



January 4, 2005

Mr. David Ikari, Chief
Dairy Marketing Branch
California Department of Food and Agriculture
560 J Street, Suite 150
Sacramento, CA 95814

RE: Class 2, 3, 4a, and 4b Hearing Proposal

Dear Mr. Ikari:

The attached extracts from the current Stabilization and Marketing Plans for Northern California and Southern California reflect Dairy Institute's proposed amendments to the current Class 2, 3, 4a, and 4b price formulas in the two marketing areas of the state. These proposals respond to the Notice of Public Hearing dated September 22, 2004. The Department of Food and Agriculture called the hearing in response to a petition from Land O' Lakes Cooperative.

Summary of Dairy Institute's Proposals

Dairy Institute's proposed formulas are as follows:

Class 4a

$$\text{Fat} = (\text{CME AA Butter Price} - \$0.0314 - \$0.1321) \times 1.2$$

$$\text{SNF} = (\text{Calf. NFDM Price} - \$0.1551) \times 1.0$$

Class 4b

$$\begin{aligned} \text{Cheese Hundredweight} &= (\text{CME Cheddar Block Price} - 0.0287 - \$0.1734) \times 10.05 \\ &+ (\text{CME AA Butter Price} - \$0.10 - \$0.1321) \times 0.27 \\ &+ (\text{Western Dry Whey Mostly Price} - \$0.2675) \times 5.8 \end{aligned}$$

$$\text{Fat} = (\text{CME AA Butter} - \$0.0314 - \$0.1321) \times 1.2$$

$$\text{SNF} = (\text{Product Value} - (3.67 \times \text{Fat Value})) / 8.75$$

Class 2 and 3

No changes are proposed to the Class 2 or 3 formulas or differentials, although the value of Class 2 and 3 prices will be impacted by the changes to the Class 4a formula.

Our purpose in proposing these changes to the Class 4b and 4a pricing formulas is in line with the objectives which we have stated in previous hearings, namely that make allowances be cost-justified, prices be reflective of what California plants actually receive for the products they produce, and that yields be reflective of what California plants can actually attain. We also recognize that the level of prices established for Class 4a and 4b must result in California's entire milk production being marketed. In recognition of that requirement, we have proposed removing the commodity price floors that were put into the 4a and 4b formulas as a result of the January 2003 hearing. The cost of doing business with the government, which has been discussed at previous hearings, leads to a net effective price received by plants on government sales that is lower than the announced CCC purchase price. Using the CCC purchase price as a floor commodity value in the formulas creates a disincentive for plants to purchase milk when market prices are below CCC support prices.

The proposed formulas incorporate the new Department information regarding relationships between California prices and Chicago Mercantile Exchange (CME) prices for butter and cheddar cheese. With regard to f.o.b. price adjusters, we have used a simple average of the published monthly California and CME price data available from 2001 forward in order to get a more accurate picture of the underlying relationship between California and CME prices. The newest Department data with respect to weighted average manufacturing costs are incorporated in the proposed make allowances in these formulas. The yield for cheese was derived from the Van Slyke cheese yield formula, assuming 2003 average California milk composition of 3.67% fat and 8.75% solids not fat. Otherwise, we have updated the technical factors of the formula to reflect the most current data wherever possible. Thank you for your consideration of our alternative proposal.

Sincerely,

William Schiek
Economist

Proposed Changes to Article III, Section 300.0 of the Stabilization and Marketing Plans for Northern California (Plan 44) and Southern California (Plan 59):

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

- (1) For all milk fat, not less than the price per pound computed by the formula using the butter price, less an f.o.b. California price adjuster of three and ~~thirty-two~~ *fourteen* hundredths cents (~~\$0.0332~~) (*\$0.0314*), less a manufacturing cost allowance of thirteen and ~~two-tenths~~ *twenty-one hundredths* cents (~~\$0.132~~) (*\$0.1321*), and the result multiplied by a yield factor of one and two-tenths (1.2).
- (2) For all milk solids-not-fat, not less than the price per pound computed by the formula using the nonfat dry milk price, less a manufacturing cost allowance of fifteen and *fifty-one hundredths* cents (~~\$0.15~~) (*\$0.1551*), multiplied by a yield factor of one (1.0).
- (3) The butter prices used in calculations pursuant to this Paragraph shall be the ~~higher of the~~ simple average of the Grade AA butter price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month, ~~or the calendar weighted average of the federal support purchase price for butter in effect for the 26th day of the previous month and concluding the 25th day of the current month as announced by the United States Department of Agriculture .~~
- (4) The nonfat dry milk prices used in calculations pursuant to this Paragraph shall be the ~~higher of the~~ weighted average price per pound for all Grade A and extra grade nonfat dry milk for human consumption sold f.o.b. California manufacturing plants for the period beginning the 26th day of the previous month and concluding the 25th day of the current month, as reported by the California Department of Food and Agriculture for the month, ~~or the calendar weighted average of the federal support purchase price for nonfat dry milk in effect for the 26th day of the previous month and concluding the 25th day of the current month as announced by the United States Department of Agriculture .~~

- (5) In the event that the Chicago Mercantile Exchange Grade AA butter price is not available to calculate the current Class 4a fat price, pursuant to Subparagraph (D)(1), then used in its place shall be the Chicago Mercantile Exchange Grade AA butter price used in the prior month's calculation of the Class 4a fat price. ~~In the event that the federal price support purchase price for butter is not available to calculate the current Class 4a fat price, pursuant to Subparagraph (D)(1), then used in its place shall be a value of zero cents (\$0.0000).~~ All other Paragraphs that use the Class 4a fat price shall operate as if the price had been established pursuant to Subparagraph (D)(1).
 - (6) In the event that the California weighted average nonfat dry milk price is not available to calculate the current Class 4a solids-not-fat component price, pursuant to Subparagraph (D)(2), then used in its place shall be the California weighted average nonfat dry milk price used in the prior month's calculation of the Class 4a solids-not-fat price. ~~In the event that the federal price support purchase price for nonfat dry milk is not available to calculate the current Class 4a fat price, pursuant to Subparagraph (D)(2), then used in its place shall be a value of zero cents (\$0.0000).~~ All other Paragraphs that use the Class 4a solids-not-fat price shall operate as if the solids-not-fat price had been established pursuant to Subparagraph (D)(2).
- (B) The minimum prices to be paid for components used for Class 4b shall be computed as follows:
- (1) The Cheese hundredweight price shall be the price per hundredweight computed by the sum of the following:
 - (a) The price per hundredweight computed by the formula using the Cheddar cheese price, less an f.o.b. California price adjuster of *two and eighty-seven hundredths three and twenty one hundredths* cents (*\$0.0287*) (~~\$0.0321~~), less a Cheddar cheese manufacturing cost allowance of seventeen and *thirty-four hundredths five tenths* cents (*\$0.1734*) (~~\$0.175~~), all multiplied by a yield factor of ten and *five hundredths two tenths* (*10.05*) (~~10.2~~).
 - (b) The price per hundredweight computed by the formula using the butter price, less a manufacturing cost allowance of thirteen and *twenty-one hundredths two tenths* cents (*\$0.1321*) (~~\$0.132~~), less ten cents (\$0.10), all multiplied by a yield factor of twenty-seven-hundredths (0.27).
 - (c) The price per hundredweight computed by the formula using the dry whey price, less a manufacturing cost allowance of *twenty-six and seventy-five hundredths seventeen cents* (*\$0.2675*) (~~\$0.17~~), all multiplied by a yield factor of 5.8.

- (2) For all milk fat, not less than the price per pound computed pursuant to Subparagraph (D)(1) of this Section.
- (3) For all milk solids-not-fat, not less than the price per pound computed by the formula using the Cheese hundredweight price established pursuant to Subparagraph (E)(1) less the product of three and ~~sixty-seven~~ ~~seventy-two~~ hundredths (3.67) (~~3.72~~) multiplied by the Class 4b fat price established pursuant to Subparagraph (E)(2), all divided by eight and ~~seventy-five~~ ~~eighty~~ hundredths (8.75) (~~8.80~~).
- (4) The Cheddar cheese prices used in calculations pursuant this Paragraph shall be the ~~higher of the~~ simple average of the 40 pound block Cheddar cheese price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month, ~~or the calendar weighted average of the federal support purchase prices for block Cheddar cheese in effect for the 26th day of the previous month and concluding the 25th day of the current month as announced by the United States Department of Agriculture .~~
- (5) The butter prices used in calculations pursuant this Paragraph shall be the simple average of the Grade AA butter price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.
- (6) The dry whey prices used in calculations pursuant this Paragraph shall be the simple average of the Dry Whey – West Mostly prices as published in Dairy Market News between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.

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