WESTERN UNITED DAIRYMEN

1315 K STREET
MODESTO, CALIFORNIA 95354-0917
TELEPHONE (209) 527-6453
FAX (209) 527-0630

February 18, 2005

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

Re: Dairy Institute Petition

Dear Mr. Secretary:

We once again respectfully request that you deny the Class 1 petition filed by the Dairy Institute of California. Though the justification they provide in this petition is slightly different from the last, it essentially the same, yet masked, argument provided in the last two petitions recently denied by the Department. In their last petition, the Dairy Institute argued, "Because of the disincentives built into the pricing formulas currently employed by the Stabilization and Marketing Plans for Market Milk, California processors actually have an incentive to purchase milk from more competitive sources." Though a different approach is taken in the current petition, this argument is still the core of their concern.

As you will find, California's Class 1 prices are in reasonable relationship to surrounding areas. So really, at issue here is the "incentive to purchase milk from more competitive sources" which is not a direct effect of California's Class 1 prices being too high, but rather the way this more "competitive" milk is handled in the pool. This is a direct link to the current "Hillside-Ponderosa" litigation and the fact that out-of-state milk used for Class 1 purposes is credited at the Class 1 price and therefore essentially exempt from pool obligations. It is this situation, which was actually supported by the Dairy Institute in their filing of an amicus brief in support of the Hillside-Ponderosa plaintiffs against you as Secretary of CDFA, that makes this milk more "competitive," not the fact that California's Class 1 prices are too high.

Also, on a similar note, as you are aware, pursuant to Section 62062.1 of the Food and Agricultural Code, the Secretary may hold a hearing to consider adjustments to the Class 1 price if the statewide weighted average Class 1 price (on milk testing 3.5 fat and 8.7 solids not fat) paid to producers is found to not be in a reasonable relationship with the Class 1 prices paid to producers in contiguous states. We respectfully argue that a Class 1 hearing is not necessary at this time.

A comparison of Class 1 prices in California to that of contiguous orders below shows that California pricing is undoubtedly in a reasonable relationship to surrounding states. In fact, in 4 months during 2004, California's statewide Class 1 average has been equal to or below that of **any surrounding area** prices with an additional 5 months in which only **one surrounding area** (So. Nevada) was below our statewide average. When compared to surrounding orders, California Class 1 averages (Northern, Southern and Statewide) for 2004 are below or are in-line with averages in nearby areas.

Area	12-month Average (Jan 04- Dec 04)
Arizona Central, Phoenix, Tucson	$17.38
Oregon, Western – Medford, Portland	$16.93
Southern CA- Los Angeles	$16.73
California-Statewide Average	$16.59
No. CA – S.F., Nevada, Northwest, Reno, Winnemucca	$16.46
Nevada, Southern – Las Vegas	$16.43

As an additional comparison, the department has in the past released data which compares the Southern California Class 1 price to what would have been in effect if California were a federal order. "Under federal order reform, Class 1 differentials were established for all counties in California. If the differentials for all the counties in Southern California are averaged based on their Class 1 utilization, the resulting weighted average Class 1 differential is approximately $2.07."[1] Though California was exempt from federal reform, if this comparison were to be used as a basis to adjust Class 1 prices in California, it should be noted that, on average, 2004 Southern California prices have been below the price that would have been established under federal reform. In fact, January-December 2004, the Class 1 differential, when compared to the federal order Class 1 base price, averaged approximately $1.68, far below the estimated $2.07 that would be in place under federal orders.

Concern has also been raised in the past by the Dairy Institute over the competition from a nearby producer-distributor (PD) in Arizona capturing the Southern California Class 1 market. We too are concerned about the ability of this PD to undercut California processors to capture market share. However, it should be noted that this producer-distributor is unregulated. There is not a low enough California Class 1 price that can possibly compete with an unregulated processor who is not required to pay any specific price for the milk he acquires. We argue that federal legislation that imposes regulation on this PD is the only way to address this problem and, to this end, Western United Dairymen is lobbying collaboratively with the Dairy Institute to close this federal regulatory loophole. Lowering the California Class 1 price would not have any significant impact.

Furthermore, the Dairy Institute provides two additional arguments as support for lowering the Class 1 price. We would argue that both fall short of providing justification for such action. First, they argue that if "milk production continues to grow at current rates, the supply of milk will exceed the capacity of the state's dairy product plants in the near future." It is highly unlikely that we will see the California dairy industry grow at the same rates in the past as cumbersome environmental regulation will greatly dampen the growth rate of both existing and new dairies. But, even if the same growth rates were realized, we cannot see how lowering the Class 1 price would provide additional plant capacity when there are larger issues (as discussed above) at hand. Secondly, the Dairy Institute argues that "Maintaining high Class 1 prices denies consumers the potential savings in milk costs that could be realized if Class 1 prices were set at economically appropriate levels." While we will not delve into this

---

[1] Memo from Dairy Marketing Branch Dated August 30, 2001 explaining analysis conducted in the May 31, 2001 "Hearing Panel Report."

issue too far, it is easy to point out the growing margins between farm level (Class 1) and retail fluid milk prices to rebut this specious claim. History has proven that retailers do not always respond to a decrease in the Class 1 price by passing savings on to their customers. There is no reason to believe that a decrease in the Class 1 price paid to producers will translate to into any significant savings for consumers. Once again, lowering the California Class 1 price is not the solution to these concerns.

In conclusion, all indications show that prices in California are not only in a reasonable relationship to surrounding states but are, in most instances, below prices in nearby states. Any reduction in Class 1 prices at this time would put producers in California at a disadvantage to producers in surrounding states. Furthermore, lower California Class 1 prices will not address the true concerns behind the Dairy Institute's petition; the competitiveness of out-of-state milk and unregulated producer-distributors.

We greatly appreciate your attention to this matter and are sure you will find that there is no justification for a Class 1 hearing at this time.

Very truly yours,

Michael L. H. Marsh, CPA
Chief Executive Officer

cc: Kim Myrman, Deputy Secretary
Kelly Krug, Director, Marketing Services
David Ikari, Chief, Dairy Marketing Branch
Board of Directors, Western United Dairymen