300-cow dairies and I have 3,000-cow dairies. So what we do with this is this is just an average. So if I -- you know, we had --

PANEL MEMBER IKARI: If you could just tell us how many dairies, that would --

MR. HOEKSTRA: Yeah, I'll see if I can get you that information.

PANEL MEMBER IKARI: Okay, thank you.

HEARING OFFICER HOLLOWAY: Okay, thank you very much.

Okay, next we have Tom Wegner.

Okay, this will be Exhibit Number 62.

(Exhibit 62 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Please state your name and spell it?

MR. WEGNER: Tom, T-o-m, Wegner, W-e-g-n-e-r.

HEARING OFFICER HOLLOWAY: And you are representing?

MR. WEGNER: Land O'Lakes.

HEARING OFFICER HOLLOWAY: Okay. And do you affirm that you'll tell the truth and nothing but the truth?

MR. WEGNER: I do.

HEARING OFFICER HOLLOWAY: Thank you very much, go right ahead.

MR. WEGNER: Madam Hearing Officer and Members of the Panel, my name's Tom Wegner and I'm here to testify on behalf of Land O'Lakes. My business address is 4001 Lexington Avenue North, Arden Hills, Minnesota. My current title is Director of Economics and Dairy Policy. We thank the Department for promptly calling this emergency hearing to address this issue of critical importance to all our California dairy producer members.

Land O'Lakes is a dairy cooperative with 3,100 dairy farmer member-owners. Land O'Lakes has a national membership base, whose members are pooled on the California State Program and five different Federal orders. Land O'Lakes members own and operate several cheese, butter-powder and value-added plants in the Upper Midwest, East, and California. Currently, our 275 California member-owners supply us with over 15 million pounds of milk per day that are processed at our Tulare and Orland plants.

Land O'Lakes supports the Alliance of Western Milk Producers to increase the price of milk used for Class 1 uses, as well as for milk used for Classes 2 and 3.

The October 2009 California Dairy Information Bulletin compares milk production costs and mailbox prices.

The mailbox prices in the first quarter of 2009 averaged $10.09 per hundredweight, but the statewide average cost of production averaged $16.67 per hundredweight. Production costs exceeded the all milk price by $6.58 per hundredweight. The mailbox prices in the second quarter of 2009 averaged $9.74 per hundredweight, but the statewide average cost of production averaged $15.37 per hundredweight. Production costs exceed the all milk price by $5.63 per hundredweight.

Looking to 2010, Land O'Lakes has concerns about feed costs increases due to the inability of farmers to harvest the 2009 crop, in addition to the quality of the crops harvested.

The average overbase price for the 12-month period October 2008 through September 2009, compared to the average overbase price for October 2007 through September 2008 decreased by $6.39 per hundredweight, representing a 37 percent decrease. This is just another indication of how bad things are for California Dairymen.

Drawing on the California Dairy Reviews of October 2009 and November of 2008 shows that feed costs have generally declined since the peaks of fall 2008, but the declines for most feed costs have been much less than the decline in California milk prices.

These comparisons confirm that California dairymen have not been covering their costs of production during 2009. The resultant losses have been very severe. Dairy producers are indeed facing miserable financial conditions. It's clear that California dairymen need help now and time is of the essence.

The timing is right. Something needs to be done now to provide relief for California dairymen. A Class 1, 2 and 3 price increase, as proposed by the Alliance of Western Milk Producers would be a step in the right direction.

Supply and demand conditions in California have changed dramatically since the January 2009 decision to reduce Class 1, 2 and 3 prices. Plants processing 4a and 4b milk are having difficulty acquiring enough milk to keep their plants running at full capacity. Compared to 2008 levels, California milk production has declined each month of 2009. We anticipate that trend will continue for the rest of the year. Table 1 of the California Dairy Information Bulletin shows that milk production for the period of January through August was down by an average 3.5 percent compared to a year ago.

According to the USD's NASS Milk Production report, dated October 17, 2009, milk production in California decreased 6.4 percent in September 2009 compared to September 2008. Cow numbers decreased by 73,000 head or about 4 percent below a year ago. Production per cow was down by 2.6 percent.

Because of high feed costs and low milk prices, dairymen were inclined to change their rations to reduce overall feed costs. As a result, production per cow has been below a year ago for some time now.

the reduction in cow numbers was largely caused by low milk prices. Feed costs declined but milk prices decreased faster and more severely than feed costs. Plants today are operating at less than full capacity. As a general rule, the Class 1 milk plants have been supplied their milk needs. Of course, there is the call provision in California that ensures that Class 1 plants will be fully supplied.

Land O'Lakes milk supply has decreased significantly this year. During 2009, Land O'Lakes' milk supply has experienced a monthly decrease of as much as four and a half percent year on year; year to date through September receipts from members have decreased by roughly 200 loads per month. Accordingly, we have reduced the volume of milk through our plants and have had to idle our plants by as much as 20 percent of the time during 2009. Idling our plants has increased our per unit cost of manufacturing cheese, butter, nonfat dry milk and whey products.

As shown in table 14 of the California Dairy

Information Bulletin, October 2009, butter production for the period of Jan. 1 through August 2009 was down by 6.4 percent as compared to a year ago. Production of nonfat dry milk powder for human consumption for the period of Jan. 1 through August 2009 was up by 9.8 percent compared to the same months a year ago; but the production of other dry milk products was down by 23.2 percent for the same months. The production of condensed and evaporated milk for the period of Jan. 1 through August of 2009 was down by 20 percent as compared to eight months ago, the eight-month period a year ago.

Production of Monterey cheese for the period of Jan. 1 through August 2009 was down by 1.9 percent compared to the same months a year ago. The production of cheddar cheese was down by 1.6. The production of mozzarella cheese was down by 2.6. The production of provolone cheese was down by 3.3 percent. Parmesan cheese down by 5.5. The production of Hispanic cheese was up by 3.6. Other cheese was down by 22.8 percent for the period Jan. 1 through August 2009. The total cheese production declined by 3.2 percent for that same period.

As expected, when milk production decreased in California during 2009 the production of Class 4a and 4b products decreased as well. Less milk means there's excess manufacturing capacity in California at this time. Running plants at less than full capacity increases the cost per pound of product manufactured.

Plant expansions have continued. California has experienced a significant increase in plant capacity the last few years. The most noteworthy expansions include California Dairies, Leprino Foods and Land O'Lakes. Not only that, Leprino and California Dairies are reportedly in the process of adding more processing capacity.

The cost-price squeeze has caused milk production to fall below last year's level. Some dairymen have been forced out of business and others are culling cows, and for most dairymen the production per cow is lower this year than last year. All of this means there's less milk being produced in California, which means that butter, powder and cheese plants have less milk to process. The costs of processing butter, powder and cheese are higher when plants are operating at less than full capacity.

According to the Cost of Manufacturing Exhibit published by the CDFA on October 1, 2009, the cost of manufacturing dairy productions increased significantly in California during 2008. Specifically, with respect to cheese manufacturing, only 4.6 percent of the cheese was manufactured at a cost covered by the current make allowance. The percentage of the butter processed at a cost covered by the current make allowance was 54 percent; and for powder, 56 percent was manufactured at a cost covered by the current make allowance.

Costs of manufacturing milk products continued to grow in 2008. The current contraction in milk supply resulting in plants operating at less than full capacity only drives manufacturing costs per pound higher.

Our dairymen need price relief so that milk volumes can again be maintained at levels prior to the severe level of economic stress experienced in the country. California dairymen will be a little better off, leading to more milk, leading to plants operating closer to full capacity. Accordingly, the costs of manufacturing dairy products will decrease as plants approach full capacity. We're not claiming that a price formula change, as proposed by the Alliance of Western Milk Producers will, in and of itself, be enough to cause milk output to grow again, but it will help stabilize the milk supply in California.

California Class 1 prices are lower than in neighboring markets. Another market factor leading to our support of the Alliance proposal concerns the level of Class 1 prices in neighboring markets. Recall that the California Class 1 formula was changed effective Jan. 1, 2009. A comparison of Class 1 prices shows that the Northern California Class 1 price was $12.51 from January through September 2009, compared to a Class 1 price in Arizona of

$13.30, and an Oregon price of $12.85 per hundredweight. The Southern California price averaged $12.78 per hundredweight for the same time period and it, too, wa below the Oregon Class 1 price.

As a result, we do not expect a competitive Class 1 price problem if the Secretary decides to adopt the Alliance proposal.

Regarding the Milk Producers Council proposal, Land O'Lakes has concerns about the impacts of implementing the Milk Producers Council's proposal to use the National Ag Statistics Services prices for nonfat dry milk value instead of the CWAP, for nonfat dry milk value in the classified pricing formulas. Formally, Land O'Lakes takes a neutral position on this proposal. We have a number of observations and concerns about the proposal and it's longer-term impacts.

Due to the potential for longer-term impacts on the export and commercial sales of nonfat dry milk, Land O'Lakes would like to request more time to fully discuss, explore and analyze this proposal. This proposal relates directly to a larger national dairy market issue of price discovery for nonfat dry milk and finding the appropriate value of nonfat dry milk to use in both the California and the federal order classified pricing systems.

We fully understand that currently California's dairymen are being treated unfairly by utilizing the CWAP price series that typically runs several cents below the NASS weekly averages. We hypothesize that there are two reasons for this disparity.

One reason for the CWAP running below the NASS may have to do with geographic pricing of nonfat dry milk. Since California plants produce nearly half of all the nonfat dry milk produced in the U.S., premiums for nonfat dry milk increase as you move east across the country from California. In this way the NASS prices will likely run a bit higher than the CWAP due to the inclusion of nonfat dry milk sales from across the U.S. We cannot anticipate how this proposal will impact this prevailing pricing practice.

The other, more often cited, reason for this price disparity centers on that the CWAP likely contains a larger portion of long-term export contracts and Dairy Export Incentive, or DEIP, sales than the NASS price series. Recall that the NASS price series excludes contracts that run more than 30 days, effectively excluding a large portion of exports. This proposal would appear to impact this part of the disparity.

Land O'Lakes believes that securing export contracts and pursuing DEIP contracts actually strengthen the spot powder markets nationwide and that those contracts have a positive effect on the NASS price series, as well as the CWAP series. But the benefits of those export sales are unequal. Because of differences in the sales reported, the NASS price series moves up more rapidly than CWP, so producers operating in NASS markets benefit more than producers who are located in California, where the CWAP price series is used.

Assuming that it is prudent to make export sales or DEIP sales, rather than to sell to the Commodity Credit Corporation, it makes sense that producers in California should have the same benefit as producers in markets using NASS price series. This would be accomplished if NASS policies were changed to include long-term contracts.

Land O'Lakes and the National Milk Producers Federation have strongly advocated for the NASS price series to move toward the methodology behind the CWAP series, to bring the two price series into harmony. Specifically, both Land O'Lakes and the National Milk Producers strongly urge the USDA to include longer-term contracts in the NASS nonfat price series. Additionally, recall that the NASS excludes fortified and high-heat powder, which the CWAP includes in their series.

Land O'Lakes has concerns about how switching to the NASS series may have some unintended negative consequences. We understand that the terms of nonfat dry milk export sales typically differ from the terms of nonfat dry milk domestic sales, especially with respect to the length of contracts.

Dairy America, the federated marketing cooperative association that jointly markets dairy products, like nonfat dry milk, on behalf of Land O'Lakes, California Dairies and several other cooperatives, tells us that the longest-term export contracts may take as many as 180 days to complete and could cover sales volumes as large as 40 million pounds. By contrast, the shortest-term export contracts of 30 to 60 days typically cover small volumes of sales of 2 million pounds or less. By limiting the allowable contracts to terms of 30 days results in the NASS price series ignoring a significant volume of nonfat sales.

The bigger question is how would California's manufacturers of nonfat dry milk react to the switch to NASS? At Land O'Lakes we believe we would need more time to fully analyze the proposal and its potential impacts in more depth. Assuming that our domestic customers had been adequately served, our first thought was that we'd be less likely to enter into longer-term export contracts because of the additional risk exposure. From our vantage point, the less risky market option would be to sell product to the CCC.

Some in the industry have suggested that nonfat dry milk processors need to make fuller use of the nonfat dry milk futures market as a means to offset risk. At this point, the level of open interest is far too small to offer the liquidity necessary to exercise that option. Would a switch to the NASS result in less willingness to participate in export contracts of longer than 30 days? Would more nonfat dry milk end up in the CCC, thereby prolonging the clearing of the nonfat dry market supply? These are critically important questions for the industry to explore in greater depth.

The Department also needs to consider the impact of this proposal on existing contracts that were entered into under the current reporting rules. Before implementing new reporting rules, consideration should be given to allowing manufacturers sufficient time to fulfill their obligations agreed to under longer-term, fixed price contracts.

Finally, recall that the primary focus of the CDFA hearing in August 2007 was exclusively related to the reporting of nonfat dry milk sales and what sales should be included in the CWAP. Industry participants thoroughly discussed these issues in full detail. We strongly urge the Department to allow the industry an opportunity to more fully discuss, analyze and formulate their positions on this proposal. Both the complexity and future impacts of this proposal do not lend themselves to an expedited hearing and decision-making process that this hearing was announced under.

MPC has also proposed adding a whey sharing factor to the 4b price. We feel that this proposal also requires more time to full discuss, analyze and formulate positions around this complex topic. Recall that the Department conveyed a whey review committee that considered a wide array of proposals. The complexity of finding the best whey factor to include in the 4b price needs to be considered in a more comprehensive manner.

We do not oppose the proposal, but share concerns that by continuing the use of dry whey pricing in the 4b formula ignores the fact that the California dairy industry is moving towards whey protein concentrates, deproteinized whey products, et cetera, and away from the production of dry whey.

From a producer member perspective, the proposal has the appeal of returning more value to producers as whey prices increase. recall that back in April 2006 Land O'Lakes proposed a similar type of sharing component, but that proposal included an additional component that shared plant losses with producers when whey prices fell below the whey make allowance.

Without time to evaluate the proposal more fully, we have concerns about adding more costs to the 4b milk price, when less than five percent of the volume of cheddar cheese made in 2008 was covered by the current make allowance. Adding the whey sharing factor to the 4b price would result in none of the cheddar cheese produced getting covered by the make allowance and offering no new relief to cheese plants from the fixed whey factor when whey prices fall.

The California Women Association -- Dairy Women Association proposes a six-month temporary increase in the price of milk for all classes. As stated in their alternative proposal, they propose a temporary change to the pricing formulas to reflect the California average milk production costs.

Based on the CDFA analysis, producers would have been worse off under the proposal. Land O'Lakes opposes the California Dairy Women Association's proposal.

California Dairy Campaign proposes to incorporate producers' cost of production into the Class 1 formula and a variable make allowance for 4a and 4b based upon the relationship between the cost of production and the end product values from the commodity reference price. They also want to incorporate the "higher of" concept of the commodity prices or the USDA support price.

Their proposal appears to reflect a permanent change in the pricing formulas. The complexity of the proposal makes it difficult to fully evaluate the impacts that the cost of production components, price floors and variable make allowances. There are simply too many moving parts to fully evaluate the proposal under the expedited timeframe.

Again, this is an emergency hearing with an expedited timeframe, with no pre-hearing workshop, and little time for a complete analysis of proposals' impacts. Land O'Lakes does not support the California Dairy Campaign's proposal. It's not clear what the full extent of the impacts would be on the manufacturers and dairy farmers of California.

The Dairy Institute proposes to raise the prices of milk for all classes by 20 cents per hundredweight for a three-month period beginning Jan. 1 through March 2010.

The full impact of their proposal is difficult to determine because we do not know when the $13 per hundredweight trigger might be implemented or how often it would be implemented during the three-month period.

Land O'Lakes opposes the Dairy Institute proposal because of the negative impact that it would have on plant earnings.

In conclusion, we thank the Secretary for calling this hearing. We support the proposal by the Alliance of Western Milk Producers. Because the price adjustment would be modest and that milk for these classes is typically local or regional in nature, we do not believe that California would lose market share to out-of-state milk either in the form of packaged or bulk milk. California producers badly need price relief. We strongly urge the Secretary to adopt the proposal by the Alliance of Western Milk Producers.

We strongly urge the Secretary to utilize their long-established practice of a public pre-hearing workshop to provide industry participants adequate time to review and analyze proposals. We have had inadequate time and information to formulate positions on specific proposals which include fundamental changes to classified pricing formulas, such as the replacement of CWAP with NASS or the introduction of cost of production considerations. having adequate time to assess the impact of proposals is especially important to member-owned cooperatives, like Land O'Lakes, that need ample time to summarize impacts for their boards and formulate positions.

In closing, we'd like to thank you for your considerations and Land O'Lakes would like to request the opportunity to file a post-hearing brief.

HEARING OFFICER HOLLOWAY: Okay, thank you, your post-hearing brief is granted.

Who would like to go first on the questions?

PANEL MEMBER IKARI: Would Land O'Lakes support, oppose, or be neutral on a proposal to implement the Alliance proposal if it was on a temporary basis?

MR. WEGNER: Well, we'd support the Alliance proposal on a permanent basis. I don't know what temporary would mean, but what period --

PANEL MEMBER IKARI: Say six months, three months?

MR. WEGNER: It wasn't considered as an option, David, I would need to check in. My assumption is that they would want to know what timing that would be, but I don't know if they would necessarily oppose it, but I don't think it would be as warmly received as a permanent, that would be my best take on it.

PANEL MEMBER IKARI: But you could address that in a post-hearing brief; right?

MR. WEGNER: Try to, yes. You're realizing you put us at a pretty short timeframe, you're talking about Thursday. National Milk Producers Federation annual meeting is on as well right now, so it's a very busy time. I will try to address that in a post-hearing brief, David.

PANEL MEMBER IKARI: Thank you.

HEARING OFFICER HOLLOWAY: Any other questions?

Okay, thank you.

Why don't we go with another one, I would like to call Dennis Brimhall.

Thank you. This will be Exhibit Number 63. Yeah,

Exhibit Number 63.

(Exhibit 63 was marked for identification and
received in evidence.)

HEARING OFFICER HOLLOWAY: Please state your name for the record?

MR. BRIMHALL: It's Dennis Brimhall, D-e-n-n-i-s B-r-i-m-h-a-l-l.

HEARING OFFICER HOLLOWAY: Thank you. And do you swear to tell the truth and nothing but the truth?

MR. BRIMHALL: Yes.

HEARING OFFICER HOLLOWAY: Thank you, go ahead.

MR. BRIMHALL: Things have changed at the hearing a little bit so I'm going to have to editorialize a little bit here, so please bear with me.

Madam Hearing Officer and Members of the Hearing Panel, my name is Dennis Brimhall; I'm the Controller at Super Store Industries. Our company has plants in Fairfield and Turlock. We process fluid milk products at our Fairfield plant, and cottage cheese, sour cream, yogurt and ice cream at our Mid Valley Dairy plant in Turlock. We supply products primarily to the Raley's and Save Mart supermarket chains. SSI management has approved this testimony and the company's position at this hearing.

Super Store Industries is a Dairy Institute of California member and we support Dairy Institute's alternative proposal and the testimony given by Dr. Schiek.

Please refer to the attached chart, that's this first graph, that compares the Northern California Class 1 prices to the Pacific Northwest federal order. The Northern California, as you'll notice, is the blue line and the Portland or the Pacific Northwest prices are the red line, and then the black line down near the bottom is the difference between those two.

This is the market in which we compete, so it's the only comparison with surrounding areas that I'll be making. The comparison shows the differences six months before the effective date of the last Class 1 hearing, and the 11 months afterward. The Northern California price, especially since May, and you can see that on the chart, especially the black line down there, has been very close to the Portland price and was even slightly higher in September and October.

Based on these facts, I see no justification to consider the Alliance proposal that is based on their perspective inequities of the surrounding areas.

We also oppose the California Women Dairy Association and the California Dairy Campaign proposals, which would incorporate milk production costs into the minimum prices. This would eliminate the motivation to keep costs in check and to operate an efficient dairy farm.

Wouldn't it be nice if we could all be paid based on the costs we incur?

The CDWA's proposal, in their proposal they brought up a common misconception that I feel compelled to address. I suspect that others at this hearing, and I suspect my suspicions were correct, will make the same misleading comments relating to retail dairy prices. In their letter to the Secretary they stated that they have lost hundreds of millions of dollars with little relief, and I quote, "while retail store prices remain high," implying that processors and retailers are not passing on lower milk costs to the consumers. This is not true.

Please refer to the attached retail price sheet from CDFA's Dairy Information Bulletin, and that's this chart here, and I've highlighted the examples that I wanted to show. I've highlighted a comparison of July 2008 to October 2009 as an example. So the Class 1 price, and this is reflect in a cost per gallon of whole milk, right off of the chart, in July of 2008 was $1.93, in October of 2009 it was $1.19, or a decrease of 75 cents a gallon for whole milk, or 39 percent.

While the retail prices, and I chose Sacramento because that's where we are, but you can choose any other city that you want in California and the relationship is the same; in July of 2008 was $3.70, the October 2009 price was

$2.87, or a difference of 83 cents, or a 22 percent decrease.

It's easy to infer that Class 1 prices have dropped 39 percent, but retail prices have dropped only 22 percent, but this is very misleading. In reality, the processors and retailers have passed along the full raw milk decrease of 75 cents, plus an additional eight cents in other savings, for a total retail price reduction of 83 per gallon of whole milk. I hope the producer community will realize that we are not profiting off their misfortune.

We recognize the financial bind that California milk producers are experiencing. Under these unusual circumstances and since we're ultimately all in this together, we feel it is appropriate to provide some aid. The premise upon which Western United's proposal, at least the one they had proposed and that has obviously been changed today, but we felt that the Western United's proposal had merit, but we feel that the assistance should be more modest and for a shorter period of time because market conditions are showing steady improvement.

Please refer to the first chart again and you can see this increase over the last few months. Refer to the first chart again, note the increase in California's Class 1 prices since August. If prices continue to improve at this rate, the producers will not need any outside assistance.

If prices do not improve, we are prepared to help, as proposed by Dairy Institute.

Another important element that the Department should factor into their consideration, and I've noticed that we've been doing that here today, is that in addition to the minimum prices that are being addressed at this hearing, the producer organizations can and do increase their revenue by raising service charges and other fees. We have recently experienced such increased and they will probably not be temporary.

We are hopeful that through the aid Dairy Institute has proposed, along with assistance from other government agencies, improving market conditions, and their own revenue enhancements that in time California milk producers will be restored to a healthy financial position.

Thank you for the opportunity to testify and I'll try to answer any questions, and ask the opportunity to file a post-hearing brief.

HEARING OFFICER HOLLOWAY: All right, you may file a post-hearing brief, your request is granted.

Are there any questions from the Panel?

PANEL MEMBER IKARI: I just have one question. Your testimony that the premise upon which the Western United proposal is based has merit seems to suggest, and I want to ask you to clarify, that even without the trigger you would be supportive of their proposal, so long as it was a more modest increase?

MR. BRIMHALL: Yes, if it was more modest and if it were temporary.

PANEL MEMBER IKARI: Okay, and modest --

MR. BRIMHALL: I think those two things are important.

PANEL MEMBER IKARI: Do you mean 20 cents?

MR. BRIMHALL: You know, frankly, between the service charge increases that we've had and the 20 cents the Dairy Institute is proposing, we're already over 90 percent of what the 50 cents the people have asked for. Yeah, so 20 cents, you know, this is all negotiable, obviously. Not negotiable with us, but based on your evaluation, yeah, 20 cents is fine. You know, 50 cents is maybe high, so we're --

PANEL MEMBER IKARI: I just wanted to get some kind of idea from you what modest meant?

MR. BRIMHALL: Yeah, we really do feel a responsibility to try to help the producers all we can, 20 cents is probably the minimum, in my view.

PANEL MEMBER IKARI: Thank you.

MR. BRIMHALL: Yeah.

PANEL MEMBER EASTMAN: I have a question. So with the 20-cent temporary increase then, on a hundredweight basis, what sort of effect do you think that would have on your sales or your competitive advantage?

MR. BRIMHALL: If it were for a temporary period of time we're talking and Dairy Institute's proposal, which we agree with, is three months, probably very little. If it were longer than that, if it were six months, that's scary.

PANEL MEMBER EASTMAN: Gotcha.

MR. BRIMHALL: Yeah.

PANEL MEMBER EASTMAN: That's all I have.

HEARING OFFICER HOLLOWAY: Okay, thank you very much.

MR. BRIMHALL: Thanks.

HEARING OFFICER HOLLOWAY: Okay, I'm going to call for a break right now and let's try and be back here by 3:30. Okay, thank you.

(Off the record.)

HEARING OFFICER HOLLOWAY: I'd like to call Greg Dryer next.

We will be marking this exhibit as Number 64.

(Exhibit 64 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Okay, thank you. Please state your name and spell it for the record?

MR. DRYER: My name is Greg Dryer, G-r-e-g D-r-y-e-r.

HEARING OFFICER HOLLOWAY: And you're representing?

MR. DRYER: I'm representing Saputo Cheese USA.

HEARING OFFICER HOLLOWAY: Okay. And do you contest you will tell the truth and nothing but the truth?

MR. DRYER: I do.

HEARING OFFICER HOLLOWAY: Thank you, go right ahead.

MR. DRYER: Madam Hearing Officer and Members of the Hearing Panel, my name is Greg Dryer; I'm Executive Vice President of Industry and Government Relations for Saputo Cheese USA. My responsibilities in that position, among other things, include milk procurement for all of the company's U.S. manufacturing facilities. I serve on the Board of Directors of the National Cheese Institute, the American Dairy Products Institute, the Dairy Institute of California, the U.S. Dairy Export Council, and the Wisconsin Cheese Makers Association. I'm a member of the Institute of Food Technologists, the Wisconsin Dairy 2020 Council, and the American and Wisconsin Institutes of CPA.

I've been directly employed in the U.S. dairy industry for the past 29 years. Our company, Saputo, has 16 manufacturing facilities across the United States, five of which are located here in California. Four of the five California plants purchase milk for the manufacture of cheese. The fifth plant utilizes cheese from our own plants and that of other companies for further processing and packaging.

We employ approximately 1,000 people in the State and purchase a substantial portion of the State's milk production, both direct from farmers and from farmer cooperatives. We can certainly appreciate and salute a desire on the part of the State to come to the aid of its dairy producers in this time of economic crisis. We recognize the risk these farmers take, having made major capital investments and then enduring the vagaries of weather, volatile input and energy costs, and most recently the impact of an unpredictable world market. We sympathize with their plight and, in fact, their success can impact ours. However, this is not a California problem but rather national and even global in scale. As such, we believe that the solution be sought on a national scale rather than at the state level, risking the creation of disparity in the national competitive landscape.

And I included a slide here entitled "Pain On The Farm Is Ubiquitous," and it shows farmers protesting from countries all around the world over low prices.

We have difficulty understanding the willingness to tinker with a system without regard to its rational underpinnings as a means to that end. We surely don't understand doing so at the expense of employees and stakeholders who played no part in the creation of this predicament. Assuredly, it would be at their expense because an isolated increase in the cost of California milk cannot realistically be passed onto customers who enjoy other alternatives.

We also believe such a decision sends a clear and discouraging message to the dairy industry. Investment in California presents an inordinate risk because there would be no reliable, stable foundation on which to build. the regulatory structure and resulting business climate that exists here in California at the moment can and likely will change based on the leaning of the policy makers of the future.

The market that led us into this crisis -- it is the market that led us into this crisis and it is the market that will eventually lead us out. It's important to recognize that despite the dreaded volatility of the market, the long-term trend of prices has been rising since the level of government intervention has been reduced.

And here I've included a chart of milk prices going back to 1970, and these are Class 3 milk prices, which are representative of the general price levels, against the support price. And clearly the trend since 1988, when the support price was reduced below realistic cost levels, has been upward, prices have been increasing despite the terrible volatility.

In fact, it could be argued that the extended duration of the current milk price recession could be attributed in part to the understandable reluctance by farmers to reduce production while on the perceived verge of a very bright future. Any decision to transfer wealth between processors and producers in periods of low prices, in all fairness should then be reversed in periods of high prices.

Regarding volatility, there are tools available in the market, such as forward contracting and hedging, which could mitigate its impact if they were made accessible to all producers. As of Friday, November 6th, 2010, Class III futures were yielding $15.49 a hundredweight.

And here I've included a chart coming from the USDA forward-pricing pilot program, from 2000 to 2004, that showed forward contract prices were effective in smoothing out highs, peaks and valleys in market prices, and over a period of time achieve prices that were very comparable on balance.

One might ask, when the federal government bailed out the auto industry did they do so at the expense of car buyers? Or when they bailed out the financial industry, was it the borrowers who bore the burden? And even now, as they appropriate $350 million to provide emergency assistance to the dairy farmers, including California farmers we might add, is it at the expense of the next closest link in the chain? No, because preserving the strength of the chain requires spreading the burden across its length rather than risking the breach of one individual link or another.

Understandably, the Department's powers are limited in this regard. There are just so many tools in the toolbox, but is the hammer the appropriate choice when thoughtfulness and precision is preferred? We think not.

For an ailing patient to simply shift the pain from one extremity to another is not a cure, it's a distraction.

Saputo appeals to the Department to come to the aid of the farmers without undermining the integrity of the system or unfairly punishing innocent bystanders. We'll leave it to others to testify in detail about the specific shortcomings of the various proposals that have been submitted. We are of the opinion that those that seek permanent changes to formulas in response to a temporary crisis should be rejected out of hand.

Proposals that have potentially far-reaching consequences deserve scrutiny not afforded by an emergency hearing and should be deferred. Adopting proposals that contrive adjustments aimed solely at causing higher milk prices without economic foundation is ill-advised and unjust. Any token or symbolic gesture on the part of the State would do little to cure the ills of the individual producer, but could have a substantial impact on companies that purchase significant volumes of milk in the State and consequently jeopardize employment.

Therefore, we'd ask that no change be made to the current milk price formulas in response to these proposals. It should be re-emphasized that the regulated price is the minimum price and not necessarily the ultimate price.

Circumstances are already changing in the marketplace; milk supplies are declining and prices are rising.

And I've included a couple of charts showing recent movements in world prices, from USDA Bi-Weekly Reports of both Oceania and Western Europe prices that showed dramatic increases in recent months.

And then following that I included a chart from Rabobank, that forecasts dairy product demands historically and going forward, and they paint a bright, a much brighter future.

If past experience be the guide, well-intentioned attempts by government in manipulating outcomes tend to be enacted at exactly the wrong time and often work counter to the best interest of all involved.

Thank you for your attention and the opportunity to testify on behalf of Saputo. I'll attempt to answer any questions you may have at this time and I also respectfully request that the Department grant a period of time for the filing of post-hearing briefs, if warranted.

HEARING OFFICER HOLLOWAY: Okay, the post-hearing brief, if you do want to submit it, is granted.

MR. DRYER: Thank you.

HEARING OFFICER HOLLOWAY: May I ask, is there any questions from the Panel?

No. Okay, thank you very much.

Next we have is John Bedrosian.

And we have Exhibit Number 65. Thank you.

(Exhibit 65 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Okay, please state your name for the record and spell it?

MR. BEDROSIAN: John Bedrosian, and that's spelled J-o-h-n, the last name is B, like in boy, -e-d-r-o-s-i-a-n. And I'm with Unified Grocers.

HEARING OFFICER HOLLOWAY: Okay, and do you affirm to tell the truth?

MR. BEDROSIAN: Yes, I do.

HEARING OFFICER HOLLOWAY: Thank you, go right ahead.

MR. BEDROSIAN: Good afternoon, I am John Bedrosian, Vice President Marketing Division -- excuse me, Manufacturing Division of Unified Grocers. And I want to thank the Secretary and the Panel for this opportunity to testify and have Unified's comments and opinions considered.

Unified Grocers is a retailer-owned, grocery wholesale co-operative serving supermarket operators located primarily along the west coast. We sell a wide variety of products typically found in supermarkets. Our customers range in size from single store operators to regional supermarket chains.

Unified opened its manufacturing division in September 1974, and it consists of a bakery and dairy manufacturing plants located in Los Angeles, California. I have the responsibility of managing our sales, operations and profitability for our bakery and dairy divisions. Our dairy division processes and distributes fluid milk, Class 1 only, juices and drinking water. Our distribution reaches south from San Diego to just north of Bakersfield.

I am here today in support of Dairy Institute's proposal for a temporary price increase because it provides and adequate -- excuse me, an equitable pricing structure that will not disrupt long-term market fundamentals.

We recognize the great resource we have in our milk supply that is provided by the dairy farmers and their families. We are sympathetic to the financial challenges created by the current cycle of record low prices. Milk price cycles are not unexpected. In fact, the dairy industry has a long history of price cycles. Just five years ago, farm milk and dairy product prices soared to what then were record highs; where they stayed throughout 2004 and 2005. This period of high prices was followed by low prices in 2006. Starting in 2007 and continuing in 2008, record high prices were reached and have been followed by record low farm milk prices seen this past year.

The low prices were the result of several key factors. It is important to note that each of the following factors are interconnected; excess milk supply, consumers are buying less, the current economic downturn greatly affected domestic and global demand for dairy products, and fluid milk consumption remains soft.

I would like to comment on each of the above factors and how they have had an impact on low prices. First, excessive milk supply. Record high prices in 2007 and 2008 encouraged a market incentive to produce more milk and then in late 2008 the economic downturn hit. this downturn had a significant impact on domestic and global demand for dairy products. The domestic demand started to slow down in 2008 and actually decreased in the fourth quarter of 2008 compared to the same period prior year. The basic supply/demand relationship was in turmoil; excessive supply, diminished demand. This trend continued in 2009. All of are aware the supply trend is starting to reverse itself. Through culling efforts, the producers are correcting or balancing the over-supply issue; however, demand is still an issue. Consumers are being diligent in their spending behavior.

The same negative economic forces that impacted our domestic demand had a similar impact on global demand. The global economic downturn is one of the reasons for the decline in milk prices. U.S. milk exports in 2007-2008 were in plentiful supply because of unfavorable weather conditions in countries such as Australia, New Zealand, Argentina and the Ukraine, while some countries placed restrictions on exports to world markets. In 2008, United States exported nearly 10 percent of its milk production on a total solids basis and about half of its nonfat dry milk. However, by the end of December 2008 exports dropped dramatically and were forecasted to decline as much as 25 to 30 percent. Demand dropped worldwide.

Per capita consumption also factors into the supply/demand market fundamental. Annual fluid milk consumption has fallen from 30 gallons per person in the 1970's to just over 20 gallons per person today. Factor in population growth, this means total fluid milk consumption continues to decline. Preliminary data by the Federal Milk Market Administrator office in Kansas shows a total cheese consumption dipping back to 32 pounds per person in 2008, after peaking at 33 pounds in 2007.

With these factors occurring simultaneous, it created a perfect storm resulting in lower farm milk prices, resulting in financial challenges for the producer community.

I would like to note that financial challenges that producers faced, Unified faced somewhat similar challenges. 2009 has been one of our most challenged fiscal years. Given the fact we are a grocery-driven company and people need to eat, our total sales and income were significantly below prior year. I've included a table, an attachment, that illustrates the impact of the economic downturn on food sales. You'll note that these are the major food companies, and also Wal-Mart is included, that shows their most recent quarter sales. The table illustrates that other than Kroeger, everyone had sales below prior year. The consumer buying behavior has changed; they became frugal. Even during 2009, when the retail fluid milk price was as low as $1.99 a gallon, our sales remained below last year. Consumer behavior changed.

Now, I would like to comment how the above factors are starting to make a marketplace correction. Marketing fundamentals do not support prices staying at low levels. As I stated earlier, we are seeing a significant reduction in milk supply. For the July through September quarter California milk production is down 5.2 percent. A reduced supply will support higher prices. We are seeing this trend of higher milk prices; over the last several months Class 1 has increased over $2 a hundredweight.

Another sign of marketplace correction is improving export markets. According to a USDA October Dairy Outlook, economic recovery has exceeded expectations in several countries in recent months, with the result that demand for dairy products has improved. A Rabobank analyst recently noted that developing countries are recovering faster and will be the key source of demand for milk products in 2010. The resumption of global growth would reestablish the foundation for strong world demand for dairy products; a marketplace fundamental that supports higher prices.

These economic fundamentals of supply/demand trends lead me to support Dairy Institute's proposal that for a three-month period beginning January 2010, all classes of milk be increased by 20 cents per hundredweight, subject to a market-price trigger based on the second prior month's Class 4a and Class 4b prices. The 20-cent increase would only be implemented if both prices -- if both the Class 4a and 4b milk prices in the second prior month do not exceed $13 per hundredweight.

I have concerns when one reacts too quickly in making a significant change to complex pricing/marketing provisions. The marketplace and consumer confidence are rebounding; however, it is in a fragile state. Programs that artificially raise milk and dairy product prices will exacerbate market uncertainty and can result in reduced purchases of dairy products. Consumers pay more attention to prices that are going up than prices that are going down.

Because there are host of macroeconomic drivers that can create market uncertainty, consideration of structural or permanent changes in the contest of this hearing could result in major negative, unintended consequences for the California dairy industry. Significant structural or permanent changes need to be fully examined by industry and assistance with the Department. Only temporary changes that do not involve major structural changes to the formulas should be considered.

In conclusion, the Dairy Institute proposal is the only option proposed that is equitable and with a short enough timeframe to limit the negative damage that will result from unilateral State action to increase prices. True price/income relief for producers must come from the market. We need to walk before we run.

Thank you again for your time to listen to my comments and opinions, and respectfully request an opportunity to submit a post-hearing brief.

HEARING OFFICER HOLLOWAY: Your request for a post-hearing brief is granted.

Are there questions from the Panel?

PANEL MEMBER EASTMAN: I have a couple questions for you. On the back page of your testimony you have the table that shows the -- on the same store sales. There's not really any units or title, I'm assuming that is the same store sales for everything purchased in the store, not necessarily dairy products or are these dairy products?

MR. BEDROSIAN: No, you're correct in regards to that, it is to same store food sales.

PANEL MEMBER EASTMAN: It's food sales.

And I don't suppose you have any access to data that shows just dairy product sales?

MR. BEDROSIAN: There's AC Nielson data, but because of the difference in the cost of milk and the retail price of milk from, say, 2009 versus 2008, you really need gallons as a measurement and that information is not available.

PANEL MEMBER EASTMAN: Understandable. And then I have a question, that your testimony shows that you are in support of the Dairy Institute proposal with the trigger mechanism. If, just hypothetically speaking, for the three months in question let's suppose that the 20-cent per hundredweight increase were implemented for all three of the months, how would you think that would affect your operation in terms of competitiveness, sales, things of that nature?

MR. BEDROSIAN: Under the temporary of three months and 20 cents, I believe we would not necessarily have a significant impact.

PANEL MEMBER EASTMAN: Thank you very much.

PANEL MEMBER IKARI: I just have one question. You had asked for a post-hearing brief, could you in your post-hearing brief address the testimony of The Alliance, who mentioned how they arrived at the 50 cents and that it would do no harm in Southern California; could you speak to that point?

MR. BEDROSIAN: I will attempt to do that, yes.

HEARING OFFICER HOLLOWAY: Okay, that's it, thank you very much.

MR. BEDROSIAN: Thank you.

HEARING OFFICER HOLLOWAY: Okay, next on the list is Mike Carpenter. Is he here?

Should I just go to the next person? Mike Carpenter.

Okay, I have Scott Hofferber.

This will be Exhibit Number 66, thank you.

(Exhibit 66 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Go ahead, please, and state your name and spell it for the record?

MR. HOFFERBER: My name is Scott Hofferber, S-c-o-t-t H-o-f-f-e-r-b-e-r.

HEARING OFFICER HOLLOWAY: Thank you. Do you affirm that you will tell the truth and nothing but the truth?

MR. HOFFERBER: I do.

HEARING OFFICER HOLLOWAY: Thank you, go right ahead.

MR. HOFFERBER: Good afternoon Hearing Officer and Members of the Hearing Panel. I am Scott Hofferber, the Controller at Farmdale Creamery, Inc., Farmdale, and I am here at the direction and on the authority of our Board of Directors.

Farmdale is a small, family-owned and operated dairy processing facility in San Bernardino, near the diminished -- this says diminishing, but it's pretty diminished, Chino Dairy Preserve. With 70 employees currently, Farmdale processes around 25 million pounds of milk and cream per month into block jack and cheddar cheeses, sour cream, buttermilk and butter. I am here today to gratefully take advantage of this opportunity to provide

Farmdale's perspective on the matters before the Panel.

Preparation for this presentation was unusually difficult, not only because of the extremely short time available, but also because of the difficulty in finding something of substance in some of the proposals to which an economic argument, for or against, could be attached. The emotion behind these proposals driven by the recent lower market prices is understood, but we would hope the remedy would not be borne by the processor community.

Hopefully, sufficient rational economic evidence will surface during the course of the hearing to afford the Department a foundation form which to build an appropriate conclusion. Our conclusion is that no change to the plan is warranted at this time. Some of our reasons for this conclusion follow.

You are being asked to assimilate and synthesize something reasonable out of two petition, five alternate proposals and a couple of days of testimony all on an expedited basis. A temporary change, even if justifiable, should be the limit of the scope of this emergency process. This has exploded into way too complicated an exercise to expect a fair result for permanent change to the plan.

Secondly, we applaud the producer community for having successfully embraced market mechanics through enacting voluntary supply management programs after years of over-supply conditions. These programs are clearly coming to fruition. Prices are up and holding and the "emergency" is passing. Farmdale has suffered, weather and survived normal business cycles over the years through management of business risk, and we don't understand why we would even be asked to underwrite a down business cycle for the producer community. Proper capitalization of working capital and fixed assets through loans or investment is each individual businesses' responsibility. The capital raised or available should be sufficient to weather down business cycles and adequate amounts should be retained during up cycles to prepare for the next wave. We have enough to do in keeping our own house in order to have to consider underwriting through the stop-gap intervention being explored.

Knowing the recent state of producers' market conditions, we have foregone petitioning for a hearing to implement the 2007 cost-justified make allowance adjustments. The 2008 cost-justified make allowance values are now known and we, of course, desire to see those values incorporated into the formula as soon as possible.

We assumed make allowances were not to be a consideration at this emergency hearing, as has been the Department's prior stance on permanent change derived from emergency hearings. The lag in implementing current cost-justified make allowances, coupled with the fact that we never get to go back and recoup the lost dollars from months where outdated make allowances are used, makes us wonder why some petitions appear to be asking for, nay, believe they are entitled to just that; the recovery of past relatively higher costs of production.

If government was the end-user of the product, such cost-plus thinking might be appropriate, but the market for these products is not one to which we can apply for cost overrun funding. Government is so involved in this pricing system now it makes such thinking tempting, but wholly inappropriate.

I then present a table showing a calculation based on Farmdale's cheese processing volumes that leads to the statement that follows next.

The table above supports a simplistic notion that we are owed just under 2 cents a pound of cheese produced for the last five years based on lagging implementation of cost-justified make allowances.

CDI's alternative proposal advocates making the Class 4a make allowance adjustment only. We, of course, would desire the 4b make allowance be implemented immediately as well. We are now suffering a 1.11 cent per pound disadvantage against the studied costs. However, we agree that make allowance changes, permanent as they are, may better be dealt with in a standard hearing process.

We want to draw a distinction between the producer-owned or controlled process and a non-producer owned or controlled processor, or proprietary processor. Our perception is that proprietary processors bear the entire cost of these sorts of proposals. When a producer-owned or controlled processor pays a higher price to its owner producers there is no economic impact to those owners, it merely shifts economic value from one income statement to another within that producer group.

When a proprietary plant pays into the regulated pricing system as a result of that same change in the system, they drain their income statement and have to go to the market for the offset. If the proprietary processor is able to recover the cost from its customer base, market price increases achieved benefit the producer-owned processor as well as revenue with no associated cost. This seems discriminatory against the proprietary processor.

Alliance of Western Milk Producer's petition, as do all of these proposals, in our opinion, address an emergency that is in its end stages. Supply has adjusted, the market has responded. Let it play out.

CDC's variable make allowance and CDWA's costs of production allowance schemes are untenable on an emergency basis. The emergency will certainly be passed by the time the infrastructure could be reconfigured to accommodate them.

MPC's suggested change to the Class 4b whey factor on a permanent basis is also inappropriate in an emergency situation. In fact, the producer community has benefitted from the 2007 25 cent whey factor adjustment for most of the time since its implementation. Only recently has the whey price risen to a point of "favoring" the processor, if you even accept the notion that 25 cents is the right value. That issue is too complicated to be dealt with here.

Dairy Institute proposes a most modest emergency basis relief plan, but we argue that no change is warranted and the application of any across-the-board price enhancement unfairly impacts Class 4b.

We conclude with our most important argument against change in general at this time by addressing specifically Western United Dairymen's proposed 50 cent a hundredweight across-the-board enhancement. I realize that that's the -- the imposition of that petition has been changed in the hearing, but the point is still made in this argument.

A 50-cent hundredweight translates into roughly 16 cents per 32-pound tub of sour cream in Class 2, or around a one percent price adjustment in the finished product. Our margins in that product class are probably able to absorb that kind of increase in the short term. But, that same 50 cents a hundredweight in Class 4b cheese translates to roughly five cents a pound or around a three and a half percent price adjustment in the finished product. Margins in commodity cheese cannot support such a penalty for any term.

Therefore, the WUD proposed construct of applying a fixed adjustment across all classes is inappropriate. It as -- what does that say? It is clearly a much harder sell to the Class 4b marketplace than to the Class 2 marketplace. Commodity cheeses compete with out-of-state product from Idaho, Washington, New Mexico and elsewhere and a 5-cent-per-pound increase is a deal killer. We do not expect to be able to pass this along to our customers.

With respect for the ability to submit a post-hearing brief, this testimony is -- with our request for the ability to submit a post-hearing brief, this testimony is respectfully submitted, Farmdale Creamery.

HEARING OFFICER HOLLOWAY: Your request is granted for a post-hearing brief.

Do we have any questions from the Panel?

MR. HOFFERBER: Dave's thinking.

HEARING OFFICER HOLLOWAY: Okay, no questions, you may go. Thank you.

MR. HOFFERBER: Thank you.

HEARING OFFICER HOLLOWAY: Okay, next we have Mike

McCully.

This will be Exhibit Number 67. Thank you.

(Exhibit 67 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Okay, we've just received another sheet of witnesses that want to testify. I'd like to right now, we're looking at five after 4:00, I'd like to get anymore that are going to sign up, otherwise we need to decide if we're going to go over today or not.

So anyone who hasn't signed up and do want to speak, please sign up now so that we can decide how much longer the hearing will last today. If not, we might have to do it tomorrow. Okay.

It looks like no one else is signing up, so I'm going to close the signing of anyone else that wants to do anymore testimony.

Okay, Mr. McCully, please state your name for the record and spell it?

MR. MC CULLY: Good afternoon, my name is Mike McCully, M-i-k-e M-c-C-u-l-l-y.

HEARING OFFICER HOLLOWAY: Thank you. And you are representing?

MR. MC CULLY: I'm representing Kraft Foods.

HEARING OFFICER HOLLOWAY: Okay, and do you contest to tell the truth and nothing but the truth?

MR. MC CULLY: I do.

HEARING OFFICER HOLLOWAY: Okay, go right ahead.

MR. MC CULLY: Thank you. Ms. Hearing Officer and Members of the Hearing Panel, my name is Mike McCully; I'm Director of Dairy Procurement at Kraft Foods in Glenview, Illinois, with responsibilities for dairy market analysis, price forecasting, risk management, and dairy policy.

Kraft owns a multi-product dairy plant in Tulare, California. This plant produces parmesan and other Italian cheeses, dry whey powder, and Knudsen cottage cheese and sour cream products. Kraft opposes both petitions from the Alliance of Western Milk Producers and Western United Dairymen, and also opposes the alternate proposals from the california Dairy Campaign and the California Dairy Women's Association, and the 4b or whey portion of the Milk Producers Council alternate proposal. As a member of the Dairy Institute of California, we support their alternate proposal, but note some policy concerns regarding it.

Sine August 2008, the world economy has experienced a crisis unlike any seen for many years. The dairy industry has not been spared from the worldwide recession with the dairy farm sector experiencing sizeable losses as milk prices declined from record highs and input costs remained above average. Before 2009, using the USDA all-milk price as the benchmark, four of the five highest milk price years in history have occurred from 2004 to 2008. As would be expected, U.S. milk supplies responded by growing an average of 2.7 percent per year from 2005 to 2008. This far exceeded the average growth rate of 1.1 percent from 1995 to 2004.

The additional growth was absorbed by new opportunities in the export market. However, the recession has resulted in lower demand across the globe. For the U.S. dairy industry this has meant lower domestic demand, particularly in the food service sector, and the loss of export sales enjoyed over the last several years, all at a time of increasing milk supplies. The resulting imbalance between supply and demand has resulted in low dairy product prices and, therefore, low milk prices.

As in past low milk price cycles, this year has seen constant requests from the dairy producer sector to government to do something to help milk prices. The response from government has been the use of existing programs, such as MILC payments and the support price program, along with the reinstatement of DEIP subsidies, FSA loans, a temporary increase in support prices, and most recently, $350 million in assistance through direct payments and government cheese purchases.

While politically popular, most of these actions did not address the root problem of too much supply when compared to demand. In fact, some have argued these actions could actually increase supplies at a time when they need to decline to bring supply and demand into balance. In short, these actions have attempted to bring short-term relief at the expense of longer-term recovery. The proposals being heard at this hearing suffer from the same problem.

While the first nine months of 2009 have been difficult for the dairy producer sector, the outlook is improving quickly. Grain and energy costs are significantly lower than last year's high, but remain above longer-term averages. In the dairy markets, green shoots are clearly visible. In the U.S., milk futures prices for November and December average over $14.25 a hundredweight and 2010 futures average $15.40, which would be the third highest annual average in history.

Furthermore, global markets have rebounded sharply with Oceania and EU prices trading above current U.S. price levels. Combined with a weaker U.S. dollar, this dynamic should be supportive for U.S. exports and prices going into 2010. Therefore, the Department should refrain from any actions that would jeopardize the ability for California producers to take advantage of this recovery.

The competitiveness of California manufacturers would be negatively impacted by the proposals being considered at this hearing. Since California manufacturers compete both within the state and out-of-state with companies based outside California, an action by the Department to increase raw product costs for California manufacturers would put them at a competitive disadvantage in relation to an out-of-state manufacturer. Additionally, increasing raw product costs will result in higher finished product values. As noted above, with the prospect of increased exports going forward, making California products less competitive in the global market seems to be a poor policy decision. It would be more preferable to allow U.S. and global market prices to lead to higher milk prices for California dairymen.

Kraft is specifically concerned about the impact of these proposals on our Knudsen brand products. While the Knudsen brand has a significant presence in California, the products are also distributed throughout the west and southwest. Once outside California, those products compete with companies that operate in Federal Orders and whose costs are determined by Federal Order Class 2 prices.

For example, a major out-of-state competitor in cottage cheese and sour cream products is Daisy Brand, based in Dallas, Texas. Daisy has been gaining market share both nationally and in California over the past several years. Any action to increase the California Class 2 regulated price would very likely increase the price of the California produced products in relation to Daisy's prices.

How does an action that would decrease demand for California milk, while increasing demand for out-of-state milk benefit California dairy producers? Obviously, it doesn't and those proposals should be rejected for this reason alone.

We believe that Knudsen products are high quality and very competitive in the marketplace. However, an arbitrary action to increase our raw product costs would not only hurt our competitiveness in california, but also in areas outside California where Knudsen products are sold. In order to keep the average price relationship with surrounding states, the Department should reject all proposals that would change these relationships because they are not supported by economic evidence.

To support the dairy industry's growth in California, it is critical that the minimum regulated prices take into consideration the need to ship manufactured products to the population centers in the Midwest and East. Kraft operates four process cheese plants in Minnesota, Missouri, Illinois and Pennsylvania, and partners with co-manufacturers with cut and wrap operations in the central U.S. We evaluate suppliers across the country that can deliver products that meet our specifications and so at a competitive price. As a supplier to these facilities, cheese plants in California require a cost structure that enables them to manufacture cheese, ship it several thousand miles, and be priced competitively with locally produced cheese. Therefore, it is critical to have minimum regulated milk prices that allow for this competition. Any action by the Secretary to increase the regulated milk prices will result in lost sales from California manufacturing plants and in the long-term will negatively impact dairy producers in California.

The Department also needs to consider the changing landscape of milk production across the country. While California milk output is sharply lower this year, milk production in the Midwest is up three to four percent versus last year in Wisconsin, Michigan, and Minnesota. The Midwest is also seeing expansion in manufacturing plants, with the recent cheese plant start-up of Green Meadows in Iowa, and Valley Queen's expansion in South Dakota, and a new butter-powder plant in Michigan.

With increasing milk supplies, more manufacturing capacity, declining milk premiums, and proximity to population centers, the Midwest is reclaiming market share lost to California and other Western states over the last two decades. Therefore, if California is to maintain or improve its competitiveness versus other areas of the country, the State needs to adapt to these new market realities.

The addition of a whey factor to the 4b price formula has a long and contentious history. Before 2003, whey was not included in the price formula for 4b milk. In early 2003, in a period of low milk prices, the whey factor was added to the formula, breaking from long-standing Department position on this issue.

The hearing Panel report noted, "For years, the Department has made policy decisions not to include an explicit pricing component for whey in the Class 4b formula. Based on testimony and relevant data, this position has been reaffirmed at each of the hearings that have been open to recommendations for including a whey pricing component."

After it was added, numerous problems arose. The hearings in 2005, 2006 and 2007 went into detail on the whey manufacturing allowance, CDFA's manufacturing cost survey data, and other whey issues. At each hearing the Panel's recommendation was the same; remove the whey component from the 4b formula.

The hearing Panel's report from February of 2005 detailed the problem.

"As was reported in the January 2003 hearing determinations, the incorporation of a pricing component to the Class 4b pricing formula to reflect

"...the value that cheese operations earn from their skim whey stream has not been easy or straightforward. The skim whey stream has historically been a waste by-product to the cheese making process. As the cheese industry has matured and environmental regulations have become more stringent, the development of whey by-products have become more commonplace by necessity. Still the investments required to process skim whey stream into valued-added products are significant and the financial risks for processing the whey stream into a value-added product are considerable."

The Panel's recommendation was to remove the whey factor in the 4b pricing formula and was concisely summarized as follows:

"The Panel is mindful of using a manageable pricing formula. It seems clear from the positions taken by producer and processor witnesses that incorporating a factor for the value of the whey stream appears to be intractable. Given the testimony and evidence before the Panel, it would be far wiser to simply remove the skim whey factor from the Class 4b pricing formula than to continue to expand this factor in an inconsistent manner with the butter, and nonfat dry milk and Cheddar cheese pricing formulas."

Following the June 2006 hearing, once again, the Panel's recommendation was to remove the whey factor from the formula for the same reasoning as the prior hearing.

"As a result of reviewing the testimony and for reasons outlined above, the Panel continues to support the removal of the whey factor in the 4b pricing formula as it did in the 2005 hearing determinations."

Unlike cheese, butter, and nonfat dry milk, there is not one standard whey product that is appropriate to use in pricing formulas. The Panel's reports from both 2005 and 2006 hearings detailed this problem.

"Whey is one of the biggest reservoirs of food protein and can be made into a wide variety of both food and non-food products. In the food category it can be used in baby food, diet supplements, bakery products, salad dressing, beverages, and confections. It can be made into pharmaceutical products, yeast products, and industrial products.

Unlike Cheddar cheese, butter, and nonfat dry milk which have defined standards of identity and fairly uniform processes, each of these whey usages require their own unique processing equipment, processing procedures, with vastly different associated costs.

While economies of scale are critical in successful whey operations, the Panel is mindful that an inappropriate decision on this factor can inadvertently make a previously profitable whey enterprise a losing proposition should it over stimulate the production of a particular whey product."

An editorial by John Umhoefer, from the Wisconsin Cheese Makers Association in the August 3rd, 2007 Cheese Market News, and that's attached as Appendix 1, provides additional documentation of the problem of attempting to value the whey stream.

Of the 90 plants that replied to the Wisconsin Cheese Makers Association survey, 91 percent did not produce dry whey.

About 42 percent of the plants performed minimal processing and received minimal payment for their product.

Those plants that sold wet, skimmed whey earned 10 to 20 cents a pound in June 2007 compared to the NASS price of 72 cents a pound for dry whey at that time.

Most of the remaining plants, there were 42 of them, performed various combinations of ultrafiltration, reverse osmosis, and/or evaporation to separate whey components and condense whey.

Following the October 2007 hearing, the Secretary appointed a Whey Review Committee with the goal of developing a long-term method that was market-based and would signal a proper value for whey that allows both California producers and processors to earn a favorable return from their investments and enterprise. After six months and numerous meetings, the Whey Review Committee recommended continuing using the fixed whey factor of 25 cents a hundredweight.

I attached the Whey Review Committee report as Appendix 2.

Since mid-2007, whey prices dropped from 70 to 80 cents a pound to below 20 cents a pound. The decision to value the whey stream at 25 cents a hundredweight has benefitted dairy farmers for most of 2008 and 2009 when compared to the prior 4b formula.

The proposal from Milk Producers Council regarding the whey factor in the 4b formula is similar to an alternative examined by the Whey Review Committee. It was soundly rejected at the time and should be again.

The volatility created by past decisions by the Secretary on the whey issue has been detrimental to the development of the cheese manufacturing sector in California. While the 2007 decision did not please all parties, it has resulted in a more stable regulatory environment for valuing a plant's whey stream. If the Secretary once again makes a change to provide a short-term benefit to producers, the longer-term viability of California's cheese manufacturing sector will be threatened.

There is also a point to be made here about the importance of hedging input costs as well as milk prices. While farmers have regularly booked feed in advance, the large majority of farmers have chosen to speculate on their milk price. As long as California's cost of production stayed low, the milk price was usually above it, so farmers profited.

At the October 2008 hearing, I noted there was a risk that milk prices could fall below, possibly fall below the break-even level which, unfortunately, has been the case in 2009.

The solution to the problem is not raising the regulated price. instead, a solution is the development and use of hedging tools for dairymen. A number of us started talking more than ten years ago about the importance of risk management tools, such as forward contracting.

Farmers should ask their co-operatives why they are not offering the opportunity to better manage their milk price income by hedging with forward contracts, futures, options, or other tools.

I've attached a graph from national Milk Producers Federation that shows Class 3 milk futures prices on selected dates in 2008. On June 12, of 2008 milk futures were above $20 a hundredweight every month through 2009. As it turns out, Class 3 milk prices will average about $11.30 for 2009. That dramatic decline of nearly $9 a hundredweight, or 45 percent, could have been hedged with futures or forward contracts.

Other risk management tools are also being developed. One new interesting concept is a margin contract which allows a farmer to essentially set the margin between input cost and the milk price. On the bottom line, this is what really counts. We need to spend more time working to develop these tools.

It should also be noted that when a market is over-supplied, as most segments of the dairy market have been in 2009, sometimes lower and even negative margins at the farm are necessary to bring supply and demand into balance. Once supply is reduced, milk prices and dairy farm revenue will increase. If policymakers step in to provide revenue for dairymen every time costs increase, or every time there is a potential for negative returns, the market would chronically oversupplied and milk prices would remain low.

At the past few hearings, I have spoken about the need for a change to the regulated pricing structure of the California dairy industry. Regulated pricing systems in California, and the Federal Orders, were established many years ago with vastly different market dynamics than exist today. The dairy markets have evolved from local to regional to national to global in nature.

Several years ago dairy farmers, through the California Milk Advisory Board, commissioned a study by McKinsey and Company on the future of the California dairy industry. I strongly believe the industry would be better served focusing on long-term solutions rather than attending hearings for short-term fixes. We should use that study as a basis for developing a regulatory system that best serves the needs of today's dairy industry. I believe the U.S.

dairy industry has the potential to fill the growing world demand for dairy products. With 95 percent of the world's food consumers outside the U.S., the potential market is enormous.

Unfortunately, out-dated regulated systems are holding back the U.S. dairy industry from realizing the full potential of this opportunity. Other countries will eventually grab it if we don't. The time for a change is now.

Kraft has long believed in transitioning to a less restrictive regulatory environment and feel the U.S. dairy industry would benefit greatly from this change. The industry needs to work together to develop a long-term policy approach for the California dairy industry.

Unfortunately, I openly question the desire of California producers and cooperatives to make the necessary changes to meet these new challenges and opportunities. Once again, today's proposals from producers attempt to force the Department to regulate the price of milk instead of the minimum price for milk.

Until the California dairy industry embraces more market-oriented policies, dairy producers will lose out to the opportunities in both the domestic and export markets. The competitive advantage enjoyed by the California dairy industry over the past 25 years is gone. To compete in the marketplace of the future, the California dairy industry needs to adapt to these new realities or lose out.

In summary, I would ask the Department to consider the long-term ramifications of the proposals heard today. If the Secretary feels he must increase regulated prices, then the Dairy Institute proposal is the only one that should be considered.

I thank you for the opportunity to testify here today and would like to file a post-hearing brief, if necessary. I welcome any questions at this time.

HEARING OFFICER HOLLOWAY: Okay, a post-hearing brief, if so submitted is granted.

MR. MC CULLY: Thank you.

HEARING OFFICER HOLLOWAY: Any questions from the Panel?

Okay, no questions. Thank you very much.

MR. MC CULLY: Thank you.

HEARING OFFICER HOLLOWAY: Okay, next we have Patty Stroup.

This will be Exhibit Number 68.

(Exhibit 68 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Okay, please state your name and spell it for the record.

MS. STROUP: Hi, it's Patricia Stroup, S-t-r-o-up.

HEARING OFFICER HOLLOWAY: Okay, and you're representing?

MS. STROUP: I'm representing Nestle today.

HEARING OFFICER HOLLOWAY: All right, thank you.

And do you attest that you will tell the truth and nothing but the truth?

MS. STROUP: I do.

HEARING OFFICER HOLLOWAY: Thank you. Go right ahead.

MS. STROUP: My name is Patricia Stroup, I am the Group Manager for Dairy for Nestle Business Services, NBS, and today I am representing Nestle USA and its division, Dreyer's Grand Ice Cream Holdings.

In my role with NBS, I am responsible for milk and dairy ingredients procurement for Nestle brands in the United States and Canada. This includes procurement relationships with individual dairy farms, co-operatives, and proprietary handlers and manufacturers. I developed today's testimony in cooperation with Nestle staff and present it today with authorization from Nestle executive staff.

Nestle in the United States includes Nestle USA, Nestle Nutrition, Nestle Purina PetCare Company, Nestle Waters North America, and Nestle Professional, and is part of Nestle S.A., the world's largest food company, in Vevey, Switzerland. Together, the U.S. companies employ roughly 42,000 employees, including 9,000 Californians, and operate 82 manufacturing facilities.

Nestle USA is headquartered in Glendale, California and manufactures and distributes a full spectrum of ice cream and frozen dessert products, including Dreyer's, Edy's and Haagen-Dazs brands. Dryer's, itself, has 7,000 employees and operates five manufacturing facilities in Indiana, Maryland, Utah and California.

Nestle USA's primary California operations include its Carnation evaporated milk plant, two Dreyer's and Haagen-Dazs ice cream plants, and a prepared foods factory, along with distribution centers and business offices.

I testify in opposition to the proposals put forth by the Alliance of Western Milk Producers and Western United Dairymen, as well as the alternate proposals offered by California Dairy Campaign and California Dairy Women. There should be no increase in the regulated minimum price levels for any class. The regulated price is the minimum price paid, not the total price paid. The purpose of the regulated price is to accurately reflect underlying commodity values and to maintain the Class 1 price within reasonable relationship to that in surrounding areas. The current milk pricing formulas are already achieving both of those objectives. Nothing has changed those relationships.

Let me be clear that I am sympathetic, even empathetic, to the financial plight of dairy farmers over the last year. I have been a dairy farmer and my family still farms, so I understand the emotional toll that financial stress has placed on many dairymen. Within my career, both as a farmer and as a processor, I have experienced several cycles of negative farm margins, with droves of farmers exiting the business each time. This is not the first, nor is it the worst, of those cycles. Yet, every time they occur, they do exact a heavy toll on the social fabric of our farm communities.

But, this cycle also provides an opportunity. It provides incentive for us to evaluate what happened and see how we can learn from this experience to improve the industry going forward. In retrospect, the current cycle is fairly simple to analyze.

The United States' main dairy competitor stepped out of the market because of drought conditions. That, coupled with a depressed dollar, enabled the U.S. to increase exports of all sorts of dairy products and drove prices across dairy commodities to record highs. Those extraordinary prices, even in the face of higher farm input costs, resulted in hefty profits for dairy farms, so dairymen produced more milk.

While they were investing in more production, manufacturers and consumers began to substitute away from dairy products because of their extremely high cost. And then, the entire economy in the U.S. and around the world began to crumble. So, much of the positive demand response we would have expected from decreasing dairy prices has been thwarted. In response to low prices, dairymen have cut back production and we are now seeing prices rise again in response.

S, how do any of the petitions before us today address any of the issues presented in my simple analysis? They do not. They do not solve weather conditions in New Zealand. They do not change the U.S. monetary policy. They certainly do not help us increase demand. The only thing they attempt to do is to increase milk production by increasing milk prices, yet the market is already taking care of that situation on its own. California milk prices are already up 15 percent versus this year's low. With all dairy commodity prices continuing to rise, milk prices will be up well over 25 percent by year-end, with futures markets indicating that next year we'll be up by more than 50 percent.

"Never give up what you want most for what you want at the moment." That's an aphorism I think of often in my own life and it is one that strikes me as particularly relevant as we all struggle with the current proposals and consider how to best position the California dairy industry to thrive now and in the future.

What we want at the moment is to feel better. We want to turn back the clock and keep dairymen from expanding production in response to the high prices of 2007 and 2008 because that action directly contributed to the ensuing low prices. We want the global economic situation to resolve itself because that is keeping prices down. We all want to not have to struggle to make a profit this year. We want both farmers and consumers to be happy. farmers want the profitability they had two years ago and we want consumers to start buying again. Consumers want to be able to start buying again. The granting of an arbitrary regulated price increase may make some of us feel better and attempt to give us what we want now, although I question that it would even do that. But, satisfying what we want now makes us give up what we want most.

What we want most is to create a vibrant, consumer-responsive dairy industry, one that is able to interpret and even predict what consumers want and delight them by providing innovative, delicious and nutritious foods. One that is able to provide high quality raw materials at reasonable and consistent prices, that consumers will perceive as providing high and enduring value. What we want most is for California to take advantage of its geography and become a consistent and dependable dairy supplier to the U.S. and to the world.

As a buyer and processor of dairy products, I want to have long-term relationships with my suppliers that enable both parties to be creative in production and pricing, to reduce price volatility for both of us, to link dairy producers' abilities to consumer desires, and to provide mutual and sustainable profitability. I want most for my friends and neighbors to reach for products made from dairy, even if they don't know or don't care if it's dairy. Then I will know that we have collectively delighted consumers. Only then will we have achieved what we want most.

Sadly, granting price increases that have no grounding in economic reasoning achieves none of this. In fact, instead of moving us toward consumer delight, it only serves to move us further away. There is no quick fix to periods of negative margin. Those periods eventually reduce the oversupply of milk, which in turn causes market prices to rise and margins to improve. We are seeing this happen right now. markets work, except when outside intervention, such as government interferences, injects artificial factors. Then, the critical link between what consumers desire and what dairymen can produce is broken, and we can no longer progress toward achieving what we want most.

Nothing has changed in the relationship between dairy commodity prices, Federal Order, and California Class prices.

The petition by the Alliance of Western Milk Producers asserts that the State should increase the price of Class 2 and 3 milk. These prices were adjusted last year to more closely align to Federal Order Class II prices, which were reduced after changes in the federal manufacturing allowances. Since that time, nothing has changed. After allowing for the impact of timing, the relationship of the California Class 3 price and Federal Order Class II price is still aligned and still just as intended in lst year's decision.

For many of the same reasons, a cost of production methodology such as that suggested by the California Dairy Women is unwarranted. Because California's minimum prices are set using an end-product pricing formula, fluctuations in farm-level profitability are already accommodated through a reflection of supply and demand in the underlying commodity prices used to set milk class prices. Increasing the price just because we don't like the price level or adding a surcharge to the price creates an unreasonable relationship to the value of the products yielded from such milk. In addition, it would make California uncompetitive with other areas in the United States.

Formula constants, such as the appropriate yields and manufacturing allowances, are debated and set with painstaking care nearly every year so that they accurately reflect the relationship between dairy commodities and the minimum price that is paid for milk going into those commodities. There is nothing in any of the proposals that supports why those relationships should change.

Just because the petitioners do not like the price levels does not change the fact that the minimum milk price generated by dairy commodity markets is being accurately reflected by the current formulas. Milk prices were not low because there is something wrong with the formulas. They were low because there was an oversupply of milk at a time when consumers around the world were not buying it.

If the Secretary decided to impose a surcharge on Class 3 milk in California or to raise the price of Class 3 milk so that it was not aligned with areas outside of California, my recommendation to our production planners would have to be to shift production out of California and on to manufacturing lines in our Federal Order plants.

A 50 cent surcharge, such as that originally proposed by the Western United, would make the regular price of our California milk more expensive -- sorry, would make the regulated price of our California milk more expensive than our Federal Order milk.

The increase proposed by the Alliance also makes California milk much less competitive with Federal Order milk. Given that, by far the majority of our products are exported from California to the rest of the United States, we could not justify spending more for milk here just to pay to ship it to places with less expensive milk.

It has been asserted earlier in the hearing that Classes 1, 2 and 3 don't have to worry about competition with national products. That's entirely untrue. We export 70 percent of our ice cream outside of California, as well as a substantial amount of our Nesquik Class 1 fluid milk.

The six-month duration of the Western United proposed increase would not be helpful. Because of the seasonal nature of ice cream consumption, an ice cream manufacturer's margin is made or lost in the first half of any year, which is precisely when the petition advocates a higher price.

It would be disingenuous of me to suggest that a three-month, 20-cent per hundredweight increase in milk costs, such as that proposed by Dairy Institute, would cause us to immediately relocate production. But in our long-term strategies, such as where to locate production, it adds uncertainty to the mix. We have many plants outside of California where ad hoc government-imposed surcharges are not a threat.

A decision by the Secretary to impose a surcharge would communicate an uncertain regulatory environment, one in which we are not keen to do business and might not be inclined to make further investment. Therefore, decisions made at this hearing are not just for the short-term, but for the long-term as well.

Increases in price do not sit well with consumers already reeling from tough economic conditions.

Last year I testified as to the elasticities of demand for ice cream and the negative net impact on producer pay prices caused by increased Class 3 prices due to decreased demand. Since then, those elasticities have only gotten worse.

Independent research, commissioned by Dreyer's in August of 2009, indicates directionally higher levels of consumer sensitivity to price. An eight percent increase today across the ice cream category would yield up to an 11 percent decrease in sales volume. This is up from a 9.8 percent decrease in volume we observed from studies in 2005. Moreover, Dreyer's heaviest use of dairy is in packaged ice cream, where the volume decrease could be as high as 14 percent for the same eight percent increase in price.

Once again, we found that a reduced volume of purchases of ice cream is not replaced by other dairy products. Our studies of the relationship between ice cream consumption and that of food categories, other food categories, demonstrate that consumers are likely to substitute bakery snacks, cookies and crackers for ice cream. Notably absent from the list of substitute foods are other dairy products. That means that when a consumer decides not to buy ice cream, he is not drinking milk. Instead, he is eating crackers or cookies. There is not much benefit for dairy farmers in that.

So let's figure out what we want most and how to get there. The dairy situation today is much like my 401K. It was my money, I earned it, I invested it, and now much of that equity is gone. I cannot go back and change what happened to it. I can only learn from the market and set myself up so that I am profitable going forward. None of the proposals today achieve those objectives for the California dairy industry. They cannot teach us anything about what happened, nor can they set the industry up to be profitable and sustainable in the future.

I challenge the entire industry, and this includes us, to invest in activities that will provide long-term returns for both producers in California and their customers, rather than focusing on how to maximize the minimum regulated price.

Teach dairy farmers how to use futures markets to mitigate the devastating impact of price volatility. The dairy farmers that I spoke to, that did use futures and forward contracts market last year are not at this hearing, they're enjoying their $20 a hundredweight milk right now. Teach dairy farmers how to use those programs.

Partner with customers and consumers to figure out how to delight them. Remove the interference of price regulation that stifles innovation and allows non-dairy substitutes to win share of stomach while we're busy calculating the Class 4a fat price or arguing over the value of a fluid carrier.

Learn how we can take advantage of California's proximity to ports and how we can parlay that into becoming a profitable world supplier. All of those things and more can help us progress toward what we want most, but none of today's proposals will do that.

Thank you for the privilege of presenting the views of Nestle. I respectfully request the opportunity to file a post-hearing brief, if needed, and welcome any questions.

HEARING OFFICER HOLLOWAY: Thank you. Your post-hearing brief is granted, if you so desire to file one.

Are there any questions from the Panel?

It looks like no. Thank you.

MS. STROUP: Thank you.

HEARING OFFICER HOLLOWAY: Okay, next is John Rossi.

MR. ROSSI: Thank you. My name is John Rossi, that's J-o-h-n R-o-s-s-i, and I'm a hay dealer from Manteca, California.

HEARING OFFICER HOLLOWAY: And you're representing yourself?

MR. ROSSI: Representing myself, and my company, and my customers.

HEARING OFFICER HOLLOWAY: Okay, and do you swear to tell the truth and nothing but the truth?

MR. ROSSI: Yes, I do.

HEARING OFFICER HOLLOWAY: Go right ahead.

MR. ROSSI: This year -- I haven't prepared anything so I'm just going to kind of wing it here, in my own words.

This year we've experienced bankruptcies, at least six of them so far this year. I believe three of them got thrown out of court because they couldn't show they could pay back the bankruptcy, file a plan. But anyway, one of them was Chapter 11, I believe it will get thrown out of court, too, because they can't possibly show they can pay back their creditors. Two of them were Chapter 7s.

Actually, I do finance and, believe me, this year it's been quite discouraging. None of these bankruptcies would have happened this year had the milk price not crashed.

The hay price was up at a right profitable level last year and, of course, when the milk price started to crash, the hay price started to crash right along with it because of the ability to buy the expensive hay that we were selling.

Right now, how I made it through this season here selling the hay, I don't know, but I'm carrying a lot of paper, there's no question about it and I want my customers to be able to pull out of it so they can pay me, naturally.

I believe this winter we're looking at probably a 15 to 20 percent increase in number one hay, and that is because of the weather conditions in Nevada and Oregon that have ruined a good substantial amount of it.

Anyway, in looking over the -- what's happening today, I must commend the processing side for keeping their businesses in such good shape. They've done a great job in marketing our milk and I think maybe at this point they can't afford to give up four bits.

All right. Well, the dairymen need a lot more than four bits, naturally. Mister -- from Genske and Mulder's testimony there, you can see they need quite a bit more than that. I think the government now is giving them $300 million to all the dairymen in the United States.

Well, if it was up to me, the $300 million would just come to California and then they'd have to allocate more for the rest of the states.

Which brings us to the point of in looking over this dairy industry from one end of the United States to the other, I thought that change in it would come from Washington DC. Well, I no longer believe that.

And I no longer believe that because things happen in California that ripple effect going east, it's not east coming back to California.

The four bits they're offering out here I believe is -- well, nobody's going to kick it aside, everybody's going to take the money, there's no question about it. But the request was way to light to make a difference.

And maybe it will put these creameries at an unfair advantage.

But now, before we get going here, I just want to talk about what real power is, and real power is not just the processing side, the real power in America today, I believe, is in this room. It's at this table. It's when each and every one of you sitting right there, you have the power to pull these dairymen out, to save this industry.

I'd say at this point between 95 percent, somewhere in the 95 percentile of all the dairymen of California are on the timeclock right now for filing bankruptcy. This is called -- when you see they're going to bankruptcy and you do nothing about it, that's called railroading, you railroad a business out of business.

I really don't believe, though, in the future that we're going to have that big of a milk shortage, myself, but I do believe that we're going to have fewer and fewer dairymen and family farms that are actually -- that are milking the cows, that are making a living with them.

And I do believe that when we're talking power here, that this committee can make a difference.

Now, I have some recommendations for you. And this can happen today, because I don't believe any of you have to answer to anybody but yourselves here. Right, today my recommendation is to floor the price. It's an emergency situation, you floor the price at $14.50 right here in California.

Now, secondly, I believe that at first when you do this, and this will be a detail there, and the details I don't want to get into that because they will take care of themselves, you're going to get a lot of milk flowing in probably, at first. Well, you're going to need a little tariff on our imports of milk coming into California, without no question about it there.

I also believe that none of the other states will allow California to make more money than them, so as soon as you floor the price, the rest of the states are going to want to have their floor, because all of their dairymen are dying on the vine just like ours, and they're all on the timeclock.

But if you floor it today, there will be bankers at these dairies tomorrow, wanting to do business. And we don't get it, they say the price is going to go up, but I've been hearing that all year long.

You think we're any match? I don't think so. No way.

Just heard from Nestle right there. Oh, I tell you what, you know, what a beautiful lady, I mean the way she talked and brought that all out, everything's fine and we're all behind all the dairymen, too.

But we need help from you guys. You guys are the power and you can do it. You must think outside the box. Four bits is not enough. You go 14.50 for all the milk, no matter what it is, and believe me those people are going to adjust just to that.

It might be a little rough at first, it's been rough at first for all of us this year. It's no big deal. Every day's a new day, you just put your best foot forward and you go for it.

So I'm asking the Panel to floor the price, $14.50. And believe me, and I'll make a wager, you won't be the only one. California will not be the only state. It will hit DC like a tsunami tomorrow.

Any questions?

PANEL MEMBER EASTMAN: I actually have one. I really appreciate your emotion. I was wondering if you would lobby the Governor on my behalf to increase my salary. What you say actually is pretty good.

MR. ROSSI: You floor the price at 14.50 and I'll go see him personally. How's that?

PANEL MEMBER EASTMAN: I'll have to think about that.

That was my only question.

HEARING OFFICER HOLLOWAY: Any other questions?

PANEL MEMBER EASTMAN: No serious questions.

HEARING OFFICER HOLLOWAY: Okay, no serious questions.

Thank you.

MR. ROSSI: Thank you.

HEARING OFFICER HOLLOWAY: We now have David Gilbert to come up.

MR. GILBERT: David Gilbert, D-a-v-i-d G-i-l-b-e-r-t. I'm President and CEO of AL Gilbert Company.

HEARING OFFICER HOLLOWAY: So you're representing the company?

MR. GILBERT: Yes, I am.

HEARING OFFICER HOLLOWAY: Thank you. Would you affirm to tell the truth and nothing but the truth?

MR. GILBERT: I affirm to do that.

HEARING OFFICER HOLLOWAY: Thank you, go right ahead.

MR. GILBERT: AL Gilbert Company is a dairy feed manufacturer operating in Northern California, between Fresno and the upper part of the State.

I came here to listen, to see today, and then I was encouraged to testify and so I'm going to testify.

Our livelihood is based upon the success of the dairy industry. We had representatives here today, we had other feed people here today that had to leave.

Going back historically, our company was very involved in milk pricing, milk pooling. My father was very active. With the division within the industry, we've kind of removed ourselves from some of that, but with the economic conditions the last year, we've gotten involved again.

I went to the USDA Outlook Conference last year in Washington, DC, in February, got up and testified about the disaster we have going on in the California dairy industry, the amount of money that's being lost.

I brought up how can you, as a dairyman, go to the bank and borrow money when you have no income, when you have a negative income? You can't do it, it's impossible. And with the credit situation that this country's in today, there is no money available. I mean, it is a serious condition.

I came to this building in February, with three representatives from the feed industry, myself, Kevin Cruz, of Western Milling, Scott Helman, of JD High School, and James Neto, of Penny Newman. We represent a significant portion of the dairy feed industry in the State.

I met with AJ Yates, and another representative in the Department, and said we have a crisis going on in this industry, in February, and we need some help, we need any kind of help that we can get. The dairymen need the help.

Because what happens when you have a situation like this in the industry going on, the people who get hurt, besides the dairymen, are people like myself. Because there's just not enough money to go around.

Mr. Hoekstra, today, which I've met with in the last month, with my father, to discuss the disaster we've got going on, a two and a half billion dollar loss in this industry. Think about what impact that has upon the State of California.

We have a lot of people that are talking about the potential impact of a 25-cent, or a 50-cent, or a 20-cent increase, but none of those people are talking about the impact that a two and a half billion dollar is in reality today, in our industry. What is the multiplier effect of that?

I can tell you the effect of it in my own company. We have 40 less employees today than we had at the first of the year, 40 less employees. Never, in our life, have we ever had to lay off that amount of people. We let off 24 people last month. Ever.

So the impact of this thing is very real, it is happening now.

And when you hear these producers get up and talk about that we need help now, it's because we really do need it now.

When Mr. Hoekstra talks about it, it's because he sees it every day. Besides the dairymen, he probably sees it better than anyone else because he sees the books.

So I don't come to ask you to do anything specifically, I don't come to speak that I understand the complicated pricing mechanisms that we have. But I do ask is that you do the best you can for the producer because they're the ones who really need it, and you're in a unique position where you can. A lot of us are in a position where we can't do anything, but you guys are in a position where you can do something.

I'd ask that you do the best that you can do for the producer this time around, because this industry needs it. We have not seen anything like this since the fifties. That's what my father says and he's an he's an expert on this. We've been in the dairy business since the fifties. This is the worst.

And the one thing that you guys can do by doing this, that would help our industry tremendously, is put some confidence back in it, because we need some confidence back in it. We need, even if it's 20 or 50 cents, or whatever you can do, it will kind of put some confidence in people like myself, like the dairymen and the bankers. We all need that.

That's all I have to say, thank you. And I just want to say, Madam Chairman, that I want to be able to submit a post-session brief.

HEARING OFFICER HOLLOWAY: It's granted.

MR. GILBERT: Thank you.

HEARING OFFICER HOLLOWAY: Any questions from the Panel?

MR. GILBERT: Thank you.

HEARING OFFICER HOLLOWAY: No questions, thank you.

All right, our last witness, Sue Taylor.

This will be Exhibit 69. Okay, the last exhibit.

(Exhibit 69 was marked for identification and received into evidence.)

HEARING OFFICER HOLLOWAY: Please state your name and spell it for the record?

MS. TAYLOR: My name is Sue Taylor, S-u-e T-a-y-l-o-r.

HEARING OFFICER HOLLOWAY: Thank you. And you are representing?

MS. TAYLOR: Leprino Foods Company.

HEARING OFFICER HOLLOWAY: Okay. And you will affirm to speak the truth and nothing but the truth?

MS. TAYLOR: Yes, I do.

HEARING OFFICER HOLLOWAY: Thank you, go right ahead.

MS. TAYLOR: Thank you. I'm Sue Taylor, Vice President of Dairy Policy and Procurement for Leprino Foods Company. Leprino operates nine mozzarella plants in the United States. Three of these are located in California, two in Lemoore and one in Tracy.

I am testifying today in support of the Dairy Institute of California's alternative proposal, not because I believe that it represents good policy, but with the pragmatic belief that the Department is committed to enhancing producer prices and the belief that the Dairy Institute proposal represents the least damaging approach being considered at this hearing.

I'm also testifying today in opposition to the Alliance of Western Milk Producers, Western United Dairymen, Milk Producers Council, CDI, CDC, and the California Dairy Women's proposals.

The management team of Leprino Foods fully appreciates the stress that dairy producers have been under since prices declined in late 2008. My farm roots and longstanding and deep relationships with many dairy producers highly sensitizes me to the significant erosion n net worth and personal hardship that has been associated with the dairy farm crisis of 2009. However, the leading proposals under consideration today are the kinds of solutions that hinder, rather than contribute to a recovery of market prices to a level that is sustainable for producers and processors.

The poor farm economics of 2009 were created by supply that outstripped demand. Neither side of that equation has been static. Supply increases were propelled by producers who were responding to a period of unprecedented profitability in 2007 and the first half of 2008. We saw demand decline initially in mid-2008 in response to the record high prices. We saw food service operators go bankrupt in the context of record high food costs in a highly competitive environment that constrained their ability to recover those costs. And we saw customers reformulate menu items to reduce the volume of cheese used. This demand destruction in itself was putting downward pressure on prices prior to the broader economic crisis that hit both the domestic and global economies and demand.

The decline in demand associated with reformulations in response to the record-high prices of 2007 and 2008 and the decline in global demand clearly exceeded the supply side's ability to adjust in a short timeframe. I don't think that any policy would have fully mitigated the market response to the diminished demand.

However, I do believe that well-meaning efforts, both by he government and private programs, have led to a slower supply correction and longer duration of pain on the producer side. One analyst coined the term "rolling optimism" for the sense that the markets would recover if a producer could hold on another -- it should be two months. The source of that optimism at times has been that external intervention, whether through the CWT program, price support increase or, most recently, the $350 million that Congress appropriated, would take care of them. Instead, it kept supply in play that would have otherwise exited and prolonged the depressed price period for all. I would categorize CDFA's consideration of an emergency surcharge as having the same potential impact, although muted by its geographic concentration.

The most concrete illustration of the negative market impact of programs intended to help producers is the futures market response to USDA's announcement that it would increase the price supports in early August. Futures market prices into 2010 immediately declined on expectation that the price support increase announcement would further slow the supply correction.

Ultimately, the only sustainable solution to the dairy crises is through a market correction. And that market correction needs to happen nationally because the manufactured dairy markets that dominate the milk utilization in the west and that drive the pricing system are traded competitively nationally.

Any surcharge added to the 4b price is a direct margin transfer from manufacturers to producers. As a marketer of product that compete in the national marketplace, cheesemakers will not be able to recover the increased cost. Although many perceive processors to be the beneficiaries of the current downturn in dairy prices, I can assure you that this is not the case with us. Our returns this fiscal year that ended October 31st are the lowest we've experienced in a very long time.

We support the Dairy Institute proposal, recognizing the extraordinary producer-level stress. This proposal strikes the appropriate balance between the stress and the recognition that the market should and will be the solution. the relief that is provided will be available if the market does not step in to address the situation. No justification exists for the surcharge if the market is addressing it. We're comfortable that, given the production correction that we have seen in recent months, market prices will continue to strengthen. Cheese markets hit $1.57 today and butter and nonfat prices have been climbing rapidly. Feed prices, while still above historic levels, have come down significantly. And international prices have also risen rapidly from their mid-year lows under $1.10, with the midpoint of Oceania cheddar prices now reaching $1.6556, another sign that supply and demand are coming into balance and that it's allowing price recovery globally.

Our opposition to other proposals are both based upon policy concerns and the inappropriateness of considering permanent changes in the pricing formulas in an emergency hearing with such a limited lead time.

Our opposition to the whey proposal by Milk Producers Council and the cost of production proposal by California Dairy Women can be quickly summarized as "asked and answered". The concerns related to the appropriateness of a whey factor when many cheese manufacturers do not have the scale that can justify whey processing are no less relevant today than they were in the last hearing dealing with whey. And cost-of-production based pricing divorces the pricing system from supply and demand dynamics and sets the system up for consistent surpluses in an environment where it would be difficult to attract capital and the burden of processing the milk would be borne by co-operatives.

The Western United proposal is too high and for too long and it's disconnected from the market.

Although we agree with CDI that the 4a and 4b price formulas should be revisited as data becomes available that would support a change, an emergency hearing with a short lead time is not the appropriate contest in which to do it.

The CDC proposal for a variable make allowance also goes well beyond what should be considered on an emergency, short lead time hearing.

In conclusion, while we are sympathetic to the producer hardships that have dominated this year, we believe that the market is providing relief. If the Department chooses to address the situation through a regulated price change, we urge the Department to do so in the measured way that is represented by the Dairy Institute proposal.

This concludes my written testimony. I appreciate the opportunity to provide input to the Department on these very important issues and respectfully request the opportunity to file a post-hearing brief.

HEARING OFFICER HOLLOWAY: Your request is granted.

Are there any questions from the Panel?

PANEL MEMBER EASTMAN: Actually, I do have one, maybe two.

Based on the tone of your testimony, it appears that your initial thought is that there's no change that's needed, but if a change were to be enacted you would support the Dairy Institute proposal; is that a fair assessment?

MS. TAYLOR: Yes, that is.

PANEL MEMBER EASTMAN: And then since they're proposing a 20-cent temporary increase, supposing that were to happen for the three-month period for whatever reason, hypothetically speaking, how do you think that would affect sales, your competitive advantage or disadvantage?

MS. TAYLOR: I won't impact our sales, it impacts our bottom line. We're in the market for the long term and we're going to have to compete and eat that cost.

HEARING OFFICER HOLLOWAY: Okay, thank you very much.

We're going to have a little, short break. Hold on just a minute.

(Off the record.)

HEARING OFFICER HOLLOWAY: Okay, once we -- well, I was going to have this gentleman go first and then, after he's done, I will announce anyone else that would like one last comment or documentation to please do so and then we'll close the record.

Okay, go ahead, please.

PANEL MEMBER FRANCESCONI: Okay, Madam Hearing Officer, we have received a fax to the Department, and I would like to enter that as a letter of support into the -- as an exhibit, Number 70.

HEARING OFFICER HOLLOWAY: Okay, and can you please state your name for the record?

PANEL MEMBER FRANCESCONI: It's Michael Francesconi.

HEARING OFFICER HOLLOWAY: Thank you.

PANEL MEMBER FRANCESCONI: And this exhibit is from Lactalis American Group and Corporation, and it was received November 9th, 2009.

(Exhibit 70 was marked for identification and received in evidence.)

HEARING OFFICER HOLLOWAY: Okay, it's admitted. If I can have it here, I'll stamp it.

Did you want to talk about it?

PANEL MEMBER FRANCESCONI: No.

HEARING OFFICER HOLLOWAY: All right. Okay, go right ahead and introduce yourself?

MR. VAN DAM: Madam Hearing Officer, my name is William C. Van Dam.

HEARING OFFICER HOLLOWAY: Okay.

MR. VAN DAM: The last name's spelled V-a-n D-a-m. And I would like to respectfully request the opportunity to file a post-hearing brief.

HEARING OFFICER HOLLOWAY: You respectfully have it granted.

MR. VAN DAM: Thank you.

HEARING OFFICER HOLLOWAY: You're welcome. That was easy and brief.

Is there anyone else?

All right, at this time I would like to close this hearing. And we have again, I just want to remind everyone that there are post-hearing briefs that will be due at 4:00 p.m. on Thursday, November the 12th, 2009.

And without any additional evidence to be presented, this hearing is now closed. Thank you.

(Thereupon, the November 9, 2009 Hearing of the Department of Food and Agriculture was concluded at 5:07 p.m.)

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CERTIFICATE OF REPORTER

I, RONALD J. PETERS, a Certified Shorthand Reporter of the State of California, and Registered Professional Reporter, do hereby certify:

That I am a disinterested person herein; that the foregoing Department of Food and Agriculture Hearing was recorded under my supervision, transcribed in typewriting, and thereafter personally proofread by me, Ronald J. Peters, a Certified Shorthand Reporter of the State of California.

I further certify that I am not of counsel or attorney for any of the parties in this matter, nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this:

November 18, 2009
Date

RONALD J. PETERS, CSR, RPR, CMRS
Certified Shorthand Reporter
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