STATE OF CALIFORNIA

DEPARTMENT OF FOOD AND AGRICULTURE

DAIRY MARKETING BRANCH

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

CALIFORNIA DEPARTMENT OF FOOD & AGRICULTURE

DEPARTMENT AUDITORIUM

1220 N STREET

SACRAMENTO, CALIFORNIA

MONDAY, APRIL 11, 2016

9:00 A.M.

Reported by: Ramona Cota

A P P E A R A N C E S

CDFA Panel

Hyrum Eastman, Dairy Economic Advisor
Division of Marketing Services

Joe Monson, Senior Agricultural Economist
Dairy Marketing Branch

Donald Shippelhoute, Branch Chief
Dairy Marketing Branch

CDFA Staff

John Suther, Hearing Officer
Bureau Chief, Bureau of Livestock Identification

Mike Francesconi, Supervising Auditor
Dairy Marketing Branch

Peter Betschart
Dairy Marketing Branch

Alternative Proposals

Dairy Institute of California
William Schiek, PhD
Patrick Fish, Saputo Foods

Western United Dairymen
Annie AcMoody
Lynne McBride, California Dairy Campaign
Rob Vandenheuvel, Milk Producers Council

Also Present

Barry Murphy
BESTWHEY, LLC

Eric Erba, PhD
California Dairies, Inc.

Joe E. Paris
Gallo Cattle Company LP d.b.a. Joseph Farms Cheese

A P P E A R A N C E S

Also Present

Edward Eddinger
Alouette Cheese USA

Greg Dryer
Saputo Cheese USA Inc.

Elvin Hollon
Dairy Farmers of America, Inc.

Eileen De Raadt
Eden Vale Dairy

Lucas Deniz
Deniz Dairy

Richard Denier
Cal-Denier Dairy

Tom Barcellos
T-Bar Dairy/White Gold Dairy

Emily Rooney
Agricultural Council of California

Jacob Peter Verburg
Verburg & Son Dairy

Leonard Vandenburg
Pacific Gold Milk Products/Pacific Gold Creamery

James De Jong
Hilmar Cheese Company, Inc.

Lynne McBride
California Dairy Campaign

Mac Moore
Cacique, Incorporated

Pete Garbani
Land O'Lakes, Inc.

Joe E. Paris (second appearance)
Rizo Lopez Foods, Inc.

A P P E A R A N C E S

Also Present

Scott Hofferber
Farmdale Creamery, Inc.

Sue M. Taylor
Leprino Foods Company

Rob Vandenheuvel
Milk Producers Council

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P R O C E E D I N G S

9:03 a.m.

HEARING OFFICER SUTHER: May I have your attention?

Before we start this hearing this morning I want to go over a few things that will help ensure that this hearing will be as productive as possible.

First, please turn off your cell phones so that they don't disrupt this hearing.

Second, anyone planning to testify, other than those that submitted alternative proposals, must sign in at the Hearing Witness Roster located in the back of the room.

Third, each person has one opportunity to come forward and provide testimony for up to 20 minutes. If you do not use up all of your allotted time you will not be allowed to come back up again. Witnesses will be called in the order in which they sign up in. The time clock to my right has been established to assist you when testifying. Remember that the testimony you provide for the Hearing Officer and the Panel is entered into the record in its entirety, so you may want to speak to the highlights of your testimony if you think you will run out of time. You will be testifying from the chair with the microphone on the left.

Fourth, if you want to submit an exhibit, please

bring it up to me before you testify.

Fifth, remember that the purpose of this hearing is to take testimony and to gather evidence. It is not to make findings or to render a decision. Therefore, be courteous and respect the hearing process for those testifying and those hearing the testimony.

Sixth, the restrooms are outside of this room. Make a left and they will be on your right.

We will probably break for lunch around 12:00 o'clock and we may take a break depending upon the flow of testimony.

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, April 11th, 2016, beginning at 9:00 a.m. The hearing will continue tomorrow at 9:00 a.m. if necessary.

My name is John Suther. I am a Branch Chief for the Department. I have been designated as the Hearing Officer for today's proceedings. I have no personal interest in the outcome of the hearing and I will not be personally involved in any decision that may result from this hearing.

On March 9th, 2016, the Department called a public hearing on its own motion to consider proposed amendments to

the Stabilization and Marketing Plans for Market Milk for the Northern and Southern California Marketing Areas for the Class 4b pricing formula.

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

Alternative Proposals were submitted by the Dairy Institute of California and the California Dairy Campaign/ Milk Producers Council/Western United Dairymen, a joint proposal. They will each have 30 minutes to submit testimony and relative material to support their proposal, which will be followed by any questions from the Panel.

Anyone who has signed up on the Hearing Witness Roster located in the back of the room will be allowed up to 20 minutes to give testimony and evidence. Please note that only the individuals who have testified under oath during the hearing may request a post-hearing brief to amplify, explain or withdraw their testimony. Only those individuals who have requested a post-hearing brief period may file a post-hearing brief with the Department. Any information submitted after the close of the hearing will not be included in the record for consideration by the Hearing Panel.

Testimony will begin with a representative of the Department who will introduce the Department's exhibits.

The audience may ask questions of the Department's representative only as it relates to the exhibits. This is the only witness that may be questioned by those other than the panel members.

As a courtesy to the panel, the Department staff and the public please speak directly to the issues and avoid personalizing disagreements. Such conduct does not assist the panel and will not be permitted.

Questioning of witnesses other than the Department's representative by anyone other than the members of the panel is not permitted.

The hearing panel has been selected by the Department to hear testimony, receive evidence, question witnesses and make recommendations to the Secretary. This panel is composed of members of the Department's Division of Marketing Services and the Dairy Marketing Branch and includes Don Shippelhoute, Branch Chief, Hyrum Eastman, Dairy Economic Advisor, Joe Monson, Senior Agricultural Economist. Again, I am not a member of the panel and will not be taking part in any discussions relative to the hearing.

The hearing is being recorded by the firm of All American Reporting, Inc. located in Sacramento. A transcript of today's hearing will be available for review at the Marketing Branch Headquarters located in Sacramento

at 2800 Gateway Oaks Drive and on the Department's website following the hearing decision announcement.

Testimony and evidence pertinent to the call of the hearing will now be received. At this time Mike Francesconi, Supervising Auditor with 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 last name for the record.

MR. FRANCESCONI: Thank you, Mr. Hearing Officer. My name is Mike Francesconi and it is spelled F-R-A-N-C-E-S-C-O-N-I.

Whereupon,

MIKE FRANCESCONI

Was duly sworn.

HEARING OFFICER SUTHER: You may proceed.

MR. FRANCESCONI: Mr. Hearing Officer, my name is Mike Francesconi; I am 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 Hearing Exhibits numbered 1 through 35. Relative to these exhibits, previous issues of Exhibits 7 through 35 are also hereby entered by reference.

The exhibits entered here today have been

available for review at the offices of the Dairy Marketing Branch since April 4th, 2016.

An abridged copy of this exhibit is available for inspection at the back of the room at the sign-in desk. At this time I am going to ask that these composite exhibits be received so I will bring these up to you.

HEARING OFFICER SUTHER: Exhibits 1 through 35 are now entered into the record.

(Exhibits 1-35 were entered into the record.)

HEARING OFFICER SUTHER: Are there any questions of the Department's representative?

Seeing none --

MR. FRANCESCONI: Okay. Mr. Hearing Officer, I also request the opportunity to provide a post-hearing brief.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

MR. FRANCESCONI: Okay, thank you.

HEARING OFFICER SUTHER: I will now call the representative testifying on behalf of the alternate proposal submitted by the Dairy Institute of California. You have a total of 30 minutes to submit your testimony. Please notice the time clock on my right.

Please state your full name, spell your last name and state your affiliation for the record, please.

DR. SCHIEK: Yes. My name is William Schiek, that's S-C-H-I-E-K, and I am representing the Dairy Institute of California.

Whereupon,

DR. WILLIAM SCHIEK

Was duly sworn.

HEARING OFFICER SUTHER: Your exhibit that you have given us will be marked as number 36.

(Exhibit 36 was entered into the record.)

HEARING OFFICER SUTHER: Is he going to testify also?

DR. SCHIEK: He is here to answer questions so he may be.

HEARING OFFICER SUTHER: Okay.

MR. FISH: Patrick Fish, F-I-S-H.

Whereupon,

PATRICK FISH

Was duly sworn.

HEARING OFFICER SUTHER: You may proceed.

DR. SCHIEK: Good morning, Mr. Hearing Officer and members of the Hearing Panel:

My name is William Schiek and I am Economist for the Dairy Institute of California and I am testifying today on the Institute's behalf. Dairy Institute is a trade association representing 27 dairy companies which process

approximately 67 percent of the state's fluid milk, manufacture about 90 percent of the state's cheese and a large majority of its cultured dairy products and ice cream. Dairy Institute's members operate in both marketing areas in the state. The position presented at this hearing was adopted unanimously by our Board of Directors. With me today is Mr. Patrick Fish of Saputo Foods - Saputo Cheese. Mr. Fish is highly knowledgeable about liquid whey markets in the Midwest and will be available to answer any questions from the panel related to whey processing and whey procurement.

In authorizing the state's dairy regulatory programs the legislature has declared that: "it is the policy of this state to promote, foster, and encourage the intelligent production and orderly marketing of commodities necessary to its citizens, including market milk, and to eliminate economic waste, destructive trade practices, and improper accounting for market milk purchased from producers." Indeed, orderly marketing is the stated purpose of most dairy regulation. The level of regulated price plays a key role in maintaining an orderly market.

To establish regulated prices so that milk production and marketing are orderly, it is important that the Department balance the needs of producers, dairy product processors and manufacturers, and consumers, not favoring

one group's need over the others. Producers are not ultimately helped when the Department sets prices so high that consumer demand is negatively impacted and investment in new plant capacity, technology and market development is stifled. It is not in producers' collective interest if the Department sets prices for milk so high that it forces cheese plants out of business by requiring them to pay more for milk than they can obtain in revenue from the products they sell after paying necessary manufacturing and marketing costs.

Sadly, the proposal by the three producer trade associations, Western United Dairymen, Milk Producers Council and California Dairy Campaign, under consideration here today, would do just that. Under their proposal, cheese plants would be forced out of business. It would reduce not only the number of milk buyers in the state but also the overall plant capacity in the state, shrinking the size of the California milk market and leaving dairy producers with fewer homes for their milk. Their proposal would devastate the cheese industry in the state and would violate the directives to the Secretary set forth by the legislature in the state's Food and Agricultural Code. More detail on the legislature's requirements of the Secretary in setting regulated minimum milk prices and the government's appropriate role in milk pricing is contained in Appendix A.

Dairy Institute's members are acutely aware that milk production in California has declined from the all-time high recorded in 2014, falling by an average of 3.4 percent for calendar year 2015, and 2.8 percent on a daily basis during the first two months of 2016. The extended period of globally lower milk prices has taken a toll on producers just as lower dairy product prices have negatively impacted dairy product manufacturers. In addition, dairy product processors and manufacturers have been facing increased costs for environmental permits, cap and trade credits, discharge permits, storm water permits and air emissions permits for some time. No doubt producers have faced increased regulatory costs as well.

But the key underlying problem facing our industry today is an imbalance in the global supply and demand for dairy products, caused by strong milk production growth in Europe and in parts of the US, such as Wisconsin, large inventories of dairy products, weak growth in key demand regions such as China, and overall weakness in the oil markets that makes other key importing countries less able to buy dairy products. This supply/demand situation cannot be amended by shrinking the margins of cheese plants in the state to the point where they can no longer operate profitably, a solution sought by the producer trade associations. Regulated price increases are neither

appropriate nor effective as a tool for changing the fundamental economics of the marketplace. CDFA cannot simply make milk worth more by declaring that it is worth more. At the end of the day, the market must determine what milk is worth. What good is it to try to alleviate the consequences of the global supply/demand imbalance by adopting a supposed "solution" that will make markets for California dairymen's milk disappear?

Increasing the regulated 4b milk price in California will not cause dairy farmers in Europe to make less milk, but it will lead to lost cheese sales in international markets as the state's cheesemakers become less competitive relative to their counterparts in other parts of the world. Increasing the California regulated price will not make Wisconsin's producers cut back on milk production, but it will cause California cheesemakers to lose sales to those in the Badger state. China's demand for dairy products will not be improved by raising the Class 4b price, but it will ensure that other cheese suppliers will gain an advantage at taking the Chinese business of California cheesemakers. Finally, increasing the regulated price here will not lead to a rebound in the oil market, but it will mean that other suppliers will have a better chance at providing the cheese purchased by countries that are dependant on oil exports.

There has been repeated argument by producer representatives at past hearings that they are entitled to the Class III whey value simply because that price exists in another market and fairness demands that they receive it too. It is certainly understandable in a time of low milk prices that producers will look for ways to increase their milk price. Unfortunately, the notion that it is desirable to have parity with FMMO prices is misguided and not founded on sound economic principles. The bottom line is that the California and Federal Order markets are quite different. What follows is a summary of some of those key differences:

In no existing area covered by a Federal Milk Marketing Order does USDA require all cheesemakers to pay the Class III price. Non-pool plants are not obligated to pay minimum prices on milk purchases or on milk that is diverted to their plants. The claim that California dairy farmers, operating in a system where all Grade A milk must be paid at least the CDFA announced minimum price, should receive the same regulated price as FMMO producers operating under voluntary regulatory system, does not hold up under scrutiny.

Today, spot milk sales to cheese plants in federally regulated areas of the Midwest are being made at prices below Class III. That fact is never part of the so-called "California Discount" discussion. California

processors, however, never pay less than the Class 4b price for market-grade milk. A review of the 2014-16 *Dairy Market News* publications show that spot milk was available to cheese plants in the Midwest at below class prices for virtually every week from late November 2014 through July 2015 and again from mid-November 2015 through the most recent week ending April 8th. See appendix B. Clearly, this ongoing below-class sales activity involves much more than just holiday and spring flush milk handling issues. Much like the P-D advantage that some Class I handlers in California have, this price advantage on spot milk is something that Midwest cheesemakers can use to garner incremental business and become more competitive overall in the marketplace.

California's binding minimum price regulations limit competition across manufacturers. That has led to adequate supplies of milk, limiting pressure for increased premiums.

In the Midwest, particularly Wisconsin, there are many specialty, value-added cheese plants, which generate more revenue than commodity products. California's largely commodity cheese plants were built to accommodate our large milk volume and historically rapid milk production growth; those commodity products generate lower unit revenue.

Midwestern cheese plants are half a continent

closer to our domestic market. California is the most distant dairy region from domestic cheese markets. It costs money to move product to market.

"The California Discount" charge makes an easy target of our state's regulated system, but the differences between our industry and those of other major cheese producing states require that milk prices be lower in California. The differences in milk value between California and the Federal Orders are discussed in more detail in Appendix C.

At previous hearings we have testified at length about the problems associated with incorporating an end-product whey factor into the regulated pricing formula. Some of those arguments are repeated here: most cheese plants receive no revenue for the whey byproduct of their cheesemaking operations, about half of those that do receive some revenue receive less than is assumed in the Class 4b formula, and the revenue streams of plants that do capture value from whey find their revenue does not track well with dry whey, and only one plant in the state is consistently making dry whey. More on the problems associated with the inclusion of whey in the Class 4b and Federal Class III formulas is contained in Appendix D.

Both the Department's current temporary whey scale and the FMMO Class III other solids formula establish a

value for milk based on the cheese plant converting the whey stream byproduct into dry whey. The problem with this formula construction is that for a plant that does not manufacture dry whey, its revenues do not match up with a milk cost that is in part driven by movements in dry whey prices. Some plants make other finished whey products that, at times, allow them to capture enough revenues to compensate for the fact that they do not manufacture dry whey. However, as the testimony of Mr. Barry Murphy at last June's 4b hearing indicated, there are many cheese plants in California that cannot capture revenues to offset their increased milk cost. For cheesemakers that do not have finished whey operations, margins can become compressed and their financial viability threatened.

Investment costs to make finished whey products - that is dry whey, WPC or WPI - are very high and a majority of plants do not have enough volume to justify the investment. There are plants that cannot make finished product and which instead are selling liquid whey to others who make the finished product. The value of this sale would be more appropriate for a pricing formula because it is closer to a value that all plants can achieve. The value of the whey contribution should be capped because there will be many cheese plants that cannot find any viable market outlet for their whey and they will capture no value from their

whey stream.

Generally speaking, end-product pricing for milk attempts to represent a market value for milk by capturing the value of the basic commodities that can be produced from milk, less their make cost plus a reasonable return on investment to processors. For cheddar cheese, those factors are reasonably well known. The byproduct from cheese production is whey and the value of whey to a cheesemaker is much more difficult to establish. Historically, the baseline product that has been chosen to represent the value of whey in both California Class 4b and the Federal Milk Marketing Order Class III other solids price formulas has been dry whey. It is thought by some to be the lowest common denominator among the wide array of products that can be derived from whey solids. The costs for drying dilute liquid whey containing approximately 6 percent solids have been debated and surveyed and have been used in both California and FMMO regulated pricing. The experience from recent years, however, has shown that dry whey prices are volatile and not necessarily indicative of whey's value to cheesemakers or of industry trends.

In order to capture value for whey it must be dried in some form by someone. That gives it the ability to be stored and shipped at a reasonable cost. The place to start in establishing whey's value to a cheesemaker, then,

is with a finished product in dry form and work backwards from there. The question is which product is the most representative indicator of the whey value to a typical cheesemaker. USDA reports information on Dry Whey, Whey Protein Concentrates and Whey Protein Isolates in its Dairy Products annual summary. They Whey Protein Concentrates are in two categories: 25 to 49.9 percent protein and 50 to 89.9 percent protein. Whey Protein Isolates contain no less than 90 percent protein. In the US just 5 percent of cheese plants produce dry whey.

Cheese whey is approximately 6 percent solids. About 12 percent of the solids are protein and 88 percent are other solids, primarily lactose. As measured by protein content, which is the most valuable whey component, more than three times the amount of US dried products is in the form of WPC/WPI rather than dry whey. Over the past eight years, production of dry whey has been declining while production of Whey Protein Concentrates and Isolates has been increasing. Growth rates over that time based on production data contained in USDA's Dairy Products annual summary for the various categories are as follows:

And this is the growth rate for these products from 2006 to 2014: WPC25 to WPC49.9 has had a growth rate of 1.1 percent. I believe that's an annual, a compound annual growth rate. WPC50 to 89.9 has had a growth rate of

8.3 percent, WPI, 9.5 percent; and then aggregating all types of WPC and WPI, a positive 6.1 percent. Dry whey has had a growth rate of -3.3 percent.

The difference in prices on a per-pound of protein basis between dry whey and WPC34 has been extremely volatile over the past eight years. You can see Figure D-2 in Appendix D. A cheesemaker whose whey revenue is derived from the market for WPC34 while the milk price is tied to the market for Dry Whey has likely experienced margin squeezes over that time, which periodically has been dramatic.

The whey business is a completely different line of business from the cheese business. The equipment is different, the technology is different, the target market is different, the sales and marketing effort is different and the products are different. Dry whey and WPC are nutritional ingredient products utilized in a wide range of ancillary products, both human and animal. Cheese, on the other hand, can be an ingredient product, but the product made by most cheese plants is more likely a consumer product either at a retail or a food service level. It is judged on the basis of flavor, texture, aroma, packaging and perhaps performance in its intended use. For many cheesemakers, making cheese is an art. Whey processing is looked upon more as a science. The capital cost required for a whey

processing and drying plant is often larger than that of a comparable cheese plant. To justify that size of investment a whey processor typically requires a substantial volume of resident whey, which may or may not be supplemented by additional sources of external whey. That scale requirement rules out the vast majority of cheese plants in the country. Despite that fact, the current milk pricing system encourages cheesemakers to venture into that line of business in which they may have little interest, no proficiency and no passion to pursue.

In 2012 a survey of all 121 Wisconsin cheese plants, which is shown as Appendix E, conducted by the Wisconsin Agricultural Statistics Service in cooperation with the Wisconsin Department of Agriculture, Trade and Consumer Protection, found that 80 percent of all respondents either did not process or did limited processing of the whey they generated. Only 20 percent produced some form of value-added dried product. Limited processing results in some degree of liquid product transport savings. Those savings are required to be retained by the cheese plant to justify the investment in processing equipment and cover the cost of labor and operating expense to perform the processing. Operating expenses include utilities, waste treatment equipment cleaning and maintenance along with depreciation, interest, insurance, taxes and the like. The

limited processing performed by smaller cheese operations is often of negligible value to whey processing facilities that dry the whey products and have extra capacity to purchase outside whey. The value of limited processing lies almost exclusively in the concentration of solids and the resulting savings in freight expense.

In California, according to recent testimony, only one plant dries whey on a consistent basis. Only 12 of the 59 California cheese plants, that's only 20.3 percent, process whey in any fashion. Most plants in the state receive no value for the whey from their operation or the value is less than the cost of recovery and transportation.

The proposed whey formula that we submitted to CDFA in June 2015 was meant to represent the value to a cheesemaker of selling liquid WPC to a plant that would then make the liquid product into a finished dry product. Since that time, we have been able to gather additional information on the market for liquid whey being sold by cheese plants and have found that there are a great variety of different forms of liquid whey being marketed, ranging from dilute whey to liquid WPC in higher protein concentrations. While there is variation in the products being marketed, the concept of adapting a formula that represents a liquid whey value, rather than a finished dry whey value, is one that we feel is appropriate.

The milk price should reflect what the cheesemaker can earn by selling his wet separated whey f.o.b. at his cheese plant. The likely buyer is someone devoted to the whey processing business that has extra capacity and lies within a reasonable distance. Ideally, an ongoing survey of prices on a pound of protein basis, for which cheese plants sell the liquid whey to other plants for further processing, should be the basis for establishing the other solids value for milk used to make cheese because it more accurately reflects returns achievable by a greater number of plants. Unfortunately, no such ongoing survey of liquid whey prices exists.

Instead, the value of whey in the Class 4b formula should be a function of the WPC34 market because that is the predominant buying scheme for liquid whey. Whey processors are interested primarily in the protein portion of the whey. The lactose or permeate portion or permeate portion represents a disposal problem by most cheesemakers and is unlikely to be compensated for by a whey processor. By utilizing a WPC34 reference price and converting it to a dry whey equivalent basis, many of the current factors and structure used in the whey contribution pricing methodology can be retained. The costs for drying whey have been surveyed and a dry whey manufacturing allowance, albeit one that is outdated, is used in the current FMMO Class III

formula. The costs for producing WPC34 are not known and we know of no publicly available data of these costs. A dry whey equivalent WPC34 price can be calculated by first dividing the WPC34 price by 0.34, which would express that price on a pound of protein basis. This resulting price would then be multiplied by 0.12, the assumed proportion of dry whey that is protein, too complete the conversion.

The Class 4b whey factor would be based on the dry whey equivalent WPC34 price, less the make allowance, less a factor to represent the cost of cooling the whey and delivering it to a nearby whey processing facility. The proposed make allowance is the current California NFDM weighted average manufacturing cost plus the difference between the current FMMO Class III dry whey make allowance over the current FMMO Class IV NFDM make allowance. This calculation is done to update the FMMO dry whey manufacturing cost allowance to be more reflective of current California costs. The transportation cost allowed is for a distance of 50 miles at $3.00 per mile on 6 percent whey or $0.05 per pound of whey solids. An allowance of $0.03 per pound of whey solids is provided to compensate for the cost of cooling the whey. Because the price does not serve to protect small cheesemakers when the WPC34 price is very high, nor dairy producers when the price is low, a floor price of $0.25 per hundredweight and a ceiling of

$1.50 per hundredweight are proposed. The formula has been rendered as a whey contribution scale based on the WPC34 price that would serve as part of the cheese hundredweight price calculation as follows. Items that have changed relative to the current formula are highlighted in what follows and you can see there is the new whey table based on ranges of the WPC34 price with the corresponding whey contribution to the Class 4b price on a per hundredweight basis.

And the remainder of the formula, the Fat price is calculated the same way as it currently is and then taking the cheese hundredweight price and converting that into a Solids-Not-Fat is also done the same way it currently is done. And we have also included the formula form of what generated these numbers in the whey table and that formula is listed on the bottom of page 8.

The whey price series used in the proposed formula would be the simple average of the weekly Central and West 34 percent Whey Protein Concentrate-Mostly prices as published in USDA's *Dairy Market News* between the 26th of the prior month and the 25th of the current month.

The changes are proposed to make the Class 4b pricing formula better reflect the current market situation and to balance the needs of producers and the diverse types of cheese plants that operate in the state of California.

It is reflective of the value of whey to cheesemakers that concentrate liquid whey and sell it to other plants for further processing and is therefore more appropriate for inclusion in an end-product formula designed to calculate minimum regulated prices for milk. This approach is in keeping with the concept of minimum regulated prices, those that reflect revenues that can be recovered by most cheese plants. It should be noted that such a scale still runs the risk of over-valuing milk to small plants that are unable to make anything saleable with their liquid whey byproduct. It is important, therefore, to have an upper limit or cap on the whey contribution that will keep smaller plants from being severely impacted when market conditions drive WPC34 prices to high levels.

Dairy Institute makes no specific proposal regarding the extension of the temporary whey scale contained in Article III, Section 300, subparagraph (E)(1)(c)(i) of the Stabilization and Marketing Plans, but requests that any extension of the temporary whey scale not exceed a term of six months following the date that the temporary whey scale is currently set to expire.

Other proposals.

Dairy Institute opposes the Western United/Milk Producers Council and CDC proposal. Their proposal is highly similar to ones that have been proposed at the past

several hearings and rejected by the Department and there is no new compelling evidence to support its adoption. It increases regulated prices on cheesemakers by too much, so that they cannot operate profitably. It is not representative of whey products made in California, is completely ad hoc for this market and is not supported by evidence of it being representative or applicable to any group of cheesemakers in the state. Its adoption will reduce demand for milk in the state while promoting increased supply, leading to uneconomic movements of milk and disorderly marketing as was the case in 2007-2008 and again in 2012. It should be rejected.

Any extension of the current temporary whey scale should be limited to six months. CDFA should adopt the permanent whey scale proposed by Dairy Institute as it more accurately reflects whey value to cheesemakers. Finally, this is yet another of several hearings that CDFA has held since 2011 to focus specifically on the whey factor, a part of the formula about which there is relatively little objective public data to support what the whey contribution should be. At the same time, the Department has failed to call any hearings in recent years to address needed changes to make allowances, where the Department's own data indicates that changes are clearly warranted. We continue to wonder about the validity of continuing to focus on only

one part of the formula for one class of milk when CDFA data clearly indicates that a more comprehensive review is necessary. Thank you for the opportunity to testify and we respectfully request the opportunity to file a post-hearing brief and we are willing to answer any questions the panel may have at this time.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

Questions from the panel?

MR. EASTMAN: All right, I have a few questions. To start off I want to walk really quickly through your appendices just to make sure that I understand them first.

The table at the end of Appendix A is sort of an estimate of plant capacity, which you have submitted frequently, and I assume the way you've estimated that is the same as you've done at previous hearings?

DR. SCHIEK: It is, it's just an extension.

MR. EASTMAN: Okay. And then in Appendix D on page 4 you have Figure D-1. I'm assuming that based on the formula within the scope of your testimony you're assuming dry whey has a 12 percent protein content. Is that how you?

DR. SCHIEK: Figure D-1 I think came from work that CDFA staff did to support the Whey Review Committee so I am not positive whether -- I'd have to go back and look and I can put that in a -- clarify that in a post-hearing

brief in terms of what the assumption was. I believe, though, we've assumed 12 percent. I think in Figure D-2 that was the assumption.

MR. EASTMAN: Okay, you're right. Now that I look at that, that does end at 2007 but you've sort of extended it beyond that on the next figure, okay. Perfect.

And then at the end of Appendix D, that looks like just a copy of what the Department had released in its exhibit, you didn't change that or alter that.

DR. SCHIEK: Correct.

MR. EASTMAN: Okay.

DR. SCHIEK: That's directly from the Department exhibit.

MR. EASTMAN: Okay, perfect. And I just have a few questions. On page 1 of your testimony you talk about the promotion, fostering and encouragement of the intelligent production and orderly marketing of milk and I'm sure that at the hearing there will be further references to the declining year-over-year milk production that the state has been experiencing. Do you feel that we are currently at a spot where there is disorderly marketing of milk or where would -- in your mind what would be the signals or signs that the state would be experiencing disorderly marketing conditions?

DR. SCHIEK: Yes, declining milk production is

something that I do believe we need to keep an eye on. We haven't heard any reports from our members that they haven't been able to get milk at this point. You know, in some cases there have been, I guess, reports in the marketplace that premiums are moving higher but we kind of feel that that's part of the natural functioning of the marketplace. That if milk supply is declining and people do need milk premiums come forward to bring forth the supply and get the supplies that plants need.

So, you know, I think we are not seeing necessarily any disorderly marketing at this time. At least I have not heard any reports from members and we do have discussions; I have discussions individually with members on this issue. But it's something we're watching. You know, I think if it gets to a point where plants can't get milk, you know, that could be considered a disorderly marketing condition, particularly if Class I plants are having trouble getting milk. But my view is that the premiums will kick in before we get to that point to make sure that doesn't happen; there will be competitive premiums in the marketplace.

And, you know, the other aspect of that is, you know, what's the solution to that? I think the issue here is we are in a situation of this global supply and demand imbalance that I talked about and that's driven prices lower

all over and causing stress all over and eventually that's going to correct itself.

MR. EASTMAN: And Mr. Fish, if you want to expand or jump in feel free. I'm just going to ask questions so if you want to --

MR. FISH: No, I'm fine. I can speak to any whey questions if they arise.

MR. EASTMAN: So I'll let you jump in if you feel you need to, okay, great.

When it comes to the construct of the table based on the formula and the assumptions that you had given. You had mentioned that there is no publicly released data that shows the costs associated with producing WPC34. So the factors that you've included in your formula, have those been just based on discussions with your members or how did you arrive at some of those figures for those factors, per se?

DR. SCHIEK: Okay. The formula itself, by converting to the dry whey equivalent we are trying to get around the whole idea of having to come up with a WPC34 yield and cost data that is actual plant data. There is some theoretical information out there from equipment manufacturers and we've, you know, we tried putting something together last year for the hearing that kind of dealt specifically with that data. But most of the real

world data on that is proprietary so it's just not available. So the reason to put it on a dry whey equivalent was to use some of the dry whey data.

So just to walk you through kind of what we did is, you're going to have some kind of a make allowance to make a dried product. Because if I'm a buyer -- I should let Pat chime in -- if you're a buyer of liquid whey, somebody is going to -- you're going to incur that cost, you're incur a drying cost. And so that has to be paid and that would go into what somebody buying liquid whey would be able to pay for that liquid whey. But I am going to let you take over that and kind of walk through what a buyer looks at.

MR. FISH: Unfortunately, whether we're speaking about California or Wisconsin, not all the cheese is made under one roof. Plants that lie outside of a common whey processing facility have to get the whey -- to extract some value you have to get that whey moved to a central whey processing plant. So it costs the -- there are costs involved, both to transport the whey and cool the whey to maintain food grade integrity. So I think the formula is constructed such that these costs need to be taken into account when deriving the total cost of drying whey.

MR. EASTMAN: Okay.

DR. SCHIEK: So getting back. We talked about

there's sort of three components in that sort of manufacturing allowance number. One is to try to get at a current dry whey manufacturing cost. We haven't had a survey for quite a number of years here in California and there weren't that many plants in the survey to begin with. The last survey that was done that was used in the Federal Order system to update their dry whey make allowance was, I think, based on 2005 data so it's pretty old at this point. I think we could all agree costs have probably changed in 10, 11 years.

So the idea was to use a -- look at the incremental cost of drying whey over nonfat dry milk by looking at the two federal make allowances, the federal make allowance for nonfat dry milk and the federal make allowance for dry whey. Taking that increment and adding it to a relatively current California nonfat dry milk make allowance cost and that gives you kind of an updated dry whey cost.

Then added to that would be the additional costs associated with liquid whey, a liquid whey marketer, which is the transport cost. We're looking at about a 50 mile transport which is, you know, probably doable in Wisconsin but that would be unusual that it would be that small in California, so it's a fairly conservative transportation cost number based on - what did we say - $3 a load or something like that. Looking at the $3 a load in the solids

content of the whey.

The other thing that has to be done, and Pat can talk more about this, is that there is a need to cool the whey if you're going to move it any distance. You might want to -- did you go into that already?

MR. FISH: Just the fact that, you know, the majority of the whey is sold into the food grade markets and the whey has to be kept under certain temperatures to be able to maintain food grade status.

DR. SCHIEK: And I think we put those costs in the body of the discussion.

MR. EASTMAN: Okay, perfect. And then towards the end of the formula it looks like you're using conversion factors that appear in the Federal Order Class III formula with regards to once you get that other solids price, to convert it then into a skin and then sort of a solids-not-fat.

DR. SCHIEK: Right. And that last term with 8.8/8.7 is to kind of put it back into our methodology so that it fits in with how we calculate those prices.

MR. EASTMAN: Right. Okay, those did look familiar. Okay, good.

Another question I had I had is associated with the whey and that is that one of the weaknesses in your testimony of using dry whey as the commodity series to

establish a dry whey value is the idea that in California there's not a lot of plants that make it. You mention that for plants that at least are moving the liquid whey portion there is a relationship with the WPC34 price. And I assume, obviously, a plant making WPC34 in its dry form, there is going to be obviously a relationship there. The question I have is, once a plant were to move past making WPC34 and to maybe a WPC of a higher protein content or even an isolate, how relatable is that sort of pricing of that product or the manufacturing experience from a cost standpoint of making one of the higher whey protein prices compared to WPC34? Those plants that make those products of a higher protein content, is there still a fairly relatable direct correlation with the WPC34 market or is there a deviation there in the relationship? Sorry, that's a long question.

DR. SCHIEK: I'll give my impression and Pat can correct me or add more detail to it. But typically if you're buying liquid whey you're making some type of fractionated WPC product or WPI out of it; you're going to do additional processing in your facility of that liquid whey. And the question is -- maybe I'm not understanding your question but in terms of how that whey that you're buying from the plant, the cheese plant that doesn't have further whey processing capabilities, it's generally priced off of that market, whether it's ultimately made into WPI or

whether it's made into WPC80 or something else. But do you want to --

MR. FISH: Really what happens in a practical sense is that the higher you concentrate the protein there's a higher cost, there's increasing costs to do that, whether or not it's a straight line in a direct sense or not. So typically you're finding that even if the product doesn't end up being -- the finished product isn't ending being sold as WPC34 in a dried form, smaller plants will concentrate the whey to the 34 percent level, transport it to a plant that's producing higher protein products. So at least some of the value in getting the product to 80 percent or 90 percent protein, some of that value is given back to the smaller plant in an attempt to at least extract some value from his whey. And at the same time have the final processing plant have enough room in the cost of buying the product and transporting and finish processing to higher protein levels so that it's still profitable. You know, unfortunately, there's not a lot of published data on what the actual manufacturing costs are for the higher protein products but there are certainly increased costs all the way from dilute to 34 to 80 to 90.

MR. EASTMAN: So would you think also then taking a different sort of route for a plant that makes its own cheese and processes its own whey stream into WPC product of

a higher protein content or even into a whey protein isolate, do you think for those plants your alternative proposal based on WPC34, do you think that is better relatable to them compared to a whey value based on dry whey?

MR. FISH: I think --

MR. EASTMAN: I guess ultimately my question is, right now with whey values being based off the dry whey there's lots of plants that don't make dry whey so there's a question, how relatable is that to them? I'm sort of curious then how relatable will be your proposal to other plants that wouldn't specifically be making WPC34 or buying a whey stream that would be made into WPC34?

DR. SCHIEK: So it sounds to me -- maybe I misunderstood your question the first time. You're kind of wanting to understand how the revenue streams relate WPC34 to WPC80 or WPI.

MR. EASTMAN: Right.

DR. SCHIEK: I don't have a lot of specific information about that. I think we -- you know, we testified some years ago, I think it was a 2006 hearing so this is getting to be 10 years old, that there was -- in the higher concentration whey products it's kind of a schizophrenic sort of market in that there is a more commodity-type WPC80, for example, and then there's sort of

specialty products that are tailor-made for specific customers and a lot of those tend to be sold on longer term contracts. So the movements in some of those products, you don't see as much up and down on a month to month basis or a week to week basis in those prices because they're set by contract for a specific time for the specific customers.

But what we do find, a couple of things I might point out. what we do tend to find is that when these new products are introduced they kind of carry their own value for awhile but eventually they take on more of a commodity dimension as more people get into the business. And to some degree with WPC80 I think that's what we're seeing and we expect, you know, that WPI will probably go the same route.

But I think the second point I wanted to make on that is that because these are all membrane filtration technologies whereas dry whey is an evaporating, typically an evaporating drying technology, just from the technical standpoint there is some ability to -- some plants have the ability to switch from let's say from doing 80 but 34 looks better, kind of switch back to 34. I read reports of that at least in *Dairy Market News* that that's happening. And that relationship will tend to keep those markets in a little better alignment than it would be with dry whey. But I think sometimes it's fair to say you might look at WPC80 and WPC34 and for a short period of time they may not look

particularly related, but they are more relatable we think than dry whey.

MR. EASTMAN: Okay. Then the last question I had was: Do you think there is any risks associated with California changing the methodology in this way of calculating its whey value or its whey factor when you compare the marketing conditions in the rest of the country that may or may not price the milk off the Federal Order Class III price and will still use dry whey, assuming, into the future, we suppose? Are there downsides? Are there additional advantages besides maybe creating a formula that better fits the experience of California cheesemakers?

DR. SCHIEK: I don't see a downside. I think the biggest downside is to kind of hang on to a revenue representation that doesn't bear much reality to, you know, what the plants are doing. I mean, we have end product formulas that are supposed to come up with a value for milk that is really derived on sort of technical factors that are part of the economic structure of how a plant would determine what they can pay for cheese. Or what they can pay for milk to use to make cheese or what they can pay for milk to make nonfat dry milk.

So that's the idea is we have a structure, a technical formula that represents the economics that an individual plant goes into in terms of their ability to pay

for milk. And that, when you have the wrong product as your primary mover, it seems to me that's a much bigger problem than the fact that you might be on a different basis than some other part of the country that has the wrong basis for their plants. Mr. Fish is from Wisconsin and he can tell you that dry whey movement creates problems for Wisconsin cheesemakers.

MR. FISH: I think kind of the long and short of it, there was a time when dry whey served the need in terms of what the -- as the value in end product pricing. But as Bill mentioned earlier in his testimony, the industry on the whey side is really a protein industry. And the WPC34 market, albeit not perfect, is much better in terms of the value of that whey, whether it's in 34, 80 or isolate. At least using the 34 market as a basis serves the industry much better than the dry whey.

MR. EASTMAN: Thank you. Those are my questions.

MR. MONSON: Thank you, Dr. Schiek, for your testimony. I had a question either for you or for Mr. Fish. At the bottom of page 5 you have some statistics regarding declines in dry whey and increased production of the other whey protein products. I was wondering if you could just expand on that and indicate why these trends, why is dry whey declining? Is it demand driven or is this an easier process for cheesemakers to produce whey protein

concentrate?

MR. FISH: I think it's -- like I said earlier, I think it's just a matter of over time what the industry has seen in terms -- what the true value of whey is. All the growth in the industry. For years it was a dry whey WPC34 market. Now with the development of higher level proteins, including isolates, that's really what customers on the whey side are asking for so that's been the trend and clearly the movement in the industry in terms of cheese plants that are processing whey to the end. It's really about processing protein. I think that in and of itself explains what you've seen in the increases in the protein pieces and the decreases in the dry whey.

MR. MONSON: Thank you. And you foresee this continuing in the future, these same trends?

MR. FISH: Personally, I think so, I think it's -- yeah, I don't think. As Bill pointed out, there has been a lot of investment across the country, obviously including California, in processing high protein products. The investments are costly and I think it's here to stay.

MR. MONSON: Thank you.

HEARING OFFICER SUTHER: Hearing no more questions, thank you for your testimony.

DR. SCHIEK: Thank you.

HEARING OFFICER SUTHER: I would now like to call

a representative testifying on behalf of the alternative proposal submitted by the California Dairy Campaign, Milk Producers Council and Western United Dairymen. You will have a total of 30 minutes to submit your testimony. Again, please notice the clock.

I guess you guys can take turns stating your full names and spelling your last names.

MR. VANDENHEUVEL: All right, I'll start. The name is Rob Vandenheuvel, V-A-N-D-E-N-H-E-U-V-E-L, with Milk Producers Council.

MS. AcMOODY: Annie AcMoody, spelled A-C-M-O-O-D-Y, am with the Western United Dairymen.

MS. McBRIDE: Lynne McBride, M-C, capital B-R-I-D-E, with California Dairy Campaign.

Whereupon,

ROB VANDENHEUVEL

ANNIE AcMOODY

LYNNE McBRIDE

Were duly sworn.

HEARING OFFICER SUTHER: Thank you. You would like to enter this testimony as an exhibit?

MS. AcMOODY: Yes.

HEARING OFFICER SUTHER: It will be Exhibit number 37.

(Exhibit 37 was entered into the record.)

MS. AcMOODY: Thank you.

HEARING OFFICER SUTHER: You've already said who you're testifying for so you may proceed.

MS. AcMOODY: Thank you. Mr. Hearing Officer and members of the hearing panel:

My name is Annie AcMoody. I am the Director of Economic Analysis for Western United Dairymen. We are an association of dairy farmers representing the state's dairy families. We are a grassroots organization headquartered in Modesto, California. An elected board of directors governs our policy. The board of directors approved the position I will present here today during a special meeting on March 16, 2016.

Joining me today, as we mentioned, are Rob Vandenheuvel of Milk Producers Council and Lynne McBride of California Dairy Campaign. While they plan on presenting additional testimony at a later time, I wanted to point out their presence again this year as it represents strong unity in the producers' community. The proposal we are presenting today was submitted as a joint effort between the three producers trade associations. In addition, it has the full support of the three main co-ops in the state - CDI, DFA and LOL. The clear unity you see today is testimony to the undeniable disruption caused to California dairy families and their employees by the inequity in 4b pricing compared

to the price discovery mechanism in states operating under the federal system.

We would like to thank Secretary Ross for the call of this hearing on her own motion. We would also like to thank Governor Brown for his oft-expressed support and recognition of California agriculture, and dairy in particular, as being a driver intrinsic to California's economy. The issue at hand for this hearing, the whey portion of the Class 4b formula, is not a new source of concerns for the producer community. We appreciate that the Secretary recognizes it needs to be addressed, especially in light of the upcoming expiration date for the temporary formula in place.

The topic of adjusting the whey portion of the Class 4b formula is not new. In fact, it goes back to 2007 when the fixed whey factor was implemented on December 1. With a fixed factor it was only a matter of time before prices would fall significantly out of alignment with federal order pricing. The issue became particularly apparent in 2011 as the value of dry whey started to rise. The producer community, concerned with the inequity, overwhelmingly supported some changes. Land O'Lakes submitted a petition, and agreeing the issue should be revisited, the Department called for a hearing on June 2011. Support from dairy producer organizations and cooperatives

was unparalleled - all sought changes that would bring the California 4b price in closer alignment with federal order prices. The support and common position among producer organizations and co-ops was not typical at the time, but it was remained throughout the last five years and is still very clear today.

As a result of the 2011 hearing, the Department decided to implement changes, eliminating the fixed whey factor and replacing it with a sliding scale. Those results were a slight improvement but fell short of getting California prices in closer alignment with Federal Order prices. An update to the whey scale occurred in 2012 when the Secretary increased the upper end of the scale by 10 cents. Following this decision, she created the Dairy Future Task Force in the hopes of finding common ground between industry participants to improve the California pricing system. Almost three years later, no significant changes occurred. Recognizing the issue of whey pricing was still present and a critical concern to producers, the Secretary called a hearing on her own motion a year ago. A temporary scale was developed. When it was announced it appeared it could yield some additional revenues for producers. This was welcomed news for producers who had been advocating for a change for almost four years. Unfortunately, as we stated in our proposal letter, for the

period August 2015 to February 2016, the temporary scale generated an average of 3.4 cents per hundredweight more to the Class 4b formula than the previous formula would have.

Every producer group in this state has worked hard on getting this issue resolved. While we very much appreciated the change in direction with the temporary formula, we would like to reiterate our preference for a different whey scale; one which we believe would create a fair method to calculate whey in the Class 4b formula in the long run and one which we would like to see implemented on a permanent basis.

We will delve into more details later, but in short, our proposal adjusts the whey scale to allow the whey value in the Class 4b formula to mirror the whey value in the Class III formula. More specifically, as outlined in the Department's analysis, if the producers' proposal had been in place for the past five years, the California Class 4b price would have averaged $1.38 per hundredweight higher with our proposal. This represents $.64 per hundredweight on the overbase price.

It is no secret that the last few years the gap between the Class III and the Class 4b price has caused much producer dissatisfaction. The part of the California Food and Ag Code that states "the methods or formulas shall be reasonably calculated to result in prices that are in a

reasonable and sound economic relationship with the national value of manufactured milk products", Section 62062, has been mentioned by many at each of the whey-related hearings, but we want to reiterate it today because it is of particular interest to us; producers want to be on a level playing field with producers in the rest of the country.

According to CDFA analysis, with the current formula, the Class 4b price would have averaged $1.85 per hundredweight less than the Federal Order Class III price for the period March 2011 to February 2016. This in itself should be evidence that the current Class 4b formula fails to determine the cheese-milk's value appropriately. Clearly, the current scale violates the mandates outlined in Section 62062 of the Code.

The deviation between Class III and 4b prices can be caused by several factors. Notably, formula differences such as different price series, make allowances, yield and formula construct contribute to the divergence. But the whey value is what creates the most variance between the two class prices and it seems the Secretary recognized that, calling a hearing with a scope pertaining only to the whey value in the Class 4b formula. It must be recognized that while the temporary scale failed to generate additional needed revenues for producers, it did decrease the gap between Class 4b whey value and the Class III whey value.

Producers would very much like to see the Class 4b equal to the Class III price, but we realize the scope of this hearing does not allow for such a proposal. The next best thing is getting a comparable whey value in Class 4b to the one generated by the Class III formula. If a formula that achieved that had been in place for the past five years, like the one we are proposing, the difference between Class 4b and Class III would have been -$.46 per hundredweight, instead of the -$1.85 with the current formula. California cheesemakers would have still gotten to pay a cheaper price for cheese-milk than their Federal Order counterparts.

Our proposal would achieve a much closer relationship between Class 4b and Class III by removing the potential for unbearable discrepancies in the whey portion of Class 4b that can occur if we do not more closely tie our whey value to the end product pricing formula used in federal orders. As outlined in our proposal, we propose the following whey value in Class 4b, and you have got the table here for your convenience.

The next figure illustrates how that proposal would have closed the gap between California's and FMMO's whey values in the last five years. And again I'd like to reiterate here following Dr. Schiek's testimony, we are not trying to solve the global supply imbalances, we are really

just trying to get processors to pay a fair value for milk.

So leaning to that, producers are facing difficult economic conditions.

Given the current volatile conditions in the industry, the years ahead will undeniably be more challenging for California dairy families. Economic and regulatory pressures are escalating in the state. Current and proposed environmental regulations have led and will continue to lead to added costs, something farmers in no other states have to deal with. Aside from this regulatory burden, costs of production on the dairy have stabilized in recent years, but in doing so also seem to have reached a new higher norm. And the following chart here of the California State Cost of Production illustrates the trend.

A minimal softening in feed costs had been a notable mover in the reduction in cost of production observed from the first quarter of 2009 to early 2010. According to CDFA data, feed costs rose from just over 51 percent of the total cost of production in 2003 to 60 percent of total costs by the third quarter of 2008. Following that high, there was a slow decline but it was short lived; since fall 2010, feed prices climbed again. And while there was a bit of a slowdown in 2013 and recently, feed costs remain high. Again, a new higher "normal" seems to have been reached. And you can see that

on the chart here.

Nationally, feed prices may be lower than 3 years ago, but costs remain higher comparatively for California operations. As an example, according to USDA data, in 2015 the average alfalfa hay price in California was $185 per ton; the average US price was $163 per ton. This trend is not only valid for 2015. Looking at the past five year averages, a similar difference with prices in California averaging $217 per ton versus $193 in the US. Similarly, the 2015 corn price was $4.50 per bushel in California versus $3.60 in the US. The past five year average is $5.55 per bushel in California versus $4.97 per bushel in the US.

CDFA data indicates that feed costs represented 57 percent of the total cost of production in the fourth quarter of 2015. While 2016 cost of production data is not yet available, the significant declines in overbase prices combined with fairly steady feed prices will likely show ever more deteriorating margins for California dairy families. With current feed prices and an overbase price that averaged $13.27 per hundredweight for the two months of 2016, the current financial snapshot for producers is somber.

Due to all those increased costs, California dairymen have lost much of their competitive position relative to the rest of the nation. Failing to capture the

value of whey, which has turned out to be a very marketable product, is hurting their competitiveness further. We reviewed the cost of production information because the Department must take it into account: "In establishing the prices, the director shall take into consideration any relevant economic factors, including but not limited to, the following: (a) the reasonableness and economic soundness of market milk for all classes, given consideration to the combined income from those class prices, 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." That was a quote from Section 62062 of the Food and Ag Code.

While 2014 was no doubt a record year for milk prices in California, 2015 came around fast and hit producer's bottom line hard. A comparison of the net income received by dairies in the state to the total cost of production illustrates the challenge clearly. The average loss in 2015 was $3.37 per hundredweight, surpassing the positive margin experienced in 2014 - that was $3.29 per hundredweight. If you look back to 2011, there are more losses than gains and this chart here illustrates that. The dark bars are supposed to be red to emphasize all the losses

but obviously milk prices are low and the color copies were expensive so you get the black and white version here.

(Laughter.)

MS. AcMOODY: Cost of production data is not available for 2016, but based on feed prices that likely did not move much, combined with the low milk prices experienced during the first quarter of 2016, it is not hard to imagine producers' financial situation remains dire and will likely not improve in the near future. The average overbase price for the second quarter of 2016 will likely be in the upper $12 to low $13 range. Current market conditions are not pointing to a rapid price recovery. During the fourth quarter of 2015, CDFA data points to a negative margin of -$3.01 per hundredweight. For that period, the average overbase price was $14.60 per hundredweight. Milk prices settled over a dollar lower than that for the first quarter of 2016. Expectations for minimum milk prices are around $1.60 lower for the second quarter of 2016. This will result in lower income over feed, assuming the feed is steady, as I mentioned above. If income declines by even just $1, this will bring the margin to -$4.01 per hundredweight for the first half of 2016. Such financial losses per hundredweight are not sustainable and will force more farms to exit the industry.

To find a clear sign that the financial situation

in California has deteriorated one needs to look no further than USDA's *Milk Production* report. Indeed, so far in 2016, first two months, milk production in California has averaged 2.8 percent below last year. What's even more concerning is that the same two months last year averaged 3 percent below the previous year. Put another way, we are in a period of year-over-year-over-year declines. It has now been 15 consecutive months of milk production declines. In the US, in contrast, milk production has been up an average 0.6 percent in 2016 compared to last year. During the same period last year, milk production was up an average of 2 percent. And this chart here illustrates that.

According to CDFA data, in 2015 there were 1,438 dairies left in the state, down from 1,668 five years ago. Consolidation, with dairies getting larger, has been blamed by others as a reason for the loss in number of farms, but it was not the only cause of that decline. In fact, the average size of a dairy farm in California dropped by 2 cows in 2015 to 1,215 cows. While milk per cow was down slightly year-over-year, a more concerning reality was apparent in the statistical data: a total of 41,670 cows left the California dairy herd in 2015.

In light of the financial harm inflicted on the average California dairy farm, and the milk production decline already at play, we want to reassure the Secretary

that the small price increase we are here asking for today will not generate a milk glut. With milk production lower than year-ago levels, the previous plant capacity issues that have been mentioned in the past should not weigh on the discussion today. Keeping a lower milk price in our state only contributes to the financial plight of dairy producers, not to bring supply more in line with capacity. Producers are the ones bearing the cost of a lack of capacity and will respond to it by either building capacity or reducing production via their plant's supply management programs.

The current whey issue is one of fairness with prices observed in the rest of the country. Looking at the aforementioned cost of production data, even if we were to add an additional $0.64 per hundredweight in revenues this year, which is the average amount our proposals would have generated these past five years, it would still yield average negative margins for producers in the state. As mentioned above, we know the average overbase price for the first quarter of 2016 will be over a dollar under the last quarter of 2015; it's closer to $1.45 based on my estimate. Looking at a conservative scenario for the first quarter of 2016, where despite the above information we assume that income over feed costs and costs of production remain the same as in the fourth quarter of 2015, if we were to add another $0.64 per hundredweight, again that's being very

optimistic considering where whey prices are at, the margin would still be a negative $2.37 per hundredweight. We would be hard pressed to find a producer willing to increase production when they are losing such a significant amount per hundredweight of milk produced. We would be even more hard pressed to find a lender supportive of that concept.

California dairy farms are the backbone of the dairy economy. According to a study conducted by UC Davis, the impact generated is quite impressive. Indeed, according to that study, the dairy industry generated $21 billion in economic activity for a total of $65 billion of dairy-related economic activity. It supported 55,000 milk production and processing jobs.

These past few years, the drought in California has been making headlines. While precipitations may have improved this year, it still remains a topic of concern. In a study conducted by UC Davis in 2014, it was estimated that 429,000 acres had been fallowed statewide, a $2.2 billion loss to the state's farming industry. When there is no surface water available, farmers have no choice but to fallow their fields or to turn to underground water. Using groundwater comes at a cost, since well drilling is rather expensive. Again based on that UC Davis study, it was found the Central Valley is hardest hit, particularly the Tulare Basin, with projected losses of $800 million in crop revenue

and $447 million in additional well-pumping costs. I know there will be additional testimony on the drought today so I don't want to take too much time on this but I really wanted to point out these costs because these added costs are related to the farming side of the dairy operation. They have been a reality for many dairies in the state and those are not included in the cost of production data cited above.

These drought and regulation realities were met with timely higher milk prices in 2014. But milk prices have changed today and environmental constraints and regulations remain. We are relieved to find that the Panel understands this reality and we want to reemphasize it as it is just as true today as it was last year. And I have a quote here from the panel report: "All of these environmental costs and regulations have limited the ability of producers to expand their production. Historically, producers seeking to increase production built new dairies and expanded the number of cows on existing facilities. Conversely, environmental costs and regulations have severely limited the building of new dairies, the reactivation of dormant dairies, and reduced the re-permitting of existing dairies. Because current environmental costs and regulations are expected to remain in place, if not intensify, they are expected to limit the ability of production to grow in the future through the

traditional method of adding dairies or adding a significant number of cows to the milking herd."

Risk management.

Since 2009 and the recent years of price ups and downs, margins at the dairy remain fragile. Volatility has been a buzzword in the last few years for a reason, it is here to stay. As you know, dairymen have no way of passing along added costs. To avoid a repeat of that economic catastrophe, many producers have turned to risk management tools to protect their operations. More specifically, hedging has become an increasing part of dairy operation management.

Hedging allows parties to secure prices months in advance. The effectiveness of hedging relies on many things but especially on the relationship between futures prices and cash prices. The futures contract most commonly used by dairymen in the US is tied to Class III. A hedge will never be perfect because of basis, but over time, with similar formulas, dairymen can assess their basis risk more effectively. As illustrated earlier, the spread between Class III and our milk price has fluctuated significantly over the years. Effectively, the issue of lower milk prices in California is exacerbated by the fact that the different whey factor in the California formula makes Class III futures contracts a less effective hedge than it otherwise

would be. As a result, the very insurance that dairymen attempt to buy to insure some operating margin does not perform as they intended.

Looking back at historical relationships between prices received at the dairy and Class III is certainly not a good predictor of basis because of the disparity. We understand that it is possible to be creative and use various contracts, in addition to Class III, to create a more effective hedge. But it remains that it is a much more difficult task in California to do it right. Adding complexity to a task that is already daunting to many has been enough to deter many producers.

Even the safety net that came out of the latest Farm Bill, the Dairy-MPP, is an issue for California producers with the discrepancy that exists between California prices and the rest of the country. The correlation between Class III and the all-milk price -- I thought talking slower might help my not screwing up words but apparently it's not related to the speed I talk; so I'll take a sip. Okay. The correlation between Class III and the all-milk price, which is the price series used to determine program payments, is much stronger than Class 4b and the all-milk price. The difference between the US all-milk price and the Class III averaged $1.55 per hundredweight over the past five years. The difference

between the US all-milk price and Class 4b averaged $3.40 per hundredweight. This makes the program harder to relate to California producers with California priced being lower than national averages. The other component of that program, the feed costs, was already indirectly highlighted earlier when we discussed the difference between California corn and the hay prices with the rest of the country. Lower milk prices in California, combined with higher feed costs, makes it difficult for the program to trigger during difficult times. The MPP margin for the first quarter of 2016 was $8 per hundredweight, which means no payment was triggered. We have highlighted the negative margins California producers have been and are experiencing. This program does not appear to be where dairies in California will get help, at least not currently. We understand CDFA is not responsible for this program and cannot change the feed cost portion of the issues, but it certainly would help if the milk price portion of the formula was more in line with the rest of the country.

Whether whey has a value or not is not the main question anymore; it is widely recognized that the whey stream has generated considerable revenues for the cheese processing industry. The Secretary's last decision and the temporary whey scale in place today is testimony to that. Producers in federal orders have benefitted from a higher

whey value in the current Class III formula - it is only fair that producers in California also get a share of this growing market.

Why updating the scale.

In the 2011 Panel Report when the scale was first implemented, CDFA stated: "such a sliding scale could be devised and updated, if need be, to better correspond with California conditions compared to an end-product pricing factor." California conditions, as outlined above, warrant an update.

The narrow range of the sliding scale used in the permanent formula is at the root of the problem. With a ceiling capping the whey value at $.75, there is tremendous potential for discrepancies between the Class 4b and Class III. Similarly, a floor of $.25 also creates a potential for discrepancies. The scale proposed in our petition significantly reduces the potential for these large discrepancies.

As the panel stated in 2005 before recommending the removal of price floors from the Class 4a and 4b formulae: "price floors create an artificial price within a market at a level that may be higher than the naturally occurring market price." The same is true of ceilings, creating an artificial price that may be lower than the naturally occurring market price. In this case, it has

prevented producers from benefitting from that value.

In the past, it has been argued that a cap is necessary for small cheese processors who do not process whey. Whey has had a value for years. Many have found ways to make it profitable by investing in whey processing facilities. Others dispose of it by selling it to dairymen so they can mix it in their feed ration for the cows. As producers frequently remind us: many dairymen sell their hospital milk to calf raisers because it makes more sense than throwing it away. Cheese plants have had plenty of time to maximize opportunities to recover value or make whey products profitable, just like dairymen found value in hospital milk.

Another key point of contention for producers: operation sizes have never been a focus in the milk pricing formulas in California - all dairy families get the same volatile price, regardless of the size of their operation. Cheese processors across the country have adapted to that reality and have adapted well. California dairy operations of all sizes have been facing dairy price volatility for years. Therefore, there is no place for a cap on the sliding scale on the grounds that some small cheese processors cannot afford whey price volatility.

As we have advocated for many years for a closer relationship between Class III and 4b, we believe the

permanent whey scale should be updated to reflect our proposed scale. This is something we want to achieve in the long run - not just on an emergency or temporary basis. The amount of time and resources the co-ops spent on the FMMO hearing process is testimony to that desire. The three trade associations also supported that process, while 32 producers directly testified. A permanent change would allow better business planning decisions for producers and processors. The proposed changes may be under a sliding scale format, but the many brackets allow for the whey value to fluctuate with whey prices. The resulting whey component value in the Class 4b formula can move quickly from a month to the next, providing a true reflection of changing values in whey markets, negating the need to make it a temporary change.

Other proposals.

We oppose the alternative proposal submitted by the Dairy Institute. While we appreciate their creative effort to reform the scale, it clearly falls short of achieving what needs to be done to restore fairness in the Class 4b pricing formula. CDFA's analysis reveals that over the past five years it would have increased the Class 4b price by $.31 per hundredweight. This is clearly below the $1.38 requested in our proposal. Of greater concern is a look at the last year, which may be more reflective of

current commodity prices: DI's proposal would have lowered the Class 4b price by 11 cents this past year. This is based on CDFA's analysis, comparing DI's proposal with the permanent scale. Comparing the DI's proposal to the temporary scale, the one in place today, yields even more shocking results. For the past year it would have decreased the Class 4b price by 42 cents. Going back three years the result gets worse, -62 cents. In light of the negative margins experienced by California producers, our concern with such a possibility is great. In short, we cannot support a proposal whose intentions are not to move the Class 4b price closer to the Class III price and have the potential effect of decreasing milk prices in California.

Specifically, we have objections to the use of the DI scale, and the Hearing Panel eloquently identified several of those last year. We will make good use of that Panel Report by including some of those quotes here to reemphasize their importance and relevance in this hearing as well:

1. A whey factor based on WPC34 may not track a whey factor based on dry whey when comparing cheese-milk prices paid by California's out-of-state competitors with California prices. A review of the dry whey price series and WPC34 price series quoted from USDA's DMN shows that the two price series tend to trend up and down together; but

there are occurrences when the two price series will move in opposite directions or when one price series will be relatively constant, while the other is moving. Moreover, a comparison of the per-pound protein price of WPC34 with that of dry whey shows that their price movements are highly correlated, but not perfectly correlated.

2. The whey factor based on WPC34 appears to have merit, but the concept needs to be vetted further in order to verify and validate the commodity price and manufacturing cost factors that will be associated with the proposed whey factor.

3. The Department needs to examine the proposed DMN WPC34 price series to determine if it will function well as a commodity price series for California. This price series is based on the Western and Central parts of the US. Although various witnesses supported this concept, it is prudent to determine if this price series is representative of the price received by California plants. Further, it is unclear if plants making WPC of higher protein concentrations receive a similar price or a price related to the WPC34 price series. If the DMN WPC34 price series is indeed representative, then this concern would be resolved. If not, other alternatives such as a California price survey or other price discovery method would need to be established.

4. The Department is not currently performing any cost studies and is not aware of any cost studies recently completed for plants making WPC34. Before implementing a whey factor based on WPC34, any explicit or implied manufacturing cost allowance and yield factor incorporated into the whey factor should be confirmed and verified as representative of California plants. The Panel is concerned with implementing a new whey factor based on WPC34 that is not accurate and consistent with actual manufacturing conditions of California plants.

5. The issue with confidentiality currently applies to the Class 4b pricing formula with cheddar cheese and dry whey. This would also be true with WPC.

To our knowledge, none of these objections have been answered or researched. It is unclear whether answers could provide a framework to effectively use this proposal in the current regulatory environment. We agree that each of these objections laid out by the Panel is an important consideration.

This concludes our testimony. The members of Western United Dairymen thank CDFA staff for their effort in preparing for this hearing. We would also be pleased to answer any questions you may have and request the option to file a post-hearing brief, please.

HEARING OFFICER SUTHER: Your request to file a

post-hearing brief is granted.

MS. AcMOODY: Thank you.

HEARING OFFICER SUTHER: Any questions from the panel?

MR. SHIPPELHOUTE: I have a question. You're quoting Section 62062 where you quote that "the methods or formulas shall be reasonably calculated to result in prices that are in a reasonable and sound economic relationship with the national value of manufactured milk products". I'd like to focus on the last three words there, "manufactured milk products." In reading the next paragraph it would seem to suggest that your interpretation of "manufactured milk products" is the same as the Federal Order Class III price; is that how you were interpreting that?

MS. AcMOODY: That's how we're looking at it. We're trying to get a reasonable relationship with the national value of manufactured milk products. Those products are those that are used in the Class III formula. Class III includes manufactured milk products.

MR. SHIPPELHOUTE: And you have quoted some quotes of feed prices on a later section in your testimony. Just curious where you pulled those numbers from?

MS. AcMOODY: Are you referring to the ones below Figure 3?

MR. SHIPPELHOUTE: Yes.

MS. AcMOODY: Those are USDA NASS data.

MR. SHIPPELHOUTE: That's all I have for now. I take that back. On your risk management you mentioned that more producers are using hedging. I was curious if you have any idea of what percentage of producers are using that?

MS. AcMOODY: No. I've been looking at that number for years, I still haven't come across it. It's just more, you know, word of mouth.

MR. MONSON: I had a question regarding the WPC34 that you mentioned at the end of your testimony. You highlighted several sections from previous panel reports. Did your board formally discuss this issue and are you guys opposed to using WPC34 as an input?

MS. AcMOODY: We've talked about. That specific proposal was different last year so I know our board has come across the specific commodity. I think our main concern is that we are trying to get our price more in line with the Federal Order Class III and by using a different commodity it would yield a potential for discrepancies.

MR. MONSON: So even if the values were adjusted in the table to where it was more closely aligned to Class III are you guys still opposed to switching from dry whey to WPC34?

MS. AcMOODY: Yeah. At this time our position is to get our price in closer alignment and there is concern

that this wouldn't do that, even if you change the scale.

MR. MONSON: Okay.

MS. AcMOODY: And I think those quotes kind of yield to that. That sometimes the prices move long and sometimes they don't and so that still creates concern.

MR. MONSON: Thank you.

MR. EASTMAN: I have a couple of questions. This is probably for all three of you, although I know Rob and Lynne, you'll probably -- we'll get to see you again and hear more from you specifically. Maybe you can answer this question, give us the abstract version, then you can give us more details as you testify if there's more in your testimony. But within this testimony you talk about margins and you talk about environmental costs and then you start talking a little bit about drought. Do you believe that factors such as drought, land use competition of other ag commodities compared to say crops that would be used for feed and dairying, do you think those factors still exist and still are an influence over dairymen today? They appeared to be an issue last summer; I'm curious if you believe that those other factors also are in play?

MS. AcMOODY: Do you want their thoughts first or I thought I'd --

MR. EASTMAN: Either one.

MS. AcMOODY: Okay. I tried to lay out that I

think those factors are definitely still at play and that's why we are really not thinking that even the price increase of what we are asking would allow producers to increase production. There's other factors others than just the financial issues that are now creating issues for sheer growth.

MR. EASTMAN: Okay, perfect. And then Rob and Lynne, you would agree or do you have something to add?

MR. VANDENHEUVEL: Ladies first.

MS. McBRIDE: Yeah, those issues are definitely issues that our membership talks about frequently. Even though we have had more participation this year, thankfully, there's still going to be a lot of issues relating to water availability and that's going to become a new norm, unfortunately, for our state, so that raises great concerns for our dairy operators.

There continues to be pressure from other crops and land being bought up to plant different crops so that pressure continues to exist and we have seen dairies, you know, leveled in order to change over to a different crop. So those are certainly issues that we talk a lot about with our membership. And then just the increasing costs of production, be it environmental regulation, labor issues and others just only increase the costs for our membership and are of great concern.

MR. VANDENHEUVEL: You know, I can't discount the impact that the drought has had on the California agriculture sector. It's probably more direct on other commodities more so than dairy, at least directly at this point, but it's going to be a long-term issue with the groundwater legislation that we're currently in the very early stages of.

But I've got to tell you, the dairy farmers in the state in terms of competition for land. There's always going to be another crop or another product or another thing you could do with the land that's perhaps more profitable. They're dairymen because they want to be dairymen, because they want to produce the -- You know, they've been doing it for generations. What you're seeing now is a direct result of many years of financial stress that they just can't recover from.

Financial institutions that no longer have faith in the dairy industry in California because of their inability to cover their costs on a long-term, ongoing basis. And so while there are other measures, drought and the rising of permanent tree crops and that increase in the Valley, you cannot understate the dramatic impact that having a lower milk price in California relative to our competitors outside of California has had on the financial state of our dairies and why they are making the decision to

increasingly either cut down the herd, or in some cases, too many cases, selling altogether.

MR. EASTMAN: Thank you. Another question I had was toward the end of your testimony you talk a little bit about floors and caps on scales. I just want to make sure I understand. It appears within the text of your testimony you argue against those somewhat but your proposal does include those. Is that just because you set them at the correct level or were you just comparing what you're proposing to, say, the permanent scale that would kick in once the temporary scale goes away? I just want to make sure I understand what you were getting at there.

MS. AcMOODY: Yeah. The scale with a narrow floor and ceiling makes it more likely for large discrepancies. As you can see on our scale that probably was as large as you could get it to fit on a page - it goes all the way up to $4 - so we are trying to minimize the potential impact for that. We're trying to stay in that scale format because we feel the Department has been comfortable with that format in recent years so we are trying to stay within that and make it move more in line with what we are expecting the prices would be in the federal Class III. So kind of a compromise and staying in that format.

MR. EASTMAN: You aren't completely opposed to the concept, just where they were set?

MS. AcMOODY: Yes.

MR. EASTMAN: Gotcha, perfect. And then the last question I had was, obviously based on how the system works, as you increase class prices that will increase pool prices to all producers that participate in the pool. I'm assuming we are going to hear testimony in a little bit about premiums that are paid by some cheese processors. And the question I have is, it could be possible that a cheese plant that is paying premiums to its shippers will reduce those premiums if the Class 4b price is increased. And although the increase in the 4b price will be shared by all pool producers it is possible that an individual shipper to a cheese plant might end up with a net lower milk price when you compare, you know, a higher pool price but a decrease in premiums. And the question I have is, obviously that's just a limitation somewhat in how the system works but do you think that just is something that has to happen for the better good of all producers or just simply an outcome of the system and there's not much you can do about it?

MS. AcMOODY: Kind of a philosophical question there. You allowed yourself that because it's your birthday, right?

MR. EASTMAN: It is my birthday. I'm glad everybody came. It's the only way I could get everybody here on my birthday.

(Applause.)

MS. AcMOODY: That's what I figured, okay.

MR. EASTMAN: Best birthday ever, I think.

(Laughter.)

MR. EASTMAN: But we'll see, we'll see what's coming next.

MS. AcMOODY: So, I mean, it kind of goes to the basis of why pooling was put in place. I'm sure some producers here in the state -- in the room probably that ship to a Class I plant feel that they would like to get those revenues directly as well but the system was put in place to share all revenues among producers and that's what we're trying to argue for here is that those revenues are shared fairly.

MR. EASTMAN: Gotcha. Rob?

MR. VANDENHEUVEL: Yeah. And I guess I would add that the buyers in the state aren't paying premiums out of charity, they're paying premiums to attract milk to compete for that milk supply. To attract quality milk, sustainable milk, on time, high volume, whatever the standards are for attracting those premiums. What we are trying to do is establish a plan, a pooling system or -- we have a pooling system. We are trying to bring back some sort of equity between the classes. Because the code also discusses the relationship between classes. When you've got one class, in

this case 4b, that is significantly below what is perceived, we believe, as the national value of comparable milk around the country and the other four classes are not, the impact that has on their relationships within each other is significant.

Which is why the code specifically addresses the relationship between the classes. As producers were heavily invested through our cooperatives in another class, 4a, and the impact on our cooperatives and their operations of 4a plants when the 4b price is significantly lower. And they're actually generating significant pool withdrawals, whereas our producer-owned assets and plants are making pool contributions over the years, that has an impact.

And so while premiums can be used at the margins to attract a milk supply, they are not guaranteed. We've seen that in the Midwest, we're starting to hear about those premiums coming down. And they're also -- there is no reason to believe that if we adjust appropriately the regulated price of the Class 4b price that those premiums won't continue, because at the end of the day they've still got to attract an adequate, high quality, at temperature, on time milk supply and that isn't free. What the co-ops and the producers do to produce and provide this milk on the processors' schedule, whatever they need, full supply contracts, there is a cost to that. That's what the

premiums are covering, the compensation for that, not some making up for what should be a base class price.

MR. EASTMAN: So you think that premiums will probably continue in the future or we are in a situation where you just foresee that will have to happen?

MR. VANDENHEUVEL: I think it's entirely possible that you could hear testimony today that those premiums will be at risk in some points, in some cases. I can't make any -- it's not my job. I don't offer the premiums, I can't take them away, I can't give them.

But what I would say is in a state where I think we are going to increasingly have competition for milk, given all the challenges we have talked about for future growth, environmental challenges, land use challenges, just doing business in California challenges. As you compete for milk, if you are the first guy on the block who decides, I'm not going to pay premiums or I'm going to pay significantly less premiums to somehow punish my shippers because the state just raised my price, I'm not sure that's a good long-term strategy for securing an adequate milk supply.

MS. McBRIDE: I just wanted to echo some of what was already said. But, you know, I think from our producer perspective, you know, premiums are great, they are just not guaranteed, and that is why we have been so strongly supportive of effective minimum pricing regulation,

especially on the 4b price because of how much milk goes into 4b utilization. So, you know, we just see that as the really key factor is to have one that is level with the Federal Milk Marketing Order system.

MR. EASTMAN: That's all I had.

HEARING OFFICER SUTHER: Ms. AcMoody, Ms. McBride and Mr. Vandenheuvel, thank you for your testimony.

MS. AcMOODY: Thank you.

HEARING OFFICER SUTHER: We will now proceed with the public testimony section of this hearing and the first witness will be Mr. Murphy. Will you please come forward.

Mr. Murphy, will you please state your full name, spell your last name and state your affiliation for the record, please.

MR. MURPHY: Barry Murphy, M-U-R-P-H-Y. I have a company called BESTWHEY, LLC, B-E-S-T-W-H-E-Y, L-L-C.

Whereupon,

BARRY MURPHY

Was duly sworn.

HEARING OFFICER SUTHER: Would you like this statement, your documents, entered as an exhibit?

MR. MURPHY: Yes. Yes, please.

HEARING OFFICER SUTHER: Mr. Murphy's document will be Exhibit number 38.

(Exhibit 38 was entered into the record.)

HEARING OFFICER SUTHER: Your written testimony now is entered as an exhibit; you may proceed.

MR. MURPHY: Good morning. My introduction is my name is Barry Murphy and I have worked in the California dairy industry for the past 26 years, first in the senior management corporate environment and for the past 16 years as a consultant to the small and medium cheese plants with specialty cheeses and whey handling and disposal needs. My background includes Dairy Science and Business post-graduate degrees, technical and operations management, sales and marketing management and green field project development and financing. I live in Petaluma, California.

My position on the proposals: BESTWHEY, LLC opposes the proposal from the three producer groups, Western United Dairymen, Milk Producers Council and California Dairy Campaign, and strongly believes that this proposal will restrict and/or reverse the growth of California's cheese industry and possibly eliminate many of the smaller and medium sized cheese businesses in the state. BESTWHEY, LLC supports the Dairy Institute of California's alternate proposal with respect to its price calculation based on the value of whey sold by cheese plants which are not capable of processing whey into powdered products and the Dairy Institute captures the value of WPC34, not dry whey, which is more aligned with what the final use of whey is in the

state when transported in liquid form such as what DFA and Land O'Lakes do today. The dairy groups proposal assumes that cheese plants receive a dry whey finished product value for their whey stream. This pricing formula overvalues milk for most cheesemakers in the state because they do not recover that assumed value from their whey operations. Dairy Institute's proposal is fair since it would work well and fairly for plants such as Dairy Farmers of America's WPC34 plant in Turlock, California and Land O'Lakes' WPC34 plant in Orland, California.

Whey Powder and Whey Protein Concentrate.

Of the 59 cheese plants in California, one plant manufactures whey powder in Kraft Tulare, and the next three major cheese companies, Leprino, Saputo and Hilmar, process some of the whey solids into products other than sweet whey that is the factor for the dairy groups' whey valuation and for which the current markets are weak. Ten other cheese companies process a liquid reverse osmosis whey or ultra-filtered whey for sale as liquid to animal feed, to other whey processors, and in four of those plants, as dried whey protein. All ten of these companies dispose of greater than 85 percent of whey solids as animal feed with little or no value.

Facts:

Twelve of the 59 cheese plants in California can

process whey to some degree per most recent CDFA data.

2. Using whey powder market value as proposed by the dairy groups does not make sense and assumes that all plants utilize 100 percent of whey solids, when in fact one plant in the state can achieve this. A handful of additional plants can capture the value from the bulk of the whey solids, while the vast majority have minimal or no recovery of whey solids.

3. Reverse osmosis whey solids are sold in liquid form by two plants in the state and achieve 50 to 70 percent of the whey powder value minus freight costs. Longer distances separate plants further in California than most other states and thereby make freight costs a significant issue. For example, Land O'Lakes' WPC34 liquid plant hauls from Orland, California to Kings County, California, so over 300 miles at a cost of $1,200 per load or $0.12 per pound of solids of WPC34. And from City of Industry, California to Tulare is 192 miles at a backhaul cost of $475 per load or about $0.05 per pound of RO whey solids. Distances between plants and freight costs in California are such that there is no interplant movement of raw, un-concentrated whey in the entire state when this is commonplace in other states.

4. Whey Protein Concentrate 34 liquid solids are sold by three plants in the state to dryers at 20 to 30 cents under, or 50 to 75 percent, of the USDA Western Average of

the Mostly series, for WPC34 delivered.

5. The smallest cheese companies, representing at least 70 percent of the 50-plus cheese plants in the state, have no ability or economies of scale to process whey and actually pay up to $1.00 a hundredweight to dispose of the whey. I work with a small cheese company right now that pays $250 a load of whey for disposal costs.

My conclusions are as follows:

A. Using the Dairy Institute's proposal to index the whey value for liquid shipment at WPC34 market values makes more sense than using whey powder market value since only one plant in the state can utilize 100 percent of whey solids. I have tested the Dairy Institute's data supporting its proposal and the data is accurate in terms of WPC yields, operating costs, sales value and transport costs for these plants able to recover whey value through concentration and sale of liquid whey.

B. Adopting the dairy group's proposal will wipe out the smaller cheese plants and may result in reduced processing levels by the larger cheese plants since they can move some of their volume to other states.

The cheese business is a tough, small margin business and for the smaller cheese companies without the ability to create value from whey it is even tougher. For the large plants, a few cents margin from cheese sales value

over milk cost combined with very large scale operations, may at best result in a break even business and the whey can add value to create a fair return on investment. For the smaller plants, even with higher margins on cheese sales value less milk cost, an ideal target gross margin milk to cheese value would be roughly $.50 per pound of cheese. But the relative overhead costs are so high that the struggle with smaller cheese plants is that they don't have the economies of scale to cover the base overhead comfortably.

I understand that the proposed dairy group's milk price increase would have averaged as much as $1.75 a hundredweight at times over the past few years. This would be $.175 per pound of cheese value and would likely wipe out half of the smaller cheese plants because this $.175 per pound of cheese would eliminate any potential profitability. California's specialty cheese business competes with products from across the US and the European Union and some of these cheese businesses outside of California must be buying milk outside of the federal pool since their pricing in some cases does not match federal order class III pricing.

Of course, we know that many of these plants located in federal order areas operate as non-pool plants and can pay for milk based on the market. When milk is in excess these non-pool plants are able to buy milk below

class in order to support -- in order to help to clear the market. Both -- that's a typo there, sorry, "Both." California's current system does not have any kind of options to buy milk below regulated class prices that exist in the federal order states.

Under the current California regulated system, cooperatives can pay minimum regulated prices to farmer members but then can assess plant losses back to the farmer members. In other words, if the regulated prices are too high for the plant to operate profitably, the cooperatives can re-blend and pay their farmer owners on the basis of what the milk is really worth to the plant. The non-cooperative cheese business milk buyers do not have such an option when the regulated price is set too high. This is clearly inequitable and provides no mechanism to clear milk with respect to cheese plants, which are owned primarily by non-cooperative businesses.

Cooperatives versus Private Cheese Companies

Whey-derived product markets have collapsed in recent months as have nonfat dry milk powder markets. In the case of nonfat dry milk powder, there are reports that the co-ops lost at least tens of millions of dollars due to selling inventories of finished products made with high milk costs in early and mid-2014 when prices were higher into a lower-priced market late in the year, in 2015 and currently

the same markets when global prices had fallen substantially. Co-ops then assessed the producers by adjusting the effective price paid them to account for these losses. Again, they have the ability under the regulated pricing system to adjust the effective price that the plant pays for the milk to match what it is worth in their plant operations including premiums based on fair market value. The mostly private California cheese industry cannot assess losses to producers and therefore must absorb these losses.

Dairy Farmers of America and Land O'Lakes have one cheese plant each in California. Both of them sell liquid WPC34 below market to private cheese plant dryers. Why have Dairy Farmers of America and Land O'Lakes not invested in whey protein dryers, not to mention lactose or whey permeate handling dryer systems? One reason is that tens of millions of dollars are required for investment in whey processing. If the dairy group proposal is adopted, with its higher regulated price for cheese milk, then both the Dairy Farmers of America and Land O'Lakes cheese plants will lose money or break-even at best, based on my knowledge of the operations that they have and the normal costs associated with such operations.

Why have the California dairy cooperatives sold or closed down their large California cheese plants and not developed their remaining cheese making operations? One has

to conclude that it was because they could not profitably operate large cheese plants. Yet now, the dairy group are proposing an increase that will force cheese plants to pay more for milk, despite the fact that when cooperatives were operating these cheese plants they, in all likelihood, could not operate them at a profit. The math simply doesn't work. There is only so much money available with which to pay for a cheese plant, run a cheese making operation, pay dairy farmers for milk and remain competitive with other cheese suppliers in the market. The dairy group proposed formula would simply increase the milk price too much for many of these plants.

My final conclusions:

Many of California's smaller cheese plants will be forced out of business should the dairy group milk pricing proposal be adopted. Several of the cheese plants that I have consulted for over the past many years will be forced out of business. The larger cheese plants may reduce milk use levels as they have the ability to move cheese production out of state. If a modest percentage of cheese manufacturing is moved out of state or disappears due to plant closure then this will provide for an oversupply of milk in California with no ability to sell below the minimum mandated pricing to clear the market.

BESTWHEY supports the Dairy Institute of

California's alternative proposal based on the value of liquid whey and opposes the dairy group proposal. Thank you.

HEARING OFFICER SUTHER: Any questions from the panel?

MR. SHIPPELHOUTE: In your work with the various cheese plants that you interact with, is most of your consultation on the whey handling side of the business or?

MR. MURPHY: I do both. My primary focus is whey and whey project development and trying to extract some value from the whey or maybe even buying whey for plants. I buy whey from some plants that just have liquid whey for my clients. Yeah. I also work with cheese economics and cheese projects and looking at -- obviously milk is a major part of that. I work on general cheese technology. But the economics, cheese economics is more of my focus.

MR. SHIPPELHOUTE: So you're interacting with the marketing side and are pretty familiar with the accounting side of the business?

MR. MURPHY: Yes; extremely, yes.

MR. SHIPPELHOUTE: That's my one question.

MR. EASTMAN: I have two questions. The first one: If you decided to did you want to request the opportunity to file a post-hearing brief?

MR. MURPHY: Yes, please, thank you.

MR. EASTMAN: Okay. And then on page 3 of your testimony you cite specific costs of moving liquid hauls and things of those nature. Is that firsthand knowledge? Do these costs come from firsthand knowledge that you have as you've worked with your clients?

MR. MURPHY: Yes, these are the transactions I'm involved with, yes.

MR. EASTMAN: Okay.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted and thank you for your testimony, Mr. Murphy.

MR. MURPHY: Thank you.

HEARING OFFICER SUTHER: Dr. Erba.

Dr. Erba, will you please state your full name, spell your last name and state your affiliation for the record, please.

DR. ERBA: Eric M. Erba, the last name is spelled E-R-B-A, and I am representing California Dairies, Inc.

Whereupon,

DR. ERIC ERBA

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or other things you would like to enter into the record at this time?

DR. ERBA: Yes, the copy I provided for the

panelists as well as the hearing officer.

HEARING OFFICER SUTHER: The written testimony from Dr. Erba's will be now received as Exhibit 39.

(Exhibit 39 was entered into the record.)

HEARING OFFICER SUTHER: And you may proceed.

DR. ERBA: Thank you. Mr. Hearing Officer and Members of the Panel:

Good morning. My name is Eric Erba and I hold the position of Senior Vice President and Chief Strategy Officer for California Dairies, Inc., whom I am representing here today. California Dairies is a full-service milk processing cooperative owned by 385 producer-members located throughout California and collectively producing 17.4 billion pounds of milk per year, or 43 percent of the milk produced in California. Our producer-members have invested over $500 million in large processing plants at six locations, which will produce about 365 million pounds of butter and 750 million pounds of powdered milk products in 2016. At their March 22nd, 2016 meeting, the Board of Directors of California Dairies approved the concepts contained in the testimony that I will be presenting today.

We thank the Secretary for calling this hearing on her own motion and keeping the hearing focused on only alternative methods for valuing whey in the Class 4b milk pricing formula. For the last four years and up until the

hearing held in June 2015 on this same topic, producer representatives in general, and California Dairies specifically, have argued that the disparity between the whey valuation in California and in federal milk marketing orders has been far too great and has too far of an impact on producer prices to be ignored. The decision from the June 2015 hearing was a refreshing change in direction in that there was validation by the Department of Food and Agriculture of our historic position on whey valuation. Unfortunately, the decision from the June 2015 hearing was only temporary and it is set to expire in July 2016, only 12 months after implementation.

Today's hearing affords us the opportunity to show our support for an improved means to value the whey portion of the Class 4b pricing formula. California Dairies fully supports the alternative proposal submitted by Western United Dairymen, Milk Producers Council and California Dairy Campaign. The proposal replaces both the permanent and temporary tables that generate values for dry whey in the Class 4b milk pricing formula. And I reference the *Stabilization and Marketing Plan for Market Milk for Northern California and Southern California, Article III, Section 300(E)(1)(c) and Article III, Section 300(E)(1)(c)(i)*. replacement table proposed by all three -- by the three producer trade associations is an expanded

matrix for determining the whey value contribution to the Class 4b milk pricing formula, based on the market price for dry whey. The values in the table emulate those achieved by the Class III pricing formula used in federal milk marketing orders. And while I recognize that this is beyond the scope of the hearing today, I will note, just as Dairy Institute did this morning, California Dairies continues to support regular reviews of manufacturing cost allowances relative to the Department's annual manufacturing cost exhibits.

The proposal that California Dairies supports is logical, corrects the well-known deficiency in the Class 4b milk pricing formula and mirrors previous positions taken with regard to whey valuation within the Class 4b milk pricing formula. It is also consistent with the producer-led effort to pursue a federal milk marketing order in California. The proposal is meant to address the singular issue of fair compensation to dairy producers for milk and its components purchased by processors. The permanent means for valuing whey in the Class 4b milk pricing formula has been in place since August 1, 2012. The temporary whey valuation that is to be active from August 1, 2015 to July 31, 2016 preempts the whey scale and provides more value contribution to the Class 4b milk pricing formula. Both tables should be replaced permanently with the dry whey valuation scale proposed by Western United, MPC and CDC.

It is clear that the permanent dry whey valuation scale found in Section 300(E)(1)(c) fails to track within a reasonable range of the benchmark for whey valuation as established by the federal Class III pricing formula. In fact, since January 2012 the California Class 4b pricing formula has averaged $1.72 per hundredweight less than the federal Class III price, almost entirely because of the inferior mechanism used to capture the value of whey. The proposal from the three producer trade associations corrects this deficiency. And I provided a chart which I will be referring to -- a graphic I will be referring to in the rest of my testimony.

From the graphic above it is plain to see that the dry whey scale proposed by Western United, MPC and CDC is superior to both the permanent and temporary scales found in the Stabilization and Marketing Plans. At dry whey prices of $0.28 per pound, the Class 4b price would be about the same using either the temporary dry whey table, which is represented by the green line, or the proposed table, which is represented by the blue line. Both tables would give a higher value and thus a higher Class 4b price than the permanent table, which is shown by the red line in the chart. However, as market prices for dry whey increase, the difference in the contribution to the Class 4b pricing formula grows. For example, at dry whey prices of $0.60 per

pound and using the proposed table, the Class 4b price would be $1.72 per hundredweight higher than the permanent table and $0.46 per hundredweight higher than the temporary table.

In a letter to the California dairy industry dated July 17, 2015, Secretary Ross noted that the implementation of the temporary scale was done with the idea that the, "... adjustment will provide a needed increase in revenue to producers to ensure a stable milk supply." While the decision was welcomed by the producer representatives, it did not have anywhere near the positive impact on producer revenue that was anticipated. Secretary Ross could not have foreseen how the dry whey market would collapse in the fall and winter of 2015, with market prices almost half of what they were just a few months earlier. As such, the increase in the Class 4b price amounted to an average of less than $0.04 a hundredweight from August 2015 to March 2016; the expectation was that the Class 4b price would increase by more than ten time that amount. In essence, the drop in the dry whey prices and the temporary nature of the Class 4b pricing formula adjustment are unlikely to allow producers to realize any meaningful increase in revenues as envisioned by Secretary Ross.

An acceptable level of price difference exists for most classes of milk when comparing California milk prices to federal order milk prices. Until recently, the exception

was the Class 4b and Federal Milk Marketing Order Class III price comparison. The temporary adjustment implemented in August 2015 should have restored some of the equity in what California cheese manufacturers are paying for milk relative to comparable manufacturers around the country and should have also generated much-needed additional revenue for California dairy farmers. To be fair, the gap between the Class 4b price and the Federal Milk Marketing Order Class III price has closed since the June 2015 hearing decision was implemented. However, the additional revenue for producers has not materialized.

The proposal submitted by the Dairy Institute of California contains a significant change to the Class 4b milk pricing formula in that the whey contribution to the Class 4b price is determined by a look-up valuation table built on whey protein concentrate. The rationale offered is that WPC34 would help, "...to make the Class 4b pricing formula better reflect the current market situation and to balance the needs of producers and the diverse types of cheese plants that operate in the state of California."

The Department's background material that was prepared for this hearing shows that the Dairy Institute proposal would have improved the Class 4b price by an average of $0.31 per hundredweight from March 2011 to February 2016 compared to the permanent dry whey valuation

table. However, the most current impact comparison by the Department, that is to say March 2015 through February 2016, shows that the Dairy Institute proposal would have resulted in an average decrease of $0.11 per hundredweight compared to the permanent table. The Department produced no comparison of the proposal to the temporary dry whey scale valuation table, which was shown to be superior to the permanent table in Figure 1 above. I have done my own calculations and for that same time period, March 2015 to February 2016, the Dairy Institute proposal would have resulted in an average decrease of $0.42 a hundredweight compared to the temporary table. And I am delighted to note that my math matches with Ms. AcMoody's math on this one, small segment of time.

While the Department's Panel Report from the June 2015 hearing suggested that a change from dry whey to WPC34 as the mechanism to determine proper valuation for whey in the Class 4b formula may have some merits, the Panel did raise some concerns about the ability of cheese plants to recover any value from their whey stream and the possibility that the Class 4b price may start to move out of sync with the Federal Milk Marketing Order Class III price. Furthermore, the Panel Report emphasized that a change this large in the milk pricing formula should be fully vetted to verify and validate the use of WPC34 as a representative of

the value of whey for California cheese plants. The Panel Report cautioned that before using a new method to value whey in the Class 4b pricing formula, there should be a thorough examination of the issue in order to ensure the needs of producer and processors are balanced adequately. I am not aware that even one industry meeting has been called or held to consider the use of WPC34 as the representative value of whey in the Class 4b pricing formula. Consequently, California Dairies cannot consider supporting a recommendation to support (sic) WPC34 for dry whey.

California dairy producers have been faced with a number of challenging obstacles that have resulted in fewer and fewer new dairies being constructed. The long list of challenges has also encouraged some dairy producers to consider what options may be available to them other than operating a dairy farm. Although lack of water is just one factor, dairy producers' experiences with a shortage of a scarce resource have played a role in altering their business decisions, which has affected how their businesses operate. I would like to add some perspective on what lack of water has done to the California dairy industry.

It is well-known that despite more rainfall and snowpack this year California continues to face a terrible drought, brought about by four consecutive dry years. Not surprisingly, the drought has had and will continue to have

for the near future significant implications for dairy farms in California, particularly those that grow some of their own feed.

Last year I shared some examples of the negative impacts of the drought on members of California Dairies and their decisions for growing feed for their dairies. Today, I am providing additional and updated material as substantiation of the impact of the California drought on dairy farming. I have four examples for you.

Dairy 1 farms 1,500 acres. When obtaining water to grow crops is not an issue the dairy grows 200 acres of alfalfa, 600 acres of corn and 700 acres of sorghum. However, the drought has altered the planting decision to include just 200 acres of corn with the remainder of the ground left unfarmed. Alfalfa and corn take substantial amounts of water and cannot tolerate stress very well.

Dairy 2 farms 1,000 acres. When obtaining water to grow crops is not an issue the dairy grows 200 acres of alfalfa and 800 acres of corn. This year, the dairy will farm zero acres of alfalfa, zero acres of corn and all 1,000 acres of sorghum. And momentarily I will discuss the effects of substituting sorghum as a dairy feed.

Dairy 3 farms 450 acres. When obtaining water to grow crops is not an issue the dairy would farm 50 acres of alfalfa and 400 acres of corn. This year, because of the

water allocation restrictions, the dairy will farm 350 acres of sorghum and let 100 acres go fallow, unfarmed.

Dairy 4 farms 600 acres. When obtaining water to grow crops is not an issue the dairy farms 200 acres of alfalfa and 400 acres of corn. This year the dairy will farm 600 acres of sorghum and zero acres of alfalfa or corn.

Because sorghum has become an increasingly popular choice for California dairy producers who do grow some feed, I would like to offer some explanation as to why dairy producers are choosing sorghum as a substitute crop. Sorghum is a warm-season annual that may be used to produce silage that is fed to dairy cattle. And when compared to corn, sorghum uses less water and is more heat- and drought-tolerant, which is important to California dairy producers when irrigation water is limited. In general, sorghum has higher concentrations of protein, fiber, lignin and ash but lower concentrations of starch compared to corn silage. While sorghum silage is not a replacement for corn silage, it can be successfully used in rations fed to growing or lactating dairy cattle if supplemented with other higher energy feeds such as rolled corn. However, given a choice, without water restrictions producers would choose corn silage over sorghum silage.

Dairy producers may also choose to supplement dairy rations by adding more alfalfa hay, which must be

brought in from out of state. The Department's background material that was prepared for this hearing verifies that while milk cow-quality alfalfa has dropped in price from a high point of over $300 per ton, it remains an expensive supplemental feed at just over $250 per ton.

We recognize that attempting to establish a milk price high enough to erase the historical financial losses sustained by dairy producers as a result of years of inappropriate whey valuation is problematic. As stated earlier in my testimony, the proposal that we support is meant to address the singular issue of fair compensation for dairy producers for the milk and its components provided to processors. Said another way, producers are entitled to be compensated fairly for the product they produce.

There seems to be a common theme underlying past hearing decisions by the Department, and that is to say, if there is a sufficient milk supply to service milk processing plants then there is no need to increase the milk price. A corollary to this basic notion is that establishing a higher minimum price will only lead to more milk production. It does not take much of an analyst or a historian to conclude that managing the State's milk supply by adjusting minimum pricing formulas only occasionally is ineffective and inefficient. All of the major cooperatives and some of the proprietary plants arrived at that same conclusion years ago

and adopted programs that allocate milk production shares to producers based on the ability of the entity to handle its milk supply. These programs are actively managed and can adjust with market conditions much faster than the Department can call hearings and institute milk pricing changes.

My concluding remarks:

California Dairies supports the whey valuation proposal submitted by Western United Dairymen, MPC and CDC; and that is to say, California Dairies favors the adoption of the expanded dry whey valuation table and making that table permanent. The proposal is logical, corrects the well-known deficiency in the Class 4b milk pricing formula and mirrors previous positions taken regarding whey valuation within the Class 4b milk pricing formula. We urge the Department to adopt the proposal as a means to bridge the financial gap from where California milk prices are today and where they need to be to prevent further attrition on the producer side of the California dairy industry.

I would like to request the opportunity to file a post-hearing brief if necessary.

Thank you for your attention. I am happy to answer any questions you may have.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

Any questions?

MR. SHIPPELHOUTE: In your opening paragraph you talk about how many producer-members you have at CDI. Is that number increasing or decreasing?

DR. ERBA: Decreasing.

MR. SHIPPELHOUTE: And the decrease, is that due to producers going out of business or are they shipping to other processors, other handlers?

DR. ERBA: Both. For the most part they are going out of business but we do have some that are leaving the cooperative to go another place to market their milk.

MR. SHIPPELHOUTE: Other cooperatives, do you know or proprietary plants?

DR. ERBA: They have left to go to proprietary plants or cooperatives, some have gone out of state.

MR. SHIPPELHOUTE: On page 3 of your testimony you talk about the proposed whey scale as being superior. I assume your use of the term "superior" means more money for producers?

DR. ERBA: That's correct.

MR. SHIPPELHOUTE: Okay. Just trying to clarify the record.

DR. ERBA: Yes.

MR. MONSON: I had a follow-up question to Mr. Shippelhoute's question about the number of dairies. If

CDFA was to adopt the producers' proposal, what impact would that have on dairies exiting the industry or even on declining milk production?

DR. ERBA: Well I think the trend is toward fewer farms and it looks like, from our point of view, less milk being produced, and we have seen that over the last couple of years. I think the hope is that adopting this proposal will slow both those down and hopefully significantly. I really have a hard time understanding that adopting this proposal would change things and push it the other direction where we would have an increase in dairy farms and an increase in milk production.

I just don't think the economics are there right now. We look at the competing interests for scarce resources and we see that in the past dairy came out on top and dairy was a logical choice for many of those things, labor, land, water. That's not the case right now and our dairymen realize that. And they have diversified over the years and I think they've experienced good successes in some of their farming operations. So that pressure is going to be there for dairy to perform or sustain more losses on the producer side.

MR. MONSON: Thank you.

MR. EASTMAN: I have a couple of questions. On page 4 and 5 of your testimony you gave the examples of the

four dairies and their farming choices. Are those hypothetical?

DR. ERBA: No, those are --

MR. EASTMAN: Those are real dairies?

DR. ERBA: Those are actual members; what they are actually doing or what they have done or will be doing this year.

MR. EASTMAN: That's what I thought, I just wanted to clarify that.

With regards to the milk supply compared to plant capacity or the demand for milk by processors in California. How is that balance looking now? We met last summer but I guess we're eight or nine months down the road. How does that balance look according to your view?

DR. ERBA: We tracked this pretty carefully. A lot of our, a lot of our budget planning that's done prior to the year is based on milk supply. And what we thought earlier this year when we did this exercise was that we would have a loss in milk production but we'd still be about where we thought we would be the last, say, five or six years on average, and we haven't had that happen. We are now at what we call our peak. April is basically our peak. March/April tend to be our peak for our co-op. And we are -- even though last year was not the high water mark we are still down from that, so we have a decreasing trend. Kind

of our magic number has always been, you know, where do we sit with 50 million pounds of milk produced on a daily basis? We haven't hit 50 yet this year and we have exceeded 50 quite substantially in years past. Last year we were at 52.5 million pounds of production per day and we haven't hit 50 this year. So we are definitely much, much lower than we were last year.

The balancing part you asked about: We've got contracts to supply customers and we adhere to those contracts, which means the milk to do that has to come out of our own plants and so even now our plants are running okay in terms of capacity. We expect that as the year goes on and summer comes in and milk production drops accordingly we will not have that milk supply to run through our own plant and we may have to do some real hard thinking about what to do to -- which plant should be operational and which plant should be greatly reduced.

MR. EASTMAN: Is it possible at some point in time you'll reach, I guess, a spot where you are just going to have to either stop shipping milk to some of your clients in order to put milk through your plants or do you think you'll always have the business plan where you'll attempt to supply your clients first, your customers?

DR. ERBA: I think what we have seen over the past several years with milk supply contracts is they have real

teeth. So if you are going to sign a contract to supply milk then you will be held to the terms of that contract. And unless you can renegotiate the contract then you're expected to provide by the terms of that contract. So we'll continue to pull out milk from our plants to make sure that our customers are supplied. Now in theory, yes, there could be a point in time where we do not have enough milk to do that but hopefully that's quite a ways down the line, if ever.

MR. EASTMAN: And then another question I had was regarding contracts. They tend to be long-term in nature, maybe measured in years; is that correct? Or are milk supply contracts shorter than that?

DR. ERBA: We have, we have all kinds. We have what we call our spot contracts, which may be basically one day's worth, maybe a week's, maybe a month. I would say most of our contracts of the nature that maybe you and I would think about are a year in length, maybe two. In the past we used to try to set those up to be a little longer, so maybe three or more years, but anymore because we don't know our future nearly as well as we did in the past we are less inclined to make a long-term commitment to supply milk. And we want them to be shorter so we can rethink what our supply situation might look like.

MR. EASTMAN: And then when you're establishing

your contracts with your customers are there any clauses that allow you to modify premium levels or try to negotiate premium levels before that contract ends? Because lots of times we hear conversations of premiums and how premiums should be a way to entice more milk production or get more milk when necessary but is that possible within the scope of the way the contracts are set up or how exactly does that work?

DR. ERBA: I'd say for the most part, no, unless it's specified somehow in the terms of the contract that there would be a period during which during the contract there may be some renegotiation. But typically that's not the way they work. The terms of the contract, which would include the premium level, are specified for the term of that contract. Which is, again, another reason why we have tended towards shorter contacts than longer ones, lately.

MR. EASTMAN: Gotcha. I think I have one more question. I guess I don't.

HEARING OFFICER SUTHER: Thank you for your testimony, Dr. Erba.

DR. ERBA: Thank you.

HEARING OFFICER SUTHER: Mr. Paris, will you please state your full name and spell your last name and state your affiliation for the record, please.

MR. PARIS: My name is Joe E. Paris, the last name

is P-A-R-I-S, and I am testifying on behalf of Gallo Cattle Company doing business as Joseph Farms Cheese.

Whereupon,

JOE E. PARIS

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or other things you would like to enter into the record at this time?

MR. PARIS: Yes, I have a written statement and you have a copy of it.

HEARING OFFICER SUTHER: Mr. Paris, your statement, written statement, will be Exhibit number 40.

(Exhibit 40 was entered into the record.)

HEARING OFFICER SUTHER: You may proceed.

MR. PARIS: Mr. Hearing Officer and Members of the Hearing Panel:

My name is Joe E. Paris. I am a dairy consultant representing the Gallo Cattle Company doing business as Joseph Farms Cheese. I am responsible for the milk and cream coming into and out of Joseph Farms' cheese plant. I provide market and other pertinent information to senior management at Gallo on a daily basis. This testimony was approved by Michael D. Gallo, CEO of Gallo Cattle Company.

Joseph Farms Cheese is located at 10561 West Highway 140 in Atwater, California. At this location we

have the Gallo Cottonwood Dairy and the Gallo cheese plant, know as Joseph Farms Cheese, as well as Gallo Global Nutrition, a whey processing plant. Two miles east of the Gallo cheese plant is the Gallo Santa Rita Dairy. Between the two dairies Gallo milks approximately 8,000 cows. We farm several thousand acres to provide feed for our milk cows.

In 1983 the Joseph Farms cheese plant was built and over time the plant has been improved and expanded continuously. The cheese plant plans to process close to 450 million pounds of milk this year into various cheese varieties including cheddars, Monterey Jack, mozzarella blocks and pasta filata. At this time, 75 percent of the milk that Joseph Farms processes is bought from outside suppliers. We concentrate whey from our own plant and are a market for concentrated whey or WPC from other small plants in the area. The WPC is processed and dried into whey protein isolate at the Gallo Global Nutrition plant, part of the Gallo complex.

Domestically we sell packaged cheese under the brand of Joseph Farms Cheese. Most of this cheese is found in grocery chains or Walmart and Costco. We also export cheese into Mexico, both branded and unbranded. About 40 percent of our cheese is sold as commercial blocks or food service.

Gallo has always tried to invest in ways to not only improve our efficiency, but in a way to protect the environment. The Gallo methane digester provides electricity to operate the plant. Waste water from the plant is used to flush the Cottonwood Dairy lanes to a separator where solids are taken out before the liquid goes into the digester. Solids are then composted and used to fertilize land. This system cost millions of dollars to build and maintain. Gallo Global Protein is another huge investment where we process WPC or whey from our cheese plant and from a few other small cheese plants. Until recently, much of this whey was being dumped or fed to cows.

If Joseph Farms Cheese had been required to pay the 4b price that would result from the producer proposal, none of these improvements could have taken place. Joseph Farms Cheese is a small plant when compared to many other plants in California and we would not have been able to generate the type of profits to invest in these long-term sustainable projects. Without profits there are no investments.

As mentioned earlier, Joseph Farms milks approximately 8,000 cows in two facilities. We certainly understand the plight of dairymen in the state of California. We know what the cost of production is on a dairy farm and we know about the cost of production in a

cheese plant because we experience it every day. Some years they both make money and some years they both lose money. Both as dairy producers and cheese plant operators we are at the mercy of the marketplace. Volatility can be the enemy and is the enemy of both producer and processors at times. Long-term planning and investment is needed in order to grow both the producer segment and the processor segment of the dairy industry. If the proponent's proposal is adopted as written it is our opinion that the cheese sector will stagnate almost immediately. Medium and small plants will no longer be able to sustain their processing plants. Producers will find themselves with fewer markets. The California market will find itself in pre-1985 position of having mostly a butter-powder industry. All of this I testified to in the hearing held on June 3rd, 2015. What is different today is that the dry whey prices have fallen 63 percent in the last two years and WPC prices have fallen 68 percent at the same time. However, because of the State of California's temporary price increase enacted in August our whey cost in milk have not reduced as much. This leaves very little margin to manufacture WPI.

Many here have spoken to the disparity between the Federal Order whey factor and the California system and we would like to address it as well. For the last eight months California has averaged 12 percent premium to the federal

order and we have none of the tools to de-pool or avoid the minimum price.

And you'll see I have a chart in there that was put together by our Ingredients Director where it shows that under the old formula that was established in comparison to where we are today, the old factor that was established in 2007 under today's conditions would have been a -$0.1233 to the processor. In today's temporary it's a $0.32-plus on the average for those months. And compared to the whey factor in the Federal Order Class III price, was only $0.2864 when you're looking strictly at the whey factor.

In fact, the current whey formula has averaged $0.44 per hundredweight premium to the whey factor that was in place during 2007. The whey factor that the State of California Hearing Panel for the October 10-11, 2007 hearing declared in their recommendations to the Secretary:

> "Based on the Panel's analysis of the hearing record, the Panel is of the opinion that the current whey factor in the Class 4b pricing formula has probably caused negative cash flows for most California cheese processors during 2007."

In evaluating both the state's temporary formula and the producer group's proposal we need to ask, why are we looking at a formula that pays even more than the formula

that the state admitted isn't economically viable? The formula that stated everything to begin with -- The formula that started everything to begin with 10 years ago.

How would we respond at Joseph Farms Cheese? One scenario would be to eliminate much of our outside suppliers of milk and reduce our cheese sales to fewer customers willing to pay higher prices. At the very least we would have to eliminate any premiums or handling charges we currently pay our suppliers. We would also look at purchasing potential unregulated out-of-state milk at prices lower than California's when it is available.

Producers have a tendency to look at the Midwest or the East Coast and feel that they are being deprived of a fair price. These producers serve an entirely different market than what we have in California. Because of their locations these areas serve the vast population that runs from the Midwest to the East Coast and from Maine to Florida. They can demand higher prices for their products because they are the source area for the East and the South. Much of California's production services not only the West Coast population but also Mexico and the export market. These export markets, including Mexico, cannot pay the prices that would be needed to offset the increased cost of the whey factor. Mexico is currently importing cheese from Europe and Oceania at prices below California-produced

cheese. The European price was $1.3150 and the Oceania price was $1.1566 last week. The GDT price on April 5th was $1.26 per pound of cheese. Independent family operated plants such as Joseph Farms cannot receive export subsidies like cooperative cheese plants from Cooperatives Working Together. All of this is putting pressure on Joseph Farms' cheese export sales including sales into Mexico, one of our major sales areas.

Even in the emerging markets, incomes will not allow any chance for profits or growth. We know that any time the market price of cheese is greater than $1.90 per pound, cheese sales to Mexico come almost to a standstill. Over $2.00 cheese greatly reduces the market in Mexico and slows sales of our cheese here in the West.

In addition to that we are seeing our costs of doing business forever increase in the state of California with a $15 minimum wage being the newest example. In this environment any additional cost added onto our margins will make us re-think our business model. Specifically, we are being offered milk from out of state at a discount and as costs rise in California this may become one of our new normal procurements.

In the Federal Milk Marketing Orders, plants are allowed to de-pool and there are no minimum pricing laws that require a minimum payment for de-pooled milk. Due to

large increases in milk production in other parts of the country it has been reported that milk has been purchased by Midwest cheese plants for as much as $7.00 per hundredweight below minimum regulated prices. In California it is unlawful to pay less than the regulated price unless the milk does not meet the Grade A standards of quality and milk is degraded.

Let me pause from my written statements and say this: At Gallo we purchase nothing but Grade A milk. On the Joseph Farms label it says 'Made from Grade A milk only' so we do not have the ability to purchase a Grade B or degraded milk in our plant.

Many of the plants in the Upper Midwest have much lower overhead costs due to regulations that have absolutely nothing to do with milk. Many of the plants are medium to small and process specialty cheeses. Some are able to buy manufacturing grade milk at a reduced cost on a regular basis. In the last several years we have seen large cooperative cheese plants closed in California due to the losses under the current pricing system. Industry rumors say that another cooperative cheese plant in California may close soon.

Joseph Farms Cheese is opposed to the producers' proposal as it is written. The sliding scale for whey would eliminate any profits for investment into new technologies

that would add value to the 4b milk. For some plants it would mean closure. For others, it might mean a complete change in the way they do business, including the amount of milk that they could purchase. I know of cheese plants that have planned to add additional cheese-making equipment or whey processing equipment that would not be able to meet that plan due to dramatically increased milk costs. The cost of raw milk in a cheese plant can be as much as 85 percent or more of its total cost. Adding the average of the last five years of $1.38 per hundredweight to the current 4b price will make California processors greatly disadvantaged to cheese processors in surrounding states such as Washington, Oregon, Utah and Idaho. Idaho and Utah are not price regulated under any state or federal order.

Joseph Farms Cheese supports the principles of the Dairy Institute proposal and particularly the concept of moving the whey pricing from the dry whey to the whey protein concentrate, WPC, a much more market-oriented price today. It recognizes a value for the whey that is always positive and has a reasonable cap. It also generates a revenue stream that is sustainable and in line with the State of California's own payment ability analysis: a $0.3099 whey make allowance and a yield factor of less than 5.8. It is important that the factor step up at the level less than 5.8 because based on the Department's panel report

from the October '07 hearing it said:

"At the time the Department incorporated the current whey factor into the formula, the Department lacked data or analysis to determine a dry whey yield appropriate to California. Now, the statements from witnesses and the Panel's review of Departmental data strongly suggest that the 5.8 yield is overstated."

The Dairy Institute proposal is also based on whey products that are produced in California. It is our understanding that there are no more than two plants in California that is currently drying whey. Most whey product pricing is related to the WPC price rather than the dry whey market. It is the opinion of Gallo that the scale used in the Dairy Institute's proposal is still too high for small to medium cheese plants, although it may be all right for very large, newer, efficient plants. Gallo is concerned that the implementation of the producers' proposal will force the closure of several small to medium size cheese plants, including Gallo's. This will result in less processing capacity in the state and more producer milk seeking a market. Over the years we have had many "temporary" adjustments that make it difficult to make long-term plans in processing. We support the Dairy Institute proposal as a permanent whey factor.

State or federally regulated milk prices should be minimum prices based on the best market-oriented criteria and should not be changed every few years. Producers have the right to negotiate higher prices than the state minimums based on the individual plant's ability to pay above the regulated price. Joseph Farms Cheese pays its suppliers based on a service charge, cheese yields, quality and other incentives to provide Gallo with high quality milk. We would like to be able to continue such programs that increase the returns to the milk producer.

We believe that this hearing has been called at this time not only to continue or make permanent the temporary whey factor but because of low producer prices due totally to global marketing forces. Temporary price relieve should be borne by all classes of milk, not just the cheese and whey plants. This extension of the temporary whey factor is patently unfair to the cheese processors and capricious on its head.

We want to thank the Secretary, Hearing Officers and Panel for this opportunity to testify in this important hearing and we would like to request a post-hearing brief.

HEARING OFFICER SUTHER: Your request to have a post-hearing brief is granted.

Questions?

MR. MONSON: I had a question, Mr. Paris. On page

one of your testimony you talk about sourcing liquid whey from small cheese plants.

MR. PARIS: Yes.

MR. MONSON: I was wondering if you could comment on how you guys agree on a price for that product. Is it based on WPC34 and specifically what's published in the *Dairy Market News*?

MR. PARIS: Yes. Today most of what we purchase is based on what the Central West WPC34 price is from *Dairy Market News*. Years ago we did use a whey factor but we've gotten away from that because the WPC price is much more market oriented for the products that we make and for the products they sell.

MR. MONSON: And I think you referenced -- is there like a certain percentage off of that price that you guys use as a rule of thumb?

MR. PARIS: There is a formula that we have put together that we use when we negotiate with these plants.

MR. MONSON: Okay, thank you.

MR. PARIS: I'm not going to get into it.

MR. MONSON: No problem. Thank you.

MR. SHIPPELHOUTE: You mentioned that you would look at purchasing potential unregulated out-of-state milk.

MR. PARIS: Mm-hmm.

MR. SHIPPELHOUTE: And you also mentioned

somewhere later that that has been offered.

MR. PARIS: Yes. We had someone in our office here within the last month, month and a half, that has offered some out-of-state milk when it becomes available.

MR. SHIPPELHOUTE: And how often is that available?

MR. PARIS: At this point I don't know. We have not purchased any at this point but believe at some point in time there may be that offer. There was opportunity a couple of months ago when a large plant up in Utah had shut down because of a collapsed roof. That has been taken care of and that milk is not available today.

MR. SHIPPELHOUTE: So I'm just thinking around the area surrounding or the states surrounding California and what plants and what I've heard of marketing conditions and milk supply. Aside from that example you mentioned where there was a plant breakdown where would the closest supply of out-of-state milk come from that would be a consistent supply for Gallo?

MR. PARIS: I don't know that there right now is a consistent supply out there.

MR. SHIPPELHOUTE: That's all I have.

HEARING OFFICER SUTHER: Thank you for your testimony, Mr. Paris.

Mr. Eddinger. Eddinger.

Mr. Eddinger, will you please state your full name, spell your last name and state your affiliation for the record, please.

MR. EDDINGER: Sure. My name is Edward M. Eddinger, the last name is E-D-D-I-N-G-E-R, and I am affiliated with the Alouette Cheese Company.

Whereupon,

EDWARD EDDINGER

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or other things you would like to enter into the record at this time?

MR. EDDINGER: Yes, I would like to enter into the record the written statement which I gave to you a few moments ago.

HEARING OFFICER SUTHER: Okay. The written testimony will now be received as Exhibit number 41 and you may proceed.

(Exhibit 41 was entered into the record.)

MR. EDDINGER: Thank you. Thank you to the members and thank you for taking the opportunity to hear my testimony today.

As stated, my name is Edward Eddinger. I am the Dairy Procurement Manager for Alouette Cheese USA. My responsibilities include buying dairy raw materials, such as

milk, for three Alouette cheese plants which are located in New Holland, Pennsylvania, Lena, Illinois and City of Industry, California. We employ about 350 people at all these locations and we produce gourmet cheese spreads, soft-ripened cheeses, goat cheese and cream cheese. The plant in City of Industry, California - which we also call the Fleur De Lait West facility - produces cream cheese for retail, industrial and food service customers in the Western half of the US. In addition, it supports a growing cream cheese export business from this particular location.

In terms of the proposals offered for changing the 4b milk price formula, our preference is to continue the existing whey pricing scale for another 12 months. Alouette opposes the proposal from California Dairy Campaign, Milk Producers Council and Western United Dairymen to dramatically increase the 4b milk price for reasons that I will explain in my testimony.

Unfortunately, the liquid whey from our cream cheese production is acid whey and not only has no value to us; but we incur a cost of between $250,000 or more per year to dispose of the byproduct as animal feed. Unlike other cheese plants, we do not have the ability to dry the whey to make a marketable product. For our plant, whey has a negative value. Therefore, any value above zero that is placed on whey in the 4b formula is value that we cannot

extract from the whey stream. This is similar to other small cheese plants around the state that produce sweet whey. The net result to our business is higher raw material costs and lower margins, as it would be difficult to pass any of these price increases proposed by the producer groups. In addition, we cannot determine exactly what this impact would be given the volatile nature of whey prices over time. But what we do know is this proposal would have a harmful impact to our business.

The plant in City of Industry needs to maintain a cost structure that is competitive with other companies but also is competitive with our other Alouette plant in Pennsylvania. If the milk cost in California increases relative to other parts of the country, it has a direct and negative impact on our competitiveness versus other suppliers of cream cheese, particularly ones in nearby states, which we compete against. This could lead to reduced margins to maintain competitiveness or losing sales due to higher prices than our competitors. Neither of these outcomes, of course, help grow our business and use more California milk. In addition, if the plant volumes are not growing, future investments will not be forthcoming as we deploy limited capital resources to other plants.

In summary, we support maintaining the current 4b milk price formula. We already lose over $250,000, which I

have stated, in disposing of our whey. I would just pause for a moment to say that we are looking at other options and we are always open to suggestions on how to dispose of whey at reduced cost but we have not found any at this time. An increase in our raw material milk costs without a corresponding gain in revenue will negatively impact our margins and profitability. Therefore, we strongly oppose the proposal from California Dairy Campaign, Milk Producers Council and Western United Dairymen. While not our preference, we can support the Dairy Institute proposal when viewed as a compromise despite the negative financial impact we would experience.

I thank you again for the opportunity to testify here today and would like to file a post-hearing brief if necessary. And I welcome any questions you may have. Thank you.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

Any questions from the panel?

MR. MONSON: Thank you for your testimony, Mr. Eddinger. I had a question just to clarify for the record. When you say you want to continue the existing whey pricing scale are you referring to the temporary one that is currently in place or the permanent one that was in place prior to that?

MR. EDDINGER: The one that is currently in place that was enacted June of last year.

MR. MONSON: Okay. And you are supporting continuing that on a temporary basis for another 12 months?

MR. EDDINGER: Yes, that is correct.

MR. MONSON: Okay, thank you for that clarification.

MR. EDDINGER: Thank you.

MR. EASTMAN: I have one question. You mention that there is a net cost to disposing of your whey so I assume that is just because whatever processing or transportation costs associated are higher than whatever revenue you get from selling it. Do you receive any revenue at all?

MR. EDDINGER: We do not receive any revenue at all. Our current situation, we have an agreement for somebody to come in; we pay them to take it out and really dispose of it or use it, sell it off as their own. We are not getting any funds at all for it right now.

MR. EASTMAN: Thank you.

HEARING OFFICER SUTHER: Thank you for your testimony.

MR. EDDINGER: Thank you.

HEARING OFFICER SUTHER: Special provisions have been made to allow witnesses presenting three minute

testimony or less. There is a sign-up sheet in the back of the room. After lunch, after the first couple of presenters we will take those three minute testimonies.

Right now we are going to go to lunch and we will reconvene at one o'clock.

Mr. Dryer, you will be up first.

(Off the record at 12:06 p.m.)

(On the record at 1:04 p.m.)

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A F T E R N O O N S E S S I O N

HEARING OFFICER SUTHER: Okay, let's go on the record. It is now 1:04.

I would like to take this opportunity to announce that the opportunity to submit a post-hearing brief amplifying, explaining or withdrawing your testimony is granted for all witnesses who request a post-hearing brief period. In order for the brief to be considered the Department must receive the brief by Monday, April 18th, by 4:00 p.m. The brief may be e-mailed to dairy@cdfa.ca.gov or submitted to the Department's branch office located at 2800 Gateway Oaks Drive, Sacramento, California, 95833. The brief may also be faxed to area code 916-900-5341.

So we will now proceed with the public testimony section and our first witness will be Mr. Dryer.

And also, after the next two witnesses we will do the three minute testimony so please sign up if you are interested in that.

Mr. Dryer, will you please state your full name, spell your last name and state your affiliation for the record.

MR. DRYER: Full name is Greg Dryer, D-R-Y-E-R, and I am with Saputo Cheese USA Inc.

Whereupon,

GREG DRYER

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or other things you would like to enter into the record?

MR. DRYER: I do, which I have distributed and would like that to be introduced.

HEARING OFFICER SUTHER: The written testimony of Mr. Dryer will be entered and will be Exhibit number 42.

(Exhibit 42 was entered into the record.)

HEARING OFFICER SUTHER: You may proceed.

MR. DRYER: Thank you.

My name is Greg dryer. I am Senior Vice President of Industry and Government Relations for Saputo Cheese USA Inc. Our company, Saputo Inc., operates seven facilities in the state of California. We employ more than 1,500 people here and purchase a substantial portion of the state's milk production both directly from farmers and from farmer cooperatives. We are very familiar with conditions in other regions from our experience operating 21 facilities in 10 other states.

I am here to testify in support of the Dairy Institute of California's proposal to replace the permanent whey scale with one based on the value of liquid WPC34. We oppose an extension of the temporary whey scale, but if an extension is granted we ask that it be limited to a period

not to exceed six months. Six more months is approximately nine and one half months from now and makes the entire duration 18 months. Anything further could not reasonably be deemed "Temporary."

World Dairy Situation.

The dairy recession is not a California problem Dairy farmers all over the world are facing the challenge of low prices. Those low prices have been driven primarily by over-production.

I've included a chart here that shows the seven major dairy exporting countries and their production relative to prior year for recent months.

How is the problem being dealt with around the world? In Europe, the limited assistance the government is providing is funded from general tax revenues while the market continues to function unimpeded. In New Zealand, the government has elected not to intervene and the farmers are feeling the full brunt of the major decline in market prices. Again the market is allowed to function. The market is allowed to function despite the fact the milk price crisis facing those two major dairy regions is far worse than the one that exists here in the United Sates. Those governments recognize that the market does and will prevail.

We have a strong domestic market that insulates us

to some degree against conditions impacting the rest of the world.

And here I've included a chart showing US cheese commercial disappearance growth in recent months versus the long-term trend. As you can see it's been quite strong.

And then underneath that a chart showing Farmgate milk prices around the world, China, Netherlands, New Zealand and the US and it shows the US All Milk Price is well above our competitors from Europe and New Zealand.

But here in California, when producer margins come under pressure, the solution sought time and time and time again is to petition the government to require cheesemakers to pay a higher price than the market will bear. In effect, this suggested solution would subtract from one group's problem and simply add it on another's.

If the current trend of declining milk production in California continues, the price of milk will inevitably rise. It won't, however, rise to the level of the Federal Order price. It will only rise to the point that cheesemakers can continue to justify maintaining their investment here, given those economics that are specific to operating in California. If the government mandates a price above that benchmark, demand for milk will inevitably decline as cheese plant reduce or cease their production here. With cheese representing 46 percent of California's

milk market, it is possible that the farmers would be unable to sell all their milk and could well be worse off than they were before. The market is oblivious to milk production costs or cheese plant profitability. It is relentless in its pursuit of equilibrium, like flowing water seeking a place to settle. Efforts to circumvent it only delay the inevitable.

California's 4b Whey Factor.

This hearing is coming at a time when most if not all cheesemakers are not covering the costs on their whey byproducts. The chart below shows the movement of whey product market prices since 2014.

And for those of you that don't see it I have 2014, '15 and '16 represented for WPC80, 34, Dry Whey and Lactose. And basically all those prices over that period of time are down in excess of 60 percent.

Despite negative returns on whey, cheese processors continue to pay producers a milk price that incorporates a positive whey contribution. That distorts the reality.

The current Temporary California Class 4b Whey Factor effective August 1st, 2015 through July 31st, 2016 has exceeded the federal whey factor for four of the seven months since it was implemented. In fact, on average, it has exceeded the federal factor for the entire period.

Notwithstanding those facts, we are here once again to consider extending or even increasing the California Whey Factor.

And there again the chart shows -- the blue bars are the temporary California price and the reddish or orangish bars are the federal price - so you can see which are higher and lower - and then the dotted lines show the average over the whole period.

Transporting of Whey.

Under end-product pricing, whey make allowances remain relevant to any discussion revolving around the appropriate value to assign whey in the pricing of milk. California abandoned that type of whey pricing in December 2007 when the high dry whey price created a crisis for the state's cheesemakers. But all the adjustments and debates that have since followed have centered on a comparison of the California whey factor to that of USDA. The whey make allowance remains a key variable in the federal whey factor so it must be deemed pertinent to this debate.

Whey make allowances assume that 100 percent of whey solids are recovered and processed on site in the form of dry whey. There is no provision for whey hauling. That logic is flawed. Whether hauling is paid for by the shipping plant or the receiving plant is irrelevant. It is pat of the cost of whey processing. Small to medium sized

plants are unable to justify the investment in whey processing. They are forced to transport the whey to those processors who will accept it or dispose of it at a cost. Transporting whey erodes much of its value given the high water content. This transportation cost issue is not just limited to small operators. Saputo in California, for example, has centralized whey processing in one major facility. Over half of the whey processed there is shipped at a substantial cost from four other Saputo facilities. Moving whey 100 miles or more virtually eliminates the potential to generate a profit from it. The federal make allowance does not provide for the cost of transporting whey.

I've included a little table there that shows the cost per pound of whey solids for shipping whey at various distances. So you can see -- and it's based on a rule of thumb of cost per loaded mile of $3 for hauling liquid refrigerated product and an assumption of 50,000 pounds per load. And it uses a 6.5 percent factor for whey solids, which is conservative, because that's a fairly high solids number. But you can see for 100 miles the cost is $0.092 per pound of solids.

So today the whey market is below $0.25, $0.245, whatever. The last California whey make allowance in 2007 was approximately $0.27. Manufacturing studies since then

have indicated those costs have gone up substantially. But a $0.245 value of whey, $0.27 make allowance, you are already losing $0.02, $0.025 a pound. And when you add the cost of transporting whey, for instance, if you haul it 100 miles. Say half of your whey is hauled 100 miles so that's $0.092, half of that is $0.045. Now you're losing $0.06.

And then to add insult to injury, in California we're paying $0.385 per hundredweight of milk for the value of whey that we're already losing money on. So $0.385 of milk is about $0.065 per pound of whey. So now we're up to $0.13 basically loss on whey, which equates to about $0.80 a hundredweight of milk. Just to give you a little perspective on what the whey situation is today.

In 2012, a consortium of Wisconsin industry leaders, known as the Wisconsin Whey Opportunities Working Group, collaborated to survey the volume and processing of cheese whey in Wisconsin. The working group included: The US Department of Agriculture National Agricultural Statistics Service, University of Wisconsin - Madison College of Agricultural and Life Sciences, Wisconsin Center for Dairy Research, Wisconsin Cheese Makers Association, Wisconsin Department of Agriculture, Trade and Consumer Protection, Wisconsin Economic Development Corporation and the Wisconsin Milk Marketing Board.

Of the 125 plants they surveyed, half did not

process their whey at all and 72 percent shipped their whey in liquid form to other plants for further processing.

The Wisconsin study is relevant to California because Wisconsin has many more whey processing options for cheese companies than does California. It gives an indication of the extent to which whey must be transported before it is ultimately dried in some form. It clearly demonstrates some of the major shortcomings in the federal whey factor. Many plants concentrate the whey prior to shipping, not because there is a significant economic benefit, but because it is logistically impossible for shipping and receiving facilities to handle the number of trucks required to carry that volume of dilute liquid. Transportation savings from the reduced number of concentrated loads are almost entirely offset by the cost of installing and operating concentration systems. Those operating costs include energy, membrane replacement, cleaning chemicals, waste treatment and labor, among others. A whey processor's cost savings from receiving a concentrated product at the whey processing plant are negligible at best.

Not all whey is processed.

The federal whey make allowance assumes that 100 percent of the cheese whey solids are recovered and processed on site in the form of dry whey. The American

Dairy Products Institute publishes an annual report called, "Dairy Products Utilization and Production Trends." It contains a schedule which attempts to account for all whey solids produced called "Estimated U.S. Fluid Whey & Whey Solids Production (by Type) and Resulting Quantity of Whey Solids Further Processed." That schedule which follows this paragraph accounts for just 53 percent of whey solids in 2014, the most recent year reported. While the accuracy of that estimate may be debatable, it clearly demonstrates the fallacy of the assumption that all whey solids are captured and sold. Also, of the whey solids that are processed and sold, many are not sold profitably.

And you can, you know, look at the table. It's basically calculating an estimated amount of whey being generated across the United States and then how much is being processed into the various categories such as dry whey for human and animal use, WPC, other concentrated whey solids; and it comes down to a number for 2014 of 53 percent of all whey solids.

Dry whey is not a good barometer of the value of whey to cheesemakers.

The USDA Class III dry whey factor has been held up as some kind of gold standard for calculating whey's contribution to the value of milk. The fact is that the dry whey price is an inherently bad predictor of the value of

whey to most cheesemakers. Very few have the desire or the requisite economic justification to produce dry whey. National dry whey production has been declining for years at the same time cheese production has been increasing. California has just one plant that consistently dries whey.

The USDA theory has been that dry whey is well suited to serve as the lowest common denominator in a formula designed to establish the minimum value for milk. While that may be true at times, it is far from true much of the time. Most cheesemakers who are able to process their whey have chosen to make some form of concentrated whey protein.

And here I've included a chart showing the trend for whey protein concentrates in all forms, production versus dry whey. Dry whey is declining at a compound annual growth rate of -3.3 percent, whereas WPC is increasing at 6.1 percent.

It is not practical for those processors to build in an "either/or" capability. That is, to be able to switch between dry whey and WPC depending on which happens to be most profitable at the moment. In the production of whey protein concentrate, between 70 and 90 percent of the whey solids are separated from the true protein, depending on the protein concentration of the WPC produced.

And just to expand on that, if you make WPC34,

roughly 30 percent of the solids are recovered in a higher value protein product, 70 percent go to the lower value lactose alternative product, which must be dealt with, you know, sometimes at a profit, sometimes at a substantial loss. As you increase the protein concentration those numbers change. For WPC80 it's probably 12 percent is recovered in the high value product and 88 percent in the lactose permeate kind of product. So there's quite a range there depending on the concentration of protein in the finished product.

So back to -- between 70 and 90 percent of the whey solids are separated from the true protein, depending on the protein concentration of the WPC produced. Those solids are referred to as "lactose permeate." The production of dry whey captures 100 percent of the solids. there is no lactose permeate byproduct. When the price for dry whey is high, 100 percent of the solids, including those lactose permeate solids, return that same high value. When making WPC, the lactose permeate byproduct must be dealt with. It can either be further processed into lactose, dried as de-proteinized whey, sold as liquid feed or disposed of.

Producing lactose is no walk in the park. it takes between 1.6 and 1.9 pounds of permeate solids to produce 1.0 pound of saleable lactose. The byproduct of

lactose production, known as "mother liquor", captures 40 to 50 percent of the permeate solids and is a very high strength waste product and an environmental nightmare. De-proteinized whey is difficult and costly to dry given its low solids content - it's lower in solids than whole whey - and high concentration of lactose. While costing more to produce, it typically returns a lower value than dry whey because of this drastically lower protein content. Selling lactose permeate as liquid feed requires concentrating the solids and most often returns less than the cost of concentrating. Disposal of permeate is a very costly undertaking if at all possible given environmental constraints.

Consider a manufacturer of WPC34. At that concentration, roughly 30 percent of the whey solids are converted to a saleable protein product. To equate then with dry whey, the price of WPC34 must be 3.33 times, or 1 divided by 30 percent, that of dry whey if you assume the ability to break even in disposing of the lactose permeate. Following is a chart comparing the National Dairy Product Sales Report dry whey price with the WPC4 market divided by 3.33. I the past five-plus years the dry whey price is always higher.

So you can see the blue line is the dry whey market and the red line is the WPC divided by 3.33; and

there's a gap, a substantial gap at times between those.

That means you must be able to generate a profit on lactose permeate sufficient to overcome the price differential to afford what the federal order whey formula adds to your cost of milk. Even for the most efficient large scale processors that is not feasible much of the time.

Dry whey does not correlate well with other whey alternatives. It tends to follow trends in the feed industry rather than those affecting the food industry. Those two can easily fall out of sync. Following are charts that plot dry whey and WPC34 prices against that of nonfat dry milk since 2001. The correlation of dry whey with nonfat dry milk is very poor, with an R^2 factor of .6347 while the R^2 for WPC34 is much better at .8054. Utilizing WPC34 value in the Class 4b whey factor could prevent crises like that of 2007 when the West dry whey market exceeded $0.80 per pound. It is more representative of the value obtainable by those fortunate enough to find an outlet for their liquid whey.

You can see the scatter charts and the trend lines and the dispersion of dots on the two charts and how much closer alignment there is with WPC34 and nonfat. And it stands to reason, WPC34 is mimicking the protein content of milk so it's more closely associated with milk and has more

alternative uses as an alternative to milk.

Make Allowances.

The current Federal Milk Marketing Order whey make allowance in the Class III formula is $0.1991. It hasn't changed since it was implemented in October 2008, over seven years ago. The data used in the allowance came from a 2007 hearing, which had relied on even older 2005 data. In November 2007, the last California Class 4b whey make allowance was $0.2670 per pound, $0.0679 per pound higher than the Federal Milk Marketing Order. That was based on a manufacturing cost study result of $0.2673 in 2004. For 2005 the study yielded $0.2851 and 2006 produced $0.3099. To argue now for the adoption of a federal whey factor or its equivalent is simply a transparent attempt at a major price increase without any substantiation. California costs are substantially higher.

California is unique.

The fundamental issue in this and all these hearings is that the situation in California is unique to California. Costs are higher here. Farms and plants are bigger here. Regulation is more intensive here. The distance to markets is greater here. California, given its importance to dairy, warrants its own milk pricing system. If California instead insists on joining the federal system, it may well end up serving as the point of reference for the

rest of the country rather than the opposite. Dr. Mark Stephenson testified the following at the recent federal order hearing:

"The concern with a California Federal Milk Marketing Order is that our current product price formulas may not set the Class III minimum price low enough to allow the western markets to clear on a regular basis. Higher transportation costs and additional surplus milk supplies suggest that the competitive price difference between the major cheese producing regions of the country has grown. Two solutions present themselves to assure orderly markets."

HEARING OFFICER SUTHER: Excuse me, Mr. Dryer. Can you kind of wrap it up?

MR. DRYER: Oh, I'm sorry. I didn't realize I was going on that long, sorry.

Basically, Stephenson is recommending that we have a western regional price rather than a lower national price service.

To summarize: Low prices is the result of a global milk imbalance not unique to California.

The US has been impacted because of reduced exports.

Whey prices down significantly, 60 percent down,

so the whey profits that were once there to bolster milk prices are no longer. California producers have been receiving more than the federal order whey factor since the temporary whey scale went into effect. Realistically, the milk price in California will remain lower than the federal price unless the state's operating cost structure change, the export market becomes more lucrative than the domestic one, or the industry downsizes to match the demand from just the Western region.

California lost 32 farms in 2015, 2.18 percent of the total. In '14 it was 26 farms, 1.74 percent. Nationally, 2.7 percent of farms were lost in '15 and 3.5 in '14. California has been well below the national average. It ranked 34th and 30th in farm losses among the 50 states according to USDA statistics. So if the situation for dairy producers in California is untenable, then what must it be for the majority of other states losing more farms percentage-wise?

We manufacture cheese in California because we want to. Our customers buy their products because they want to. Cooperatives and farmers sell their milk to us because they want to. That is how the free market functions. But this debate is about seeking a price that cheesemakers must pay because they have to. That is not how a free market operates and the market will always prevail in the end.

We support the proposal from the Dairy Institute and we think the cooperative proposal should be rejected. It was rejected in the past and -- I'm trying to wrap up.

That's all I had. Thank you for the opportunity to testify and I request the permission to file a post-hearing brief if warranted.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

Questions from the panel?

MR. EASTMAN: Actually, I had more of a request than a first question, which actually to put it in a post-hearing brief would probably work out better. In a lot of the graphs, especially at the beginning of your testimony, there's not really a source of where the data came from.

MR. DRYER: Okay.

MR. EASTMAN: Is it possible for you to go ahead and let us know the --

MR. DRYER: Certainly.

MR. EASTMAN: -- source of the data for all of the, sort of the figures. You may be able -- when it came to the freight costs I realized what you were doing there, you kind of explained that so that worked.

MR. EASTMAN: Maybe through shake of head. You were referencing in the middle a study done in Wisconsin and it appears that Dr. Schiek in his testimony submitted as one

of the appendices the study itself; is that correct?

MR. DRYER: I believe so.

MR. EASTMAN: Okay. Maybe we're all shaking our heads "yes" so that's good. So that makes sense.

And then towards the end of the testimony you have a plot point and a simple regression where you're comparing dry whey to nonfat dry milk and WPC34 to nonfat dry milk. Is it possible for you to report either a standard error, a t-statistic to show the statistical significant of the coefficients that are estimated in both of those regressions?

MR. DRYER: Certainly.

MR. EASTMAN: Okay. I think that's really what I had.

HEARING OFFICER SUTHER: Thank you for your testimony, Mr. Dryer.

MR. DRYER: Thank you.

HEARING OFFICER SUTHER: Mr. Hollon.

Mr. Hollon, will you please state your full name, spell your last name and state your affiliation for the record, please.

MR. HOLLON: I'm Elvin Hollon, E-L-V-I-N, H-O-L-L-O-N, and I am Vice President of Fluid Marketing and Economic Analysis for Dairy Farmers of America, Inc. I think those were the two questions.

HEARING OFFICER SUTHER: That's it, yes.

Whereupon,

ELVIN HOLLON

Was duly sworn.

HEARING OFFICER SUTHER: Mr. Hollon, do you have any written statements or other things that you would like to enter into the record at this time?

MR. HOLLON: I have a written statement and three attachments to go with it, which I have circulated to the hearing panel.

HEARING OFFICER SUTHER: The written testimony of Mr. Hollon is now going to be Exhibit number 43 and you may proceed.

(Exhibit 43 was entered into the record.)

MR. HOLLON: I am Elvin Hollon, Vice President of Fluid Marketing and Economic Analysis for Dairy Farmers of America, Inc., DFA. On March 22, 2016, the DFA Western Area Council, whom I am representing, unanimously approved the position that I will be presenting today. Our members support the regulated pricing system. They clearly believe the regulated system provides the best framework to support their farm operations, the customers to whom they market milk and the plants that they have invested in and operate.

Dairy Farmers of America is a Capper Volstead milk marketing cooperative owned by approximately 270 farms that

market milk in California. We market approximately 20 percent of the state's milk supply. We market milk to more than 35 buyers in the state and operate two wholly-owned plants. Our facility at Hughson, California is primarily a Class 4a facility and our plant in Turlock, California is primarily a Class 4b facility. DFA operates plants and market whey both in California and also in the Federal Order system and is well qualified to submit testimony and evidence to the Secretary on the matter of the appropriate contribution of whey value to the Class 4b price.

DFA along with California Dairies, Inc. and Land O'Lakes, Inc., continue to work towards a California Federal Order. However, we and the other participants in this hearing also recognize the need to fully engage in matters related to the California state milk pricing system.

Dairy Farmers of America supports the alternative proposal submitted by California Dairy Campaign, Milk Producers Council and the Western United Dairymen, which if adopted would modify the permanent dry whey scale in the Class 4b formula. Our support of this proposal aligns with our intentions in the California Federal Order proposal.

I'm going to skip the next two paragraphs because I think they've been said by other speakers and start with the paragraph:

DFA fully supports the position and testimony of

Annie AcMoody representing The Producers. Specifically, we support the proposed changes to the whey component of the 4b formula in response to the Secretary's direction in the Hearing Notice. We note that the Secretary has specifically directed that:

> "Proponents of any alternative proposal shall address, at a minimum, the economic conditions that would support extending the effective date of the temporary dry whey scale or adjustments to either the temporary or permanent dry whey scales contained therein."

We agree with the contention that the method for calculating the contribution of whey to the Class 4b price understates its market value and the resulting lower than justifiable Class 4b price damages the viability of all California dairy farm businesses. We also agree that a reasonable economic indicator of the value of whey in the Class 4b formula is embedded in the Federal Order Class III price and that The Producers proposal best aligns the Class 4b price with that value.

I am also going to skip the next paragraph and go on to Table 3. I'm sorry, page 3, DFA Table 1.A.1-5. And that is the set of spreadsheet tables that is titled "Comparison of Mailbox Milk Prices Standardized for Butterfat, Protein and Other Solids Tests, California and

Comparable Markets, August 2012 - 2015" demonstrates the alignment of producer mailbox milk prices we see with the two regions of the United States that have similar milk utilizations to California. One of our goals at this hearing is to achieve more parity between the milk prices received by DFA's California members and those of other similarly situated markets in the United States by making adjustment in the whey component of the 4b price. We see a significant price misalignment at the producer level when we make those comparisons. We attribute a portion of this difference to the fact that milk produced in California is valued outside of the national price grid. While this hearing is not designed to place California's milk marketing system entirely into the national price grid, it can better align California producer milk prices with those of the rest of the country by adopting the proposal we are supporting.

Many factors in the operation of a dairy farm are localized but several key input factors are increasingly becoming regional, national and even international. As a part of DFA's overall cooperative business plan we have business units that provide risk management services, financing, purchase of inputs and supplies, business consulting and several types of insurance. The scope of our cooperative allows us to be a knowledgeable marketer of these services in terms of availability and price. We can

offer these services at competitive prices but we cannot offset the wide differences in milk prices our members face when compared to the rest of the country. Our members in California find it increasingly difficult to purchase business resources when faced with lower returns than their counterparts around the country and the world and as a result many have left the industry altogether.

A reliable and reasonable measure we can use to demonstrate the price disparity for similarly situated producers is the Mailbox Milk Price published by USDA's Agricultural Marketing Service. This price series has been available since at least 1998 and is calculated on a consistent basis. As stated in the USDA/AMS publications, the price series is an at-test, all revenues included and net of marketing expenses.

There are Mailbox Milk Prices published for 20 different market regions. For comparison purposes we isolated the three states that comprise the majority of the Upper Midwest - Federal Order 30 marketing area that has a large production of cheese, butter and nonfat dry milk and lower Class I utilization. The states are Wisconsin, Minnesota and Illinois. Federal Order 30 had an average annual average of 11.5 percent Class I use, 5.8 percent Class II use, 79.2 percent Class III use and 3.5 percent Class IV use in 2015. For calendar year 2015 measured on a

total solids basis CDFA reports in the state order Class 1 compared to FO Class I use at 13.06, Class 2 and 3 at 8.84 percent compared to FO Class II, Class 4b at 46.3 percent compared to FO Class III and Class 4a at 32 percent compared to FO Class IV.

We also selected the Northwest States series composed of data from Oregon and Washington for comparison. These states comprise a significant portion of FO 124, the Pacific Northwest. Like Federal Order 30 and the California market, the Northwest States have significant manufactured dairy product output. The region shows a high use in both Class III and Class IV products. Federal Order 124 had an annual average of 30.7 percent Class I use, 8.4 percent Class II, 18.0 percent Class III and 42.8 percent Class IV use in 2015. Additionally, the Northwest States are similarly situated geographically as western states and face similar competitive situations in the marketing of manufactured dairy products to both eastern domestic markets and westward export markets.

While the Upper Midwest and Pacific Northwest regions have many characteristics similar with the California dairy marketplace, a similar Mailbox Milk Price is not one of them. We measured the period August 2012 to the most recent data available, December 2015. This period includes both the recent permanent adjustment in the whey

factor and the current temporary adjustment made by the Secretary for the purpose of better alignment of the Class 4b price and marketplace returns.

Since the Mailbox Milk Price is an at-test price, we adjusted the price for components in each region to the federal order standard for butterfat of 3.5 percent for protein of 2.9915 percent and for other solids of 5.6935 in order to arrive at a standard, and more importantly, comparable price for evaluation. We used the monthly federal order price per pound of each component in the calculation to compute a cents-per-hundredweight value. We used the Federal Order 30 average producer milk component test for the Midwest Order states as Federal Order 30 does not publish state level component tests to calculate the component value adjustment. California does not publish a protein or other solids component values, so we used all DFA producer component tests for the California averages under the assumption that since our producer volumes account for approximately 20 percent of the state's milk supplies it would be generally representative of the state's component test averages. For the Northwest states, we used the Federal Order 124 market tests. In each case the monthly announced test was compared to the adjusted standardized test and the difference over or under the standard test was subtracted or added to the mailbox price.

For the period August 2012 through December 2015 there are 41 monthly observations from the states listed. DFA Table 1.A.1-5, "Comparison of Mailbox Milk Prices Standardized for Butterfat, Protein and Other Solids Tests, California and Selected Markets, August 2012 - December 2015". For the 41 months and the four Mailbox Milk Price regions for comparison, 164 observations, California had a higher Mailbox Milk Price only one time, August of 2015, compared against the Northwest States region. The average difference over all observations was $1.82 per hundredweight. The single largest difference was -$4.35 in Wisconsin, December 2012 comparison, and the closest was +$0.05, the Northwest States, September -- July (sic) 2015. The California region averaged $2.12 per hundredweight below, lower than the Wisconsin region for the 41 months; $2.05 per hundredweight lower than the Minnesota region; $2.25 per hundredweight lower than the Illinois region; and $1.01 lower than the Northwest region. DFA Table 1.A.5 details a sample calculation to demonstrate the methodology of using actual data for California and Wisconsin for the month of October 2015.

The regions we surveyed all have Federal Order prices as their base price. It is also DFA's experience that despite the elimination of the Federal Milk Marketing Order within the Idaho market in 2004, the Idaho cheese

manufacturers have now based their milk purchases on a FMMO Class III basis or have developed proprietary formulas that are designed to closely align with the Federal Order Class III price. We suggest this practice was determined to be necessary in order to maintain a viable milk production base to feed the states milk processing plants with adequate milk supplies.

Using the Mailbox Milk Price as a proxy for producer prices clearly reveals there are wide differences for farms in similarly situated regions of the country. Our proposal will reduce this misalignment of producer prices by establishing a value for whey included in the Class 4b formula that is in line with plants in the rest of the United States.

Previous hearing comments referred to comparing the New Mexico region with California for the purpose of Mailbox Milk Price alignment. There are several key differences in the two milksheds that would greatly impact a comparison. The first is that the New Mexico milkshed transports an average of 60 loads of milk per day into Central Texas markets for Class I sales. These loads travel an average of 550 miles one way to these markets. There is no comparable market servicing cost in the California milkshed. Of greater importance, the New Mexico market does not have adequate manufacturing capacity. And in spite of

expanded manufacturing capacity, milk must be transported out of the milkshed to other markets for processing. Again this happens in the California market but not routinely.

Plant Investment.

Secretary Ross's California Dairy Future Task Force discussed intently the issue of attracting new capital investment in dairy processing facilities in California and we feel it continues to be an important albeit underlying factor in this hearing. Aside from the new Hilmar drying facility and the potential new plant announced in Turlock by Valley Milk LLC, we feel it is a valid conclusion that the capital investment in dairy manufacturing facilities has not been as prevalent in California as in the rest of the United States.

Our own manufacturing profile has grown since the hearing last June. We are building a milk powder plant in Western Kansas, expanding an existing plant in New York with cooperative partner Arla Foods to make cheddar cheese and are finalizing plans to expand our existing manufacturing plant in Cass City, Michigan.

Additionally, DFA monitors new investment by other firms in dairy processing, as best we can, as they represent potential opportunities to market members' milk as well as potential partners for value-added processing opportunities. In our testimony last June we mentioned 15 primarily cheese

plants in the Central, Mideast, Southwest and Upper Midwest Orders with just-completed, ongoing or planned expansions; the majority of which have either been completed or are still in progress. We noted new capacity or expansions in the Northeast Order in addition to our own investments there and those too are either completed or still in progress.

All the plants referenced to above operate in areas where Federal Order pricing is the basis for the minimum price and most if not all have some premium over the minimum price. Perhaps the Hearing Panel should consider if a factor or perhaps the primary factor in the consideration of dairy plant investment is the desire for a steady and expanding milk supply prior to committing capital for construction and expansion.

Cost of Operating Dairy Manufacturing in California.

It is often noted that California is a very expensive place to operate a business at the state level when compared to other states and the statistics prove that to be true. But when the data is examined more closely at the region and metropolitan level where most of the actual manufacturing takes place, cost of doing business conditions are very favorable.

Attachment A - "The Comparative Cost of Doing Business in California, November 2015, Central Valley

Communities are Competitive with the Rest of the Nation" depicts a study done for California Dairies, Inc., Dairy Farmers of America and Land O'Lakes, Inc. to provide clarity on the cost of cheese manufacturing in California compared to other primary cheese manufacturing locations in the United States. The study was completed in the fall of 2015 by Lon Hatamiya of the Hatamiya Group.

Mr. Hatamiya's professional background and qualifications to perform this study are outlined on page 1 and include a period of public service as the Secretary of the Technology, Trade and Commerce Agency of California from 1999-2003 as well as the Administrator of the Agriculture Marketing Service of USDA from 1997 to 1999. Both positions dealt heavily with dairy manufacturing and dairy economics.

The study utilized data from the "North American Business Cost Review" published by Moody's Analytics in May 2014 and updated in October 2014. Moody's Analytics is a subsidiary of Moody's Corporation established in 2007 to focus on non-rating activities, separate from Moody's Investors Service. The following link shows a link to the database - and I will not read the Internet account but for the court reporter, you can pick it up off the transcript - [https://www.economy.com/store/shop.aspx?pubid=11&site=0&searchTerm=north american business cost review] and how to access it. I will say that that link tells you how you can

purchase it. It doesn't say that you can get it. And if you were to link Moody's Analytics you would find dozens of sites about its validity by publications, studies, government studies, magazines, business magazines. I will attach the full study as a part of my testimony and make several references to it.

Study findings include:

As a state California generally ranks among the states with the highest cost of doing business. At the state level California would have one of the highest cost indexes, 110 where 100 equals the average cost index, ranking 7th highest out of 50 states.

However, when focusing on the San Joaquin Valley Region where the largest concentration of cheese plants are in the state, an entirely different picture emerges. This region includes the counties of San Joaquin, Stanislaus, Merced, Madera, Fresno, Kings, Tulare and Kern.

Within the region the data can be further focused by individual metropolitan area and data for Bakersfield, Fresno, Hanford, Merced, Modesto, Stockton and Visalia is available.

Moody's Analytics provides measures for the Unit Labor Cost, Energy Cost, State and Local Taxes and Office Rent as their metrics for comparing 384 metropolitan locations for business purposes.

California's major cheese production locations compare very favorably with locations around the US in dense cheese production regions. Comparable competing locations include northern, southern, eastern and western Wisconsin, southeast and south central Minnesota, western Texas, northern Colorado and south central Washington, all areas of dense production.

All the indexed comparisons of metropolitan locations in the San Joaquin Valley fared very well with the indexed comparisons of the non-California locations.

In terms of labor rates, four of the California locations were in the ten lowest identified cheese manufacturing locations, representing 24.7 percent of the 23.55 cents published make cost for cheese manufacture.

In terms of state and local taxes, six of the California locations were in the ten lowest identified cheese manufacturing locations.

In terms of office rent, three of the California locations were in the ten lowest identified cheese manufacturing locations.

The least competitive area was energy costs, which is measured by Moody's analysis as the average commercial and industrial electricity costs. According to the CDFA 2014 costs studies, this represents only 2.5 percent of the 23.55 cents published make cost for cheese manufacture.

I'm going to skip the next paragraph and go down to Objections to the Institute proposal.

Ms. AcMoody voiced several objections to the Institute's proposal. To those I'd like to add the following comments. The published statistics of whey protein concentrate production offered by the Department notes that production data covered much more than just WPC with the 34 percent standardized protein level. The production data also indicated the inclusion of other high protein composition products up to 100 percent protein. The data on WPC prices are designated as only WPC34. Certainly some, maybe much, of the liquid whey purchased by third parties is further manufactured into whey protein concentrates with a protein concentration greater than 34 percent. Thus the production and price data series do not match and conclusions drawn from them may be incomplete. It will be difficult to get a standard price definition in order to operate this formula without additional detail of how much product is further manufactured into higher concentrated products.

We were unable to see the specifics of the Institute's proposal until today. And I would say I have been able to hear them but not see them. However, DFA Chart 1 - Comparison of Dairy Institute Proposal 2015 & 2016 Using the Proposed Brackets - in those two studies - and the

Actual WPC prices 2010-2015 indicates it is virtually identical in construction. Given our assumption that the construction is similar and perhaps identical minus the alteration of the floor and the ceiling referred to in Dr. Schiek's testimony at the June 3, 2015 hearing we offer the following comments. And I would say after hearing Dr. Schiek that there are some differences, but when I look at the chart and I see the movements and the ups and the downs and the patterns, it looks pretty similar.

And I would say that his statement referred to the inclusion of a 15 cents discount for the purchase of liquid whey protein concentrate; a stated 35 cents make allowance and a factor representing the cost to transport liquid whey from a seller's plant to a buyer's plant. None of these factors are based on any type of CDFA review or verification and there is no substantiation of how they were constructed or how they might be constructed. In some cases the transport cost allowance may be a windfall to a plant that pumps liquid whey from one side of the same plant for further processing - the likely result for much of the whey processed in the state.

We support The Producers proposal to replace the "permanent" scale in the Stabilization plans. This change would support long-term business planning for all parties involved in the industry.

We note The Producers bracket "floats" with the whey markets and thus has a self-adjusting effect and would move quickly with changes in the market reflecting truer market values for whey component to both buyers and sellers.

I will leave the Summary alone but I would like to respond to several questions that you asked earlier in the morning. Is that allowable?

MR. EASTMAN: You have a few seconds.

MR. HOLLON: You did ask for some observations about what things the Department might consider. The first I would say is that I don't know if it's a legal requirement by the Code that there has to be some sign before the Department can act; I suspect it isn't. I would give as an example, in the federal orders producer-handler provisions were implemented in the southeast based on -- the southeast federal orders based on a three million pound handler. If you added all the producer-handlers in the market they wouldn't add up to three million pounds but it was a forward thinking observation.

I would say that some of the things you might look at is milk volumes declining. Farm losses. I would say from DFA's standpoint we have had no new farm starts in a number of years. We have had members who have populated some existing dairies but not very many. We have had no one from out of state come to us and say, we'd like to talk to

you about establishing a dairy in California. We have had California-based members build dairies in other states. We have had California-based members who have said that, we want to locate a dairy in Colorado and in Nevada.

We are concerned about the current milk supply. I would say that this spring has been one of the lightest in terms of trying to balance the milk supply.

You do have -- I think one of the things that you would pay a lot of attention to is your own cost of production studies. That those are pretty detailed right down to the farm level. In fact, they're some of the best in the country as far as the data and the detail.

Growth in other areas, businesses willing to invest in other areas.

I think all of those ought to be, you know, signs of concern.

There's been quite a few comments and you asked some questions about the impact on varieties of plants but I think you do have an obligation to measure that impact on the volume produced. And while it is true -- I'm going to do the number from memory so I'll miss it -- but there's 57 cheese plants in California; 70 percent of the whey is processed in half a dozen of them. So I think you have some obligation to consider those types of relationships when you're trying to decide what the policy ought to be,

especially in line of transporting whey. No doubt the majority of that processing is done in plants where the transport cost is from one side of the plant to another.

And the last question is -- there was a question Mr. Shippelhoute asked about out of state milk. And to my knowledge, and I'm pretty knowledgeable about milk marketing all over the country, there is simply not much opportunity for out of state milk to be moved in. I don't think much milk is going to come from Arizona, the most likely possibility. There was one specific instance mentioned where a plant in Utah had a -- their roof fell in. I think the marketing agent for the milk supply that was looking for the home in California is also the marketing agent for Gallo Cheese. They're one and the same person so I think maybe there was some additional knowledge. But I just don't know of much milk that's going to move into California on a regular basis. There may be some solids but -- and even then it wouldn't be on a regular basis.

The end. I'll be happy to answer any questions you may want to originate.

HEARING OFFICER SUTHER: I do see in your written testimony you request the opportunity to submit a post-hearing brief; is that correct?

MR. HOLLON: It is.

HEARING OFFICER SUTHER: Okay. A post-hearing

brief will be granted.

MR. MONSON: Do you want to go first since it's your birthday?

(Laughter.)

MR. EASTMAN: Well your microphone is already on, go ahead.

MR. MONSON: All right. Thank you, Mr. Hollon, for your testimony.

A quick question. In the first part of your testimony you say the DFA Western Area Council. Can you explain to me what that is? I apologize for being kind of new to this.

MR. HOLLON: Certainly. Dairy Farmers of America is a cooperative with national reach, if you will. We have members in something like 46 out of 47 states' market. And all of them, for governance purposes and for day-to-day business purposes, it's organized into seven geographic areas. So the western area would represent producers who live in California, who live in Nevada. There are six others in addition to that, the Southwest, Central, Southeast, Mideast, Mountain, Northeast. And so the DFA Western area would be involved very heavily with California marketing.

MR. MONSON: Okay. So most people on that board are from California?

MR. HOLLON: All are from either California or Nevada.

MR. MONSON: Okay. And then on page 6 you talked briefly about plant investment and the lack thereof in California and mentioned several examples of new plants outside of the state. Can you maybe just expand more on that as to why that is?

MR. HOLLON: The chief reason, I would say, is it costs a lot to build a plant. And the number one criteria we have when people approach us and the existing manufacturing customers that we supply is, is there going to be an adequate, stable, growing supply of milk to meet my business? And so we are involved in expanding a plant in New Mexico. We are involved in plant expansions by others in Colorado. We are involved in, you know, expanding an existing plant in Michigan, in western New York. Our customers in Minnesota and Wisconsin and the upper Midwest have come and asked us. One of their number one criteria is, before I spend $450 million to build a cheese plant I want to make sure that the milk supply is going to be there and it's going to grow. And we don't have those inquiries here.

MR. MONSON: Okay. So if the producers' proposal was to be adopted as it's written what impact would that have on further plant investment?

MR. HOLLON: It would be our opinion that there would be a desire, an expressed desire by producers again to want to grow, to expand facilities, to have a more optimistic outlook and then we would begin to see that.

As was mentioned earlier in the morning, at the present state California's capacity is generally adequate for the milk production in the state. In the last 12 months only a very limited amount of time have we been involved in moving solids out of state, maybe even a week or two. But there's also not been a lot of growth, you know, in that.

This has been the lightest flush that we've experienced in a large number of years. Every week I'm involved in talking about that topic with DFA locations, those other seven areas around the country. And in other parts of the country this year's flush is one of the most difficult but it's not the case here.

At the California Federal Order hearing there were 30 producers who testified in addition to those who were represented by others. There were none who talked optimistically. There were at least 3 that I can remember, entities whose business was representing producers. For example, one was a nutrition consultant, one was someone who located farms and sold cows. None of them said that they were gaining new customers and all of them said they had lost pieces of their business to farms that had either gone

out of business or also had moved out of state. And so it's just hard to find optimism to want to expand.

MR. MONSON: Thank you.

No further questions from me.

MR. SHIPPELHOUTE: You mentioned in Idaho with the elimination of the federal order there that plants have created their own formulas to mimic, basically, the Federal Order Class III prices.

MR. HOLLON: Correct.

MR. SHIPPELHOUTE: Has there been any -- do any of your customers do that here in California?

MR. HOLLON: At times there has been some premium offered, they have been withdrawn, but there were some premiums that had some of that as a function of the calculation.

I think there was a question earlier this morning about how might this proposal and premiums match up. And what I would tell you is that generally there is an equation eventually negotiated out by both parties. And to the extent if both parties can agree on a value and the regulated price is here there may be some negotiation over the balance and so from time to time that has happened. But not to the extent that we would see it by the Idaho procurers. There are two major private procurers in the state and to our knowledge both of them have procurement

offerings that mimic the Class III.

MR. SHIPPELHOUTE: Thank you.

MR. EASTMAN: I just want to walk through really quickly your appendices just to make sure that --

MR. HOLLON: Sure.

MR. EASTMAN: -- we've got it since --

MR. HOLLON: I didn't offer you any statistical analyses but I could do a T-test if I had to.

MR. EASTMAN: I want you to do that off the top of your head right now then. No, I'm just joking.

MR. HOLLON: The formula that I offered you the last time worked out, it did have a valid T-test.

(Laughter.)

MR. EASTMAN: That's true. All right, I appreciate that. So for the tables, it looks like the last page there you give an example of how the methodology is standardizing.

MR. HOLLON: I did. I learned from Mr. De Jong that that was a good thing to do.

MR. EASTMAN: I appreciate that, okay. So the first four pages then are just simply, they're pretty much the same, it's just going over time.

MR. HOLLON: Correct. They're the summary of the results --

MR. EASTMAN: You start off with the mailbox price

as announced by USDA, you standardize it for components using the methodology in the last page and then you're just simply subtracting California from the other areas.

MR. HOLLON: Correct.

MR. EASTMAN: Okay. That's what I thought.

MR. HOLLON: And each individual calculation was plused or minused by -- the protein add value or subtract value -- or and other solids and butterfat to get to a standardized price.

MR. EASTMAN: Okay, perfect, that's what I understood. Attachment A was just simply the study by Mr. Hatamiya.

MR. HOLLON: It was.

MR. EASTMAN: Great. And then I was just -- Not that there wasn't a lot of this at the California Federal Order hearing but I think on page 5 of your testimony in that second paragraph you were talking about, you know, the differences in the mailbox prices and there's some averages and then there's a month where it's the highest and a month where it's the lowest.

MR. HOLLON: Some say the widest, might be --

MR. EASTMAN: The closest. Yes, the largest difference and the closest difference, I guess.

MR. HOLLON: Correct.

MR. EASTMAN: And so for the northwest states I

think you had struggled. I think you meant to say August 2015. You kind of said July but I'm guessing you meant August now that you have a second to think about it, right?

MR. HOLLON: Correct. Yes.

MR. EASTMAN: Okay. I don't mean to --

MR. HOLLON: It's hard to read and have an eye on that red light over there.

MR. EASTMAN: I have to do that all the same. It can get embarrassing when you have to decide which month is the one and you start counting. You might not want to do that publicly but, all right, good, that's all I had.

MR. HOLLON: Thank you for your time.

HEARING OFFICER SUTHER: Thank you for your testimony.

Okay, we are now going to deviate from the script for a minute and go to the three minute witnesses. Ms. De Raadt.

MS. De RAADT: Sorry, my name is a little bit complicated.

HEARING OFFICER SUTHER: So could you please state your full name and spell your last name and what affiliation you're with.

MS. De RAADT: My name is Eileen De Raadt and I am a -- it's D-E and then space, capital R-A-A-D-T, and I am a California milk producer.

Whereupon,

EILEEN De RAADT

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or anything you would like entered into the record?

MS. De RAADT: No, thank you.

HEARING OFFICER SUTHER: You may proceed.

MS. De RAADT: Hello, everybody, Panel Members.

My name is Eileen De Raadt. I am 21 years old and I am currently a junior at Fresno Pacific University.

I have grown up on a dairy my entire life and I wouldn't have it any other way. Being raised on a dairy I have been taught a hard work ethic, perseverance and responsibility. As I have grown up I have tried to do my best to be as involved as possible with the industry.

I showed in 4H for eight years, showing cows. My family and I go down to San Diego County Fair every year to show cows but also to use it as a form of outreach to the general public. I was also the District 7 Dairy Princess my senior year of high school. I love being an advocate for the industry that I have such a passion for. Today, nothing has changed. I participate on the Dairy Princess Committee and I am the coordinator for the Milk Maid program.

I work at the Kings County Farm Bureau office as a

teacher for a very special program called Farm Academy Life. This program gives the opportunity for any classroom in the world to learn either about cotton or milk through a virtual field trip, so through on-line. I love my job because it gives me the opportunity to share my passion every class.

As busy as I am though, I always find chances to come back to the dairy and help my dad and herein lies why I am here today. As much as I love working on the dairy with my dad it makes me quite upset when he brings up selling the dairy. By the way, my dairy is currently on the market.

My dad is frustrated and he's tired. He loves this industry but there is so much that goes along with it, so many complications that we are trying to face. When he talks about these things it's heartbreaking. It kills me because everything that I built my past around and everything I hope to build my future around may not even be in existence by this time next year.

If you take a drive through the Central Valley you're going to see a lot of empty dairies. Seeing friends of mine and others in the industry being forced to sell out or just take a safer avenue like growing trees, it hurts, it's mind boggling, it's confusing, it's frustrating. And if my dairy sells out it will show me that unfair milk prices along with other factors have impacted us and this issue has come full circle.

I am not coming before you today as the technical one with all the answers. I am young and that's why I'm here, to be educated by this process. Rather I am coming to you as a representative for the younger generation who wants to see this industry thrive, who hopes to carry on milk production in the future.

I am looking for a competitive, fair and permanent solution to low milk prices, the current low milk prices, specifically with the whey factor in mind. I'm looking for fair compensation for our whey.

I want to be given the opportunity, the chance to help this industry, to participate in this industry, to help it grow. I want to maintain my passion and also regain the passion of many dairy farmers who have lost theirs through all these trials they're going through.

So, in summary, I am in favor of the proposal given by these three trade groups that are working on behalf of the dairy producers such as myself. Thank you.

MR. MONSON: Thank you for your testimony, Ms. De Raadt. Can you tell us a little bit more about your dairy, the size of herd?

MS. De RAADT: Yeah. We are a 1,000 cow, around a 1,000 cow dairy and we are located in Lemoore, California. We currently -- we live about five miles from the Leprino factory so that's where we send our milk. My dad runs the

dairy along with my brother who helps out and I kind of have started making my way in as well with doing more of the social media and hopefully more of the paper stuff that my dad isn't as familiar with.

MR. MONSON: Thank you.

MS. De RAADT: All right, thank you.

HEARING OFFICER SUTHER: Thank you for your testimony.

Mr. Deniz.

Mr. Deniz, could you please state your full name, spell your last name and state your affiliation for the record, please.

MR. DENIZ: Lucas Deniz, D-E-N-I-Z, with Deniz Dairy in Petaluma. We're a small family dairy there. So I'm here today --

HEARING OFFICER SUTHER: Just one more second, sorry.

Whereupon,

LUCAS DENIZ

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or any other things that you would like entered into the record?

MR. DENIZ: I do not.

HEARING OFFICER SUTHER: You may proceed.

MR. DENIZ: So I am here today to testify in support of the proposal set forth by the three dairy producer organizations.

I want to start off by saying that I have a lot of respect for the cheese producers. I am certainly happy for their success. We need them to be successful. But they also need us as well and they need the dairy producers to be successful. And for far too long they have taken advantage of a formula that does not accurately account for the true market value of whey.

We've heard a lot today about the horror stories of what could happen to the cheese processors if the dairy producers' proposal were to be put into place. And I have some doubts as to whether those would actually come to fruition, but nonetheless it's speculation.

What we don't have to speculate on is what has happened to the producer industry in the last eight years. From 2008 through 2015 we have lost 414 dairies in this state. That's a CDFA number. Those are my friends, those are my neighbors.

Now if a different whey formula had been in place since 2008 would it have saved all of those producers and helped the ones that are currently left? It wouldn't have saved all of them, no, absolutely not. Would it have saved a significant number and helped out the ones that are still

in the state? You bet, absolutely it would have. Excuse me. I'm sorry.

I've also heard today about having a whey formula that is more accurate for the products that are truly made from the whey stream in the state. But I think we as producers would probably be willing to enter into that discussion as long as we also discussed the types of cheeses and the yields that are actually produced in this state. Because as you know, the cheese the 4b formula is based on is a cheddar cheese yield, which is 10.2 pounds. The vast majority of the state is not producing cheddar cheese, it's producing much higher yielding cheeses.

Now if you're buying a commodity, let's say oil, and you pay the market price for oil, you don't get a barrel of oil plus 10 percent; you get the market price. Well in essence that's what the cheese producers are getting here today -- are getting. They're getting free product. And I know that we are not here today to discuss that part of the equation but at the same time it is relevant because it gives you a more accurate picture of the economic reality, the advantage that the cheese producers currently have.

I've also heard, and this was addressed a little bit earlier, that somehow the value from the whey should be part of those producers' bonus program. To me this goes back to Pooling 101 where you share in the total revenue of

the products that are generated from the pool. By that logic, me as an almost 100 percent Class I shipper, would be sharing my -- I would generally be sharing about a $2 to $3 bonus with the people who ship to a cheese processor. But that's the way the pool works.

The pool is also designed to not have unfair market advantages based on the product being produced and we are starting to see that now. I firmly believe that a permanent change to the whey scale in support of the producers' proposal would go a long way towards reestablishing one of the basic principles pooling has, which is that all producers and processors share equally and accurately account for all milk products.

Once again, that's why I am here today in support of the producers' proposal.

MR. EASTMAN: Actually I do have one question.

MR. DENIZ: Sure.

MR. EASTMAN: I know that over the last number of years through the Dairy Task Force and other sort of industry-wide sort of meetings and get-togethers, sort of speak, I know that you have served on --

MR. DENIZ: Yes.

MR. EASTMAN: -- you've actually been involved with a lot of those. Maybe more than you'd like to have been involved with.

(Laughter.)

MR. EASTMAN: But you kind of mentioned in your testimony that besides just the whey values there's other parts of the system and other parts of the pricing formulas that probably need to be looked at and to be reviewed as well. Do you think that although, granted the scope of this hearing is limited to one portion of one formula, do you believe in your involvement in the task force and the other industry meetings that there's other portions of the system, other portions of the formula that also probably need some sort of revamp or some sort of discussion and some sort of modification as well?

MR. DENIZ: Wow, tough question. I think, all in all I think we have a very good system. I think, no different than any other system it needs to be looked at and tweaked and changed over time. I know that some people think that our system is broken, we need to throw out the whole thing. I am not necessarily of that mind. I think that we -- it was established for very specific purposes, it served very specific purposes and it continues to do those today; to make sure that, you know, marketing practices are fair. But right now we have a situation where we have products that are not being adequately valued through the system through what their market is and so I think, you know, that's where we just need to focus right now.

HEARING OFFICER SUTHER: Thank you for your testimony.

MR. DENIZ: Sure.

HEARING OFFICER SUTHER: Mr. Denier.

Mr. Denier, could you please state your full name, spell your last name and state your affiliation for the record, please.

MR. DENIER: Yes. Get my reading glasses on here. I don't have to look up my name but I've got --

(Laughter.)

MR. DENIER: My name is Richard Denier and my brother and I, my brother Fred and I have a dairy in Galt, California; we milk about 950 cows.

Whereupon,

RICHARD DENIER

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or any other things you would like entered into the record at this time?

MR. DENIER: I do. I didn't when I got here this morning but I put it in my iPad here and I'd like to e-mail it to the appropriate e-mail address when I finish, if that's okay.

HEARING OFFICER SUTHER: That sounds very good, thank you.

MR. DENIER: All right. For me the question is, is our milk pricing system equitable? Of course, this includes the 4b pricing formula which is being discussed today.

You listen to the processors, you listen to the producer organizations, so many numbers and so much complexity. Well if I'm you up there, who do you believe? Well, I think it's pretty tough.

All I know is that our dairy is losing a lot of money just like most dairies in California.

But what about the processors, most of whom are represented by the Dairy Institute? Of course, the Dairy Institute will always tell you any increase to us will decrease their profits and threaten their existence, just like the processors have told us that.

But I ask you, how much profit do the processors need? Three of the largest processors in California are Leprino, Saputo and Hilmar. I don't address Hilmar Cheese, most of us in California are familiar with them.

Leprino Foods.

Now you're going to hear some testimony probably that you have never heard before at a hearing. And this is the first hearing I've ever been to and I came here because Peter Warmerdam called up my brother and asked if he could go. He was too busy but I told him, well, I can make it I

think. And I decided -- when I came in that door and they said, 'You want to testify?' I said, 'No.' But then as I heard everything these folks had to say I said, 'Yes, I want to testify.' So I went back and told that gentleman back there, 'Yeah, I do want to testify.' I started looking up stuff -- and I had of all this information before I got here; I picked it up about a year ago.

Okay. How much profits do the processors need? All right, we know about Hilmar Cheese a little bit, you know, from what we see goes on down in Hilmar.

Leprino Foods. Three of their nine plants are in California. My guess is most of their cheese, maybe not most but a lot of their cheese nationally gets made here in California. Well do you guys know, does the Department know that James Leprino is the fourth-richest person in Colorado at $3.1 billion. Now I don't have a problem with people making money.

In regards to another large producer, Saputo. I listened to the testimony of Mr. Dryer. He presented a lot of numbers and how tough this would be on Saputo. And you know, he might have to take a pay cut. But if I was him I'd go and I'd ask for a pay raise. Now why would I ask for a pay raise? Well, in 2014 the list of Canadians by net worth lists Saputo and family as the sixth richest family in Canada at $6.24 billion. You probably didn't even know

that.

Well, the source -- because I love -- I don't know your name over here but boy, I tell you, I loved it when you asked for some coefficients of determination for P-values, for R^2 factors and all that type of stuff. My source is the *Canadian Business* magazine, January 15, 2015.

Yeah, they're worth $6.24 billion. In 2009 Saputo and family's net worth, you want to take a guess at how much it was? $2.76 billion. In five years you've got $3.5 billion. So I don't know how much profit they need. Of course, 2009 was our industry's worst year. Saputo's biggest cheese plant is in Tulare so you can surmise that much of their profit probably comes from that plant.

So to reiterate, in 2009 Saputo and family had a net worth of $2.76 billion. Five years later they have a net worth of $6.24 billion. I think many of us here know where much of that increased net worth came from.

So I ask you and I let you decide, is California's milk pricing system equitable to the producer and to the processor? That's what I've got.

HEARING OFFICER SUTHER: Any questions from the panel?

MR. EASTMAN: Just quickly, can you just let us know where your dairy is at?

MR. DENIER: Yes. I gave her the address, 10715

Arno Road, Galt, about 30 minutes south from here.

MR. EASTMAN: Oh, so you're not too far away.

MR. DENIER: Yeah, not too far.

MR. EASTMAN: About how many cows do you --

MR. DENIER: We milk 950.

MR. EASTMAN: Do you grow any crops at all?

MR. DENIER: Yeah, we grow, we grow about 350 acres.

MR. EASTMAN: Has the drought affected you substantially with regards to your farming operations?

MR. DENIER: It hasn't affected us substantially. We're in northern California, we've got wells, we've got pretty good water.

MR. EASTMAN: That's what I thought. Okay.

MR. DENIER: Thank you.

HEARING OFFICER SUTHER: Thank you for your testimony.

Mr. Barcellos.

MR. BARCELLOS: Good afternoon.

HEARING OFFICER SUTHER: Good afternoon. Mr. Barcellos, could you please state your full name, spell your last name and state your affiliation for the record, please.

MR. BARCELLOS: My name is Tom Barcellos, B as in B, A-R-C-E-L-L-O-S and I am here representing T-Bar Dairy

and White Gold Dairy.

Whereupon,

TOM BARCELLOS

Was duly sworn.

MR. BARCELLOS: Well good afternoon, Mr. Hearing Officer and Panel. Thank you for this opportunity to testify.

I'd like to start out by making a statement that I know that all of us in this room are acquaintances or friends and that we will abide by whatever the results of this hearing are. That's just the way we have to do things.

I am here in support of the petition put forth by Western United, Milk Producers, CDC and also supported by the co-ops.

A little bit about myself. I've had a farming operation for 40 years. I reentered the dairy business as another business 29 years ago when I returned to the family facility where I was born and raised and I have been operating that dairy and then started another dairy five years ago with my daughter and son-in-law. Both of them are 800 cow facilities.

We are considering, we're in the process of trying to upgrade the facilities. But in that process, because we're trying to make something better, the Air Board thinks that we need to invest in air credits, even though we're

going to improve it just by doing upgrades. And I don't get a premium for that so, you know, I have some concerns there.

We have labor issues now since the minimum wage has gone up even though we've always paid substantially over. There are Spanish radio stations that are coaching labor that now with the higher minimum wage that they can work less hours and qualify for many different types of benefits and not have to work nights and weekends on a dairy, they can do stuff during the week. So by no fault of ours we are being challenged on the labor side as well.

When it comes to premiums for producing milk, I'd like to have it in my check twice a month, not where it comes when there's a threat of a hearing and disappears after things are settled.

I would have brought my wife with me because she keeps bending my ears that it wasn't that long ago that our milk check was 40 percent higher than it is now. And the fact that it's that much lower and the retail prices in the store are only down by pennies, she has some concerns on who is keeping that money. Because she knows the difference between 40 percent reduction in our milk check versus what she has to still spend at the grocery store.

You've already heard about dairy sales. Just a couple of months ago my neighbor a mile down the road who has been dairying there for 57 years sold out. And they had

a new modern facility that they had upgraded ten years ago. A very nice facility. But rather than stay in the industry they sold the cows, closed the facility down, planted half of it to trees and they're row cropping the rest for a short period of time depending on the water situation.

Next week my cousins sell out after 71 years in business. And that's because they just didn't see any light at the end of the tunnel. And with seven family members it was a little bit of a challenge. I won't say it was poor estate planning but, you know, when you get that many not everybody sees eye to eye. So it's probably best for them but it's not best for the industry.

When you want to talk about water, I sit on an irrigation district board. We get our water on the east side in the Friant system. And if you hear that we got a 40 percent allocation, that sounds all fine and wonderful except 40 percent allocation is only 40 percent of what we have a contract with the Bureau of Reclamation. So that 40 percent is actually only going to be 15 percent of my water needs. So even if we got 100 percent allocation of our Class I and our Class II, which is additional water, if I got 100 percent of everything that's still only 80 percent of the surface water that we apply; and so we still rely on groundwater.

There are flood releases that can come into play,

but as we irrigate we also recharge the underground so it plays two-fold. As we manage our farm and irrigate and do the proper things we also help the surrounding communities. Now if dairy feed goes away and everything becomes drip and micro there is no groundwater recharge. That's done and the communities are going to continue to have issues.

We do have a Sustainable Groundwater Management Act that we have to deal with, so going forward we have some real challenges that we're faced with. And then of course you hear about the west side getting only a 5 percent allocation. That's a state project. And, you know, we're just not in love with the Governor over that either. So looking forward gets to be a little difficult.

And also the fact that all of our fall feed, our silages and stuff that went in, it's all been devalued because as crop prices fall so does the value there. So we've actually lost some money on inventory.

And Joe Paris made a comment about without profit. And I have to -- I have to kind of piggyback on that because he's right. Without profit there is no future milk. So in all the times that I've seen dairies go out of business I have not seen a cheese plant go out of business. And I'm not picking on the cheese plant, I believe I'm just stating a fact as well.

So thank you for that and I'd be happy to answer

any questions.

HEARING OFFICER SUTHER: Thank you, Mr. Barcellos.

Ms. Rooney.

Ms. Rooney, will you please state your full name, spell your last name and state your affiliation for the record.

MS. ROONEY: Emily Rooney, R-O-O-N-E-Y, Agricultural Council of California.

Whereupon,

EMILY ROONEY

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or other things you would like entered into the record?

MS. ROONEY: Yes, just what I've given you guys.

HEARING OFFICER SUTHER: Your written testimony will be Exhibit number 44.

(Exhibit 44 was entered into the record.)

HEARING OFFICER SUTHER: You may proceed.

MS. ROONEY: All right, thank you. I am just going to walk through some of the highlights of the written testimony I've provided this afternoon.

So thank you, Mr. Hearing Officer and members of the Panel. I appreciate the opportunity to testify today. My name is Emily Rooney and I am President of Agricultural

Council of California. Ag Council represents approximately 15,000 farmers throughout California ranging from small, farmer-owned businesses to some of the world's best-known brands.

Our dairy membership includes the three California cooperatives - California Dairies, Inc., Dairy Farmers of America and Land O'Lakes. We collectively represent over 75 percent of the fluid milk in California. Ag Council supports the proposal submitted by California Dairy Campaign, Milk Producers Council and Western United Dairymen.

Ag Council also appreciates the Secretary for calling this hearing on her own motion. Additionally, we thank the Secretary for her commitment toward finding long-term solutions to issues impacting the dairy industry.

The drought continues to linger in California. I would like to take this opportunity to provide an update on the drought and its impacts to the dairy industry. According to the US Drought Monitor, the geographic area of the most severe drought distinctions has had some shrinking due to the recent rainfalls. As an example, the Sacramento Valley has had some relief, but its drought intensity has only downgraded from the most extreme designation, known as "exceptional drought," to the previous designation known as "extreme drought."

According to its April 5th, 2016 weekly report, the US Drought Monitor states, and I quote: "large swaths of extreme to exceptional drought remain in ... [the] Southern half of California." This area includes the vast majority of the San Joaquin Valley. A copy of the map highlighting this region is attached to the back of my testimony.

The US Drought Monitor has kept its most critical designation, "exceptional drought," for all of the San Joaquin Valley Counties including but not limited to, San Joaquin County on the north to Kern County to the south. Most of the surrounding counties, including those in the Sacramento Valley are still designated as "extreme drought."

In August, UC Davis released an *Economic Analysis of the 2015 Drought for California Agriculture* -- increasing the statewide losses due to drought from $2.2 billion in losses in 2014 to $2.74 billion in losses in 2015. Total job losses are estimated in the range of 21,000 jobs in 2015.

The report states that dairies will add $250 million in lost revenues for 2015 due to the drought. Additionally, farmers will fallow approximately 542,000 acres, most of it coming from the San Joaquin Valley. Groundwater pumping costs increased to $587 million.

Furthermore, the report concludes that the losses are uneven. Specifically, greater losses will be

experienced in areas of San Joaquin Valley with poor groundwater supplies, such as Tulare, Kinds and Kern Counties. The report also predicts greater deterioration of these numbers into 2016 and 2017 if the drought continues.

According to California's Employment Development Department, in February 2016 the preliminary unemployment rates in these counties are as follows: Tulare County at 12.2 percent, Kings County at 11.3 percent and Kern County at 10.9 percent; while the statewide unemployment rate was 5.7 percent.

There is also an increased reliance on groundwater due to shortages of surface water supplies. Even with increased use of groundwater, overall water use is down approximately 1.6 million acre/feet as groundwater use is only replacing about 75 percent of the water needs for California agriculture.

This historic drought merely adds to the burden being shouldered by California dairymen and dairywomen. Depressed dairy prices in 2015 only exacerbated the problems faced throughout the San Joaquin Valley.

These events trickle down to the farm level and contribute to the overall declining health of the dairy farms in the state. While dairy is the leading sector in California agriculture, the number of dairy farms is decreasing. Additionally, the state's milk production

decreased in the first quarter of 2016. The recent declines have been attributed to the drought, decreasing dairy prices and increasing regulatory and feed costs.

And I just wanted to comment on some of the comments brought up today that the drought is not totally impacting dairy. I would actually say it's more of a geographic issue so the northern part of the state isn't seeing what I'm hearing from my dairymen in the southern part of the state where their wells are going dry, they are not getting their surface water allocations, like Tom Barcellos just testified to. So it really is more a bigger problem in the south San Joaquin Valley, which is in accordance with the map that you've seen.

The solution being offered by Western United Dairymen, Milk Producers Council and California Dairy Campaign will assist California's dairy families. It is also consistent with the cooperatives' effort to bring California's Class 4b formula in alignment with the Federal Order Class III price. The cooperatives remain focused on this effort and have invested significant resources on that front. The trade associations' proposal fills a short-term gap that would provide relief until a determination is made on the Federal Order.

In closing, we thank the Secretary for calling this hearing and urge the Department to adopt the proposal

by the producer groups. Thank you for your time and consideration.

HEARING OFFICER SUTHER: Any questions from the panel?

MR. EASTMAN: Actually it's more of a question/favor request. I was wondering if you would be willing to request a post-hearing brief so that in the post-hearing brief you could just include the links in your footnotes. It's just easier to access. It really doesn't have to say much except, these are the links in my testimony.

MS. ROONEY: Okay.

MR. EASTMAN: Is that okay?

MS. ROONEY: I would like to request a post-hearing brief to fulfill Hyrum's birthday request.

(Laughter.)

MR. EASTMAN: And I only want that because it's my birthday, not because it will contribute to the hearing record. Just so you know.

(Laughter.)

MS. ROONEY: Right. Consider it done.

HEARING OFFICER SUTHER: All right. So your request for a post-hearing brief is granted and thank you for your testimony.

Mr. Verburg.

Mr. Verburg, will you please state your full name,

spell your last name and state your affiliation for the record.

MR. VERBURG: My name is Jacob Pete Verburg, V-E-R-B-U-R-G.

HEARING OFFICER SUTHER: And your affiliation?

MR. VERBURG: I am a dairy producer in Modesto, California.

HEARING OFFICER SUTHER: Thank you.

Whereupon,

JACOB PETER VERBURG

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or other things you would like entered into the record?

MR. VERBURG: Yes, the statement I gave you and also I request a brief afterwards.

HEARING OFFICER SUTHER: Okay. Your request for a brief is granted and your statement will be -- the exhibit will be number 45.

(Exhibit 45 was entered into the record.)

HEARING OFFICER SUTHER: You may proceed.

MR. VERBURG: Thank you.

My name is Peter Verburg; I am a dairy producer from Modesto, California. I am here to testify in support of the proposal put forward by the California Dairy

Campaign, Milk Producers Council and Western United Dairymen to bring the whey value in the 4b milk pricing formula closer in line with the whey value paid to dairy producers in the federal milk marketing order system.

I was not planning to testify today because this is an extremely busy time for me on my dairy, but I wanted to take the time to travel up here to Sacramento because I am really alarmed about the number of dairies that are closing across this state. Just in my area alone, seven dairies have gone up for sale and have been sold and no more cows on the places. I don't think these recent closures would be reflected in the latest data put out by CDFA so I wanted to be here to give a firsthand account of how radically the dairy industry is changing in my area and across the state.

California milk production has been down for the last 15 months. The drop in milk production is dramatically changing the dairy landscape all around my operation.

One dairy that just went up for sale is the Genasci Brothers Dairy. They will be sold on the 14th of this month. That dairy has been in operation for 100 years. The Gen-Ace Cattle, this is their marker for their cattle, they are recognized all over the world for the quality of cattle that those people have. But, they're going out.

The other one that's right down the road from me

is the Furtado Farms. They were already in business when I moved up here from Torrance, California. We had a cash and carry operation in Torrance, California originally. When I moved up here Furtado Farms was already there. Their cattle were sold a month and a half ago. The dairy is now empty, it's going to trees.

Another one, the other side of me, Jelle VanDer Hoek. Jelle had two dairies. Jelle VanDer Hoek sold his cows three weeks ago. Overland Livestock sold the cows at auction. Both dairies are now gone. VanDer Hoek originally did buy a ranch in Nevada where he had a younger brother that was raising all the hay and still he couldn't -- he wasn't going to make it, so he got out.

Another one is Amaral & Amaral Dairy which closed due to a change in ownership of the rented facility.

One dairy near me that sold a while back was a state-of-the-art dairy built five years ago; sold to be torn down to plant almonds. Within six miles of my dairy. This is a new dairy. It was bought and bulldozed to plant another crop.

This story is all too common in my area and across the state. These are seven dairies that have sold in recent weeks and there are many more dairies that are closing or likely they will close. We haven't seen the end of this trend.

Many of these dairy producers I knew personally and were dedicated to the dairy industry and worked hard to sustain their dairy operations, but the fact that dairies in our state have been underpaid compared to dairy farms in other states has jeopardized the future of these and all other dairies in our state. The seven dairies that have just gone out near me range in size from 900 to 1,500 cows. The owners and operators of these dairies decided to leave the business because they could no longer justify the long hours, hard work and financial risk given the lack of any sort of profitability.

Part of the issue this year is the tightening credit situation given low milk prices that is causing the banks to stop extending credit. In '09, if you people remember, the banks kept loaning dairymen money. They'd loan them some more money. They were short, loan them some more money. The banks are not going to make that same stupid mistake again. They did it once, they're not going to do it twice. Today banks realize it is cheaper to let the dairy go out of business, which is putting pressure on those operations and leading to more closures. For the first time in more than 15 years that I can remember, the state's largest dairy cooperative is actually looking for new dairy producers to join their co-op due to the many dairy closures up and down our state.

I know that some will argue that milk production is down in some other states like New Mexico and Texas, but that drop in production is due to an act of God when a storm hit last Christmas. These states are no comparison to California because the drop in milk production here is due to an act or a failure of our CDFA Secretary to act to bring dairy producer prices in our state in line with the rest of the country.

I have owned and operated a dairy farm in Modesto for more than 50 years. Our state has some of the highest costs of production in the country due to the high cost of land, dairy inputs, costs associated with environmental, labor and all the many other regulations that dairy producers must follow in order to operate a dairy in California. The historic and ongoing drought in California and the uncertainty about water availability makes it even more challenging for dairies like me to remain in operation.

For far too many years, dairy producers in California have been paid substantially less than dairy producers in the federal order system. Adoption of the proposal put forward by CDC, MPC and WUD and supported by the CDI, DFA and LOL will bring our 4b price closer in line with the federal order Class III prices paid in the federal order system. Given that the majority of the milk produced in our state is used for 4b production, it is critical that

the whey value in the 4b tracks the whey value paid in the federal order system.

Time and again I and other dairy producers have called on California Department of Food and Agriculture to fix our state pricing system so that I and other dairy producers in our state are paid prices for our milk that are in line with the rest of the country. The failure of CDFA to fix our state system has led me and other dairy producers across our state to support joining the federal milk marketing order system. And I would like to add, I am a very high quota holder and yet I am still going to go with the federal order system, even if it may jeopardize what I have in quota.

I and other dairy producers simply cannot afford to be so significantly underpaid compared to dairy producers in the rest of the country. If our prices were in line with dairy producer prices in the federal order system we would not have seen more than 300 dairies exit in the last five years and many more dairy producers questioning whether to continue.

Not only are we paid significantly less than the farmers in other states but we also are at a great disadvantage under the new Dairy Margin Protection Program. Because our prices in this state are so much lower, the Dairy Margin Protection Program, DMPP, is much less

effective in California. Given the fact that the all-milk price is used in the DMPP is approaching $2 higher than the price I and other dairy producers in our state receive, this program provides no real "safety net" when prices drop out here.

In conclusion, I support the proposal put forward by CDC, MPC and WUD because it will better align our 4b pricing with the federal order system. I would like to request an opportunity to file a post-hearing brief and thank you for allowing me to speak here today.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

Questions from the panel?

MR. EASTMAN: I don't actually have a question but I appreciate you coming up to spend a little time with us, even though we realize this is a busy time for you on your dairy and you obviously had to make sacrifices to be here, whereas others are paid to be here, so we appreciate you testifying on your own accord.

MR. VERBURG: Well I love -- the reason I'm here, I love this industry.

MR. EASTMAN: It shows. It shows.

MR. VERBURG: And we can't let this industry go. California needs dairies. I have 12 employees on my dairy. Those are all steady jobs. Those people will lose all their

jobs. Those are not part-time. I provide housing, I provide medical, I provide everything for my employees. And I guarantee you, they ain't going to be happy if Verburg says, 'I'm selling the cows.'

MR. EASTMAN: Thank you.

HEARING OFFICER SUTHER: Thank you for your testimony.

MR. VERBURG: Thank you.

HEARING OFFICER SUTHER: Mr. Vandenburg.

Mr. Vandenburg, would you please state your full name, spell your last name and state your affiliation for the record, please.

MR. VANDENBURG: My name is Leonard Vandenburg, V-A-N-D-E-N-B-U-R-G.

Whereupon,

LEONARD VANDENBURG

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or other things you would like entered into the record at this time?

MR. VANDENBURG: I do, it's the testimony I handed to you.

HEARING OFFICER SUTHER: The written testimony of Mr. Vandenburg will now be received as Exhibit number 46 and you may proceed.

(Exhibit 46 was entered into the record.)

MR. VANDENBURG: I'm going to ad lib some of this testimony as I made some notes prior to this.

It makes it a little bit difficult when you know a lot of the people, when you've got a passion, certainly for producers that I know really well, that I represent. My dear friend Richard Denier that was up here. And Richard, I'll address some of the things that you talked about. So it makes it difficult but --

I want to thank Secretary Ross and the hearing panel for the opportunity to express our views today.

I am Leonard Vandenburg representing Pacific Gold Milk Products, also known as Pacific Gold Creamery, which its owners consist of dairy producers and several private investors, including myself. I am currently President and CEO and representing Pacific Gold Milk Products, a specialty cheese plant.

Pacific Gold Creamery would not currently support any proposal that allows an increase in class prices and/or whey price increases. The current commodity price weakness and increased inventories gives little support for such a change.

And behind this testimony there will be 15 attachments that you can see that will support a bunch of the documents. I didn't label all of them but you can

certainly look at them whenever you wish.

One of the things I wanted to mention, in our cheese plant - and it may address Richard's situation a little bit when you talk about large companies that have become very wealthy over the many, many years in processing dairy products and investments - is that our cheese plant is owned basically by dairy producers. We've made a special and asserted effort for them to have that same opportunity.

And nobody else in this state is doing that. And at the end of the day I believe major cooperatives have failed their members. Because when a member leaves a cooperative he takes nothing with him. He has no assets in that company, he has no investments that's going to come back other than the retains. None.

Pacific Gold Milk Products is a private company held by dairy farmers and that's why we do that.

I will keep my testimony very brief and to the point and that's a promise. Pacific Gold Creamery is a specialty cheese plant that started in December of 2012. We currently employ 35 people and make over 10 types of cheeses. Our current volumes are approximately 25 million pounds of milk annually.

Pacific Gold Creamery has limited options for whey use.

1. We can sell it directly to cattle feeders,

which the whey price there is based on 70 percent of the value of number 2 yellow corn, which is $160 a ton today. And 70 percent of that is $112 or a little over $0.055 cents a pound. For about 3,000 pounds of solids in a load of whey, this equates to $168 per load. And the delivery cost for this whey is $250 or a loss of $82 per load, a little over $0.04 per pound.

2. When some of the whey is converted to Ricotta, which is the only thing we can do in the plant at times, only half of those solids are captured, resulting in a small potential margin.

3. The third option would be to RO the whey and sell it to someone willing to dry it. However, this would require a $2.5 million investment or more for an RO, additional silo space, chilling and installation costs. With the current whey prices at only $0.245 plus operating cost, there might be a return in 20 years from now. I don't believe that the Department would expect us to do that.

And number 4. The last option would be to dry our own whey on property that we don't own and the current required investment to dry our own whey would be approximately $15 million. And I have spent time even looking into that. We have had proposals, quotes. If you wish to have that I can get that to you in a post-hearing brief. But for our size operation it would be a $15 million

investment. And this is no option that we would even consider and neither should the Department expect such a risky proposition. Especially the fact that 2012 (sic) dry whey prices are 37.5 percent of the 2014 yearly averages. Furthermore, dry whey prices are the lowest since 2007.

The WPC34 price for 2015 average just under $0.80, which is the lowest since 2009. The current WPC34 at approximately $0.57, which the previous 9 year average is $1.135. That makes our current WPC34 almost half of the 9 year average. These historic low WPC34 prices and dry whey prices are creating financial challenges for our cheese operation. The future for dry whey prices are almost at a current level for the next year when you look at futures.

With the total cheese inventory reported nearly at a billion pounds, dry whey at over 75 million pounds, which is 50 percent more than the previous year average, WPC over 65 million pounds in inventory. With very strong US milk production there are reports that there is milk being sold for $8 under the class price, which I talked about.

There was also a bunch of talk earlier in this hearing, and I think there was some interest about, is there potentially outside milk coming into California? And I can tell you there is. Would it be year-round? I don't know. But I personally have discussed with outside processors and milk handlers that they are swimming in a glut of milk.

That they are looking at moving west. And I think that's the first time I've ever experienced that in all the years I've handled milk.

The producers are challenged with lower milk prices, and I get that. And again, however, feed costs has dropped dramatically and continue to drop. Silages, grains, hay and almond hulls are being offered at prices not seen since 2010. This is another reason why whey values are even worth less because their energy value as compared to what number 2 yellow corn is. And that's how we determine the value of that whey sometimes.

This has created a market climate that will encourage more production, more product, with already weaker export markets and greater inventory, intensified competition for dairy product sales, resulting in lowered margins and/or likely losses.

Pacific Gold Creamery wishes to currently support the Dairy Institute position, however - and this was brought up earlier and I didn't know if somebody was going to bring it up and it was a topic - but we strongly -- Pacific Gold Creamery strongly believes that a renewed attempt to bring representatives of producers, cooperatives and processors together in a serious effort to draft a simplified milk pricing structure for the mutual benefit of producers and buyers. And I represent producers as well as our cheese

plant so I understand both sides of it and there has been an everlasting battle it seems like lately of, you know, who should get what.

The reason for this proposal is because we are here today in the hopes of maintaining our state order through more pricing adjustments when in fact there are so many fundamental differences between the California state order and the Federal Milk Marketing Orders. We have been patching our system for 40 years. Let's be honest, our California milk pooling system is broken.

I would ask for a post-hearing brief if it's required and I thank you for consideration of this testimony.

I would want to make one comment. I believe there was a statement earlier that our 4b pricing is the lowest value of all the classes. I think I heard that earlier in a testimony and I just want to make that correction. You know, it's at least 80 cents higher as of March and I think prior months the same.

One other statement. People are wondering whether premiums are going up. Through the confidentiality between contracts and buyers and sellers I can't divulge what the number is but I can assure you that premiums are definitely higher.

HEARING OFFICER SUTHER: So your request for a

post-hearing brief is granted.

MR. VANDENBURG: Thank you.

HEARING OFFICER SUTHER: Now questions from the panel.

MR. SHIPPELHOUTE: I just want to clarify. In your written testimony you speak specifically to Pacific Gold Milk Products, not the cooperative.

MR. VANDENBURG: Correct.

MR. SHIPPELHOUTE: But then in your verbal statements you suggested that you -- you mentioned that you also represent the co-op. Were you representing the co-op with this as well or --

MR. VANDENBURG: No.

MR. SHIPPELHOUTE: -- at other times you represent the co-op?

MR. VANDENBURG: At other times we represent the co-op.

MR. SHIPPELHOUTE: Okay, thank you.

MR. VANDENBURG: This testimony here is strictly for the cheese plant.

MR. SHIPPELHOUTE: Okay.

MR. VANDENBURG: You know, if I may add. In the past I have testified on behalf of dairy farmers and, you know, you think that cheese plants are making a ton of money. As the President and CEO of a cheese plant, and I

write all -- I sign all the checks. Learn one thing, you don't make a lot of money in a cheese plant until you're maybe in it 10, 15, 20 years with a lot of investment, positioning markets, getting entrenched. But it's a huge investment and sacrifice, if you will, before you ever get there. That I can assure you myself.

MR. SHIPPELHOUTE: No other questions.

MR. MONSON: I had a quick question, Mr. Vandenburg. In your testimony you mentioned several options that your company could consider with what to do with its whey stream and none of them sounded very positive. What do you guys currently do?

MR. VANDENBURG: We try to sell as much ricotta as we can.

MR. MONSON: Okay.

MR. VANDENBURG: Whenever you have -- you know, whenever you have lower milk prices it becomes more difficult. Quite frankly, I think every processor out there wishes we had $18 milk, it would be much better. Because when you have $18 milk you also have higher premiums in the market, there's more demand for it and it's easier to sell. When you have $13 milk it's much more difficult. So we try to make ricotta out of it whenever we can. But what product that we can't put in ricotta we are forced to send it to a dairy and we lose money on every single load. If somebody

wants to see an invoice for the hauling please let me know and I'll send it to you. I send the checks for it.

MR. MONSON: Thank you.

MR. VANDENBURG: You're welcome.

MR. EASTMAN: I think just for the record, that would be good if you could submit that in the form of a post-hearing brief. I think you had mentioned in your testimony as well that you had some quotes for investment in whey processing equipment; is that what you had mentioned?

MR. VANDENBURG: Yes. Drying equipment and RO, RO equipment.

MR. EASTMAN: If you wanted to submit both of those in a post-hearing brief that would be great.

MR. VANDENBURG: I can do that.

MR. EASTMAN: Put that on the record.

MR. VANDENBURG: Thank you.

HEARING OFFICER SUTHER: Thank you for your testimony, Mr. Vandenburg.

MR. VANDENBURG: You're very welcome, thanks.

HEARING OFFICER SUTHER: Mr. De Jong.

Mr. De Jong, will you please state your full name, spell your last name and state your affiliation for the record, please.

MR. De JONG: Sure. My name is James De Jong, I'm with Hilmar Cheese Company. The last name is spelled D-E,

space, capital J-O-N-G.

Whereupon,

JAMES De JONG

Was duly sworn.

HEARING OFFICER SUTHER: And do you have any written statements or other things you would like entered into the record?

MR. De JONG: Yes. I provided you with copies and there is an attachment of our Federal Milk Marketing Order brief. And I would ask you to pay special attention to pages 32 to 37, are most applicable to this hearing.

HEARING OFFICER SUTHER: The written testimony of Mr. De Jong will be marked as Exhibit number 47 and you may proceed.

(Exhibit 47 was entered into the record.)

MR. De JONG: My name is James De Jong. I am the Dairy Policy and Economic Analyst for Hilmar Cheese Company, HCC.

HCC is a cheese and whey products manufacturer with locations in California and Texas. In California, HCC purchases milk from over 200 dairies processing about 12 percent of the milk produced in California each day. We employ over 1,000 people at our facilities in California and sell finished products to over 50 countries around the globe.

HCC was formed in 1984 by a group of innovative, market-oriented dairymen who sought to capture the full value of their high quality milk. They founded the company on the ideal that producers should receive a competitive market-driven price for their milk.

Position

I am here today to represent HCC and our dairy producer owners. HCC supports the Dairy Institute of California, DIC, alternative proposal to value whey and does not support the increases in the Class 4b minimum prices as proposed by the trade associations, WUD, CDC, MPC, and supported by the three cooperatives, CDI, DFA and Land O'Lakes. HCC believes their proposal significantly overvalues the whey stream and will lead to or magnify negative returns for California cheese makers. Minimum prices need to be set at levels that allows for a return on investment and facilitates milk clearing the market.

Background

Today, the dairy industry is challenging for both producers and processors. For producers, ongoing low milk prices have added to the stress of a prolonged water shortage, intense competition for land and higher regulative and labor costs. While feed prices have also come down, it has not been enough for many producers and some have left the industry. Still, the rate of producer consolidation in

California has remained below the national average from 2010 to 2015. For manufacturers, commodity markets for milk powders, cheese, lactose and whey proteins continue to be depressed, resulting in tight or negative margins. This leaves both producers and processors at this hearing fighting over a share of the shrinking revenue pie. As such, HCC believes the California system is in desperate need of reform. Increases in minimum prices will do nothing to address our most basic problems. Instead, they will only further damage our industry by continuing to deter investment and delay necessary long-term reform.

Economic standards for milk product price regulation

For 50 years, CDFA has used component pricing to regulate the price that must be paid to dairy farmers for Grade A milk used for manufacturing purposes. For over 25 years, two manufactured product prices have been employed, the Class 4b and the Class 4a milk. Under component pricing, CDFA has consistently applied economic formulas which start with monthly California market prices for cheese powder and butter. From these prices, California-specific product manufacturing costs, including a reasonable return on investment, are subtracted. The difference is fixed as the minimum regulated price that manufacturers must pay to dairy farmers.

CDFA's 4a and 4b price formula decisions have consistently recognized that it is a good economic policy to provide a manufacturing margin between product prices received and milk prices that must be paid - that provides a reasonable return on investment.

The process employed by CDFA is essentially a mirror image of familiar utility and transportation rate regulation, in which costs plus a reasonable return on investment are calculated to produce a regulated price that utility and transportation providers may charge. A reasonable return on investment over time has long been deemed a constitutional imperative in utility rate regulation and other forms of price control. Although CDFA has not expressly articulated these legal standards as governing the agency's long-term practice of using a return on investment as a factor in milk pricing formulas, CDFA's decision-making history has generally conformed to this ideal. The result has achieved a balance between the interests of reasonably efficient manufacturers in a return on investment and interests of dairy farmers in milk revenue reflecting product values in a competitive marketplace.

For example, when unrealized imputed revenue from whey byproducts in the regulated 4b price formula resulted in a failure of the manufacturing allowance to cover costs in 2006 to 2007, requiring many cheese manufacturers to

operate at a loss and reject milk offered for manufacturing purposes, CDFA responded with a correction in the formula, reestablishing a fair return for cheese manufacturers of reasonable efficiency.

However, we are here as a result of continued pressure to increase the Class 4b prices without apparent regard to product revenue and return on investment actually experienced by California cheese makers under CDFA's Class 4b price formula. The proposal advanced by the trade associations and the cooperatives would cross the line of rational economics by providing long-term negative returns on investment to California cheese manufacturers.

Trade association proposal does not allow for return on investment for manufacturers

Part 1. Dry whey make allowance

The Trade association proposal closely mirrors the whey factor in the USDA Class III formula, which implies a make allowance of $0.1991 per pound of dry whey. However, given this Federal Milk Marketing Order make allowance was based on 10 year old survey data and used several plants outside of California in its survey, it is likely not applicable to California and understates the cost. CDFA's second-to-last audited dry whey manufacturing survey for 2005, arguably the last survey the Department had confidence in, showed a cost of about $0.285 per pound -- $0.2851 per

pound. From 2005 to 2014, CDFA data shows NFDM manufacturing costs increased 24.2 percent, which like dry whey also has a manufacturing process that requires substantial water removal.

If the 2005 $0.2851 per pound dry whey manufacturing cost also rose by 24.2 percent, like NFDM, this would equate to a 2014 dry whey manufacturing cost of $0.3541 per pound. This is not an unreasonable assumption given HCC'S own WPC80 manufacturing costs increased 40 percent from 2006 to 2014. Expanding this thought further, the difference between the implied $0.3541 per pound manufacturing cost and what is assumed in the trade association proposal, which is $0.1991 per pound, implies a negative return of $0.155 per pound of dry whey produced. When using a whey yield of 5.9 pounds per hundredweight, as assumed in the USDA Class III formula, the $0.155 per pound discrepancy equates to a loss of $0.91 per hundredweight. For a plant running 13 million pounds of milk per day, the trade association proposal would cost $118,000 per day or $43.2 million per year over the implied $0.3541 make allowance for dry whey with standard test milk.

Part 2. Converting the Class 4b whey factor into a SNF price causes distortions in high component milk

Furthermore, since the whey factor in the Class 4b formula is blended into the SNF price, an increase in SNF

milk content above 8.8 percent will increase the given whey factor proportionately. For example, the trade association proposal calls for a whey factor of $2.04 per hundredweight when the dry whey price is $0.53 per pound, which is the previous five year average dry whey price. But at 9.1 SNF, 9.2 percent SNF, a reasonable test for milk going into a cheese plant, this increases to $2.11 per hundredweight.

By contrast, the USDA whey factor is determined by the 'other solids' test of the milk, which tends to be constant or even slightly declining with higher SNF percentages. The current USDA Class III whey factor would value $0.53 per pound dry whey at $1.95 per hundredweight at a real world 'other solids' test of 5.72 percent. This implies the trade association proposal is asking for a whey factor $0.16 per hundredweight higher than the unacceptable USDA Class III whey factor for real world test milk assuming a $0.53 per pound dry whey price. This is illustrated in Figure 4. For a plant running 13 million pounds per day, this would cost an extra $21,000 per day, or $7.7 million per year, over the current USDA Class III whey factor.

Looking at the trade associations' whey factor proposal, the combined impact of an outdated make allowance for dry whey manufacturing and the overvaluation of the whey factor at real world test milk would overvalue the whey stream approximately $1.07 per hundredweight, relative a

USDA Class III whey factor with updated make allowance. This result is graphed in Figure 5.

Part 3. The trade association proposal and temporary whey factor does not allow for an adequate return on investment relative liquid WPC

Comparing the trade association proposal and temporary whey factor against the DIC proposal also shows a large contrast. For a cheese maker only able to capture the liquid WPC value from their whey stream, the trade association proposal would have overvalued whey by an average of $0.54 per hundredweight from the year 2000 through 2015 using historical dry whey and WPC34 prices and 9.1 percent SNF milk. For some years the difference exceeds $1.00 per hundredweight. Looking at the temporary proposal, it would have overvalued the whey stream by an average of $0.33 per hundredweight relative the DIC liquid WPC value from 2000 through 2015. These results are unacceptable because many cheese makers would not be able to earn a return on investment most of the time.

4. Outdated manufacturing make allowances cannot be ignored

The Class 4b cheese make allowance is using CDFA manufacturing cost data from 2006. From 2006 to 2014, CDFA audited manufacturing cost data for cheddar cheese increased from $0.1988 per pound to $0.2355 per pound, a $0.0367 per

pound increase. Assuming a 10.2 pound per hundredweight cheese yield, this shortfall equates to a $0.37 per hundredweight milk loss, or $48,700 per day, $17.7 million per year for a 13 million milk pound per day plant. The Class 4b whey factor cannot be looked at in isolation when considering the latest cheese manufacturing costs imply a negative return on investment. HCC's own cheddar manufacturing costs are not covered under the 2006 make allowance currently employed. In conjunction with Class 4b make allowances, the 4a make allowances have also become outdated and imply a negative return on investment. Both must be addressed.

In 2011, Dr. Eric Erba, representing CDI, filed a post-hearing brief to CDFA that read:

> "At the forefront of the information available is the manufacturing cost studies conducted by the Department, which have been the cornerstone of California's milk pricing foundation. The cost studies have provided unparalleled credibility to the milk pricing system in California, and their importance to the milk pricing process is unquestioned."

Again, in 2014, Dr. Eric Erba, representing CDI, filed a petition for a 4a hearing to update the make allowance. He stated in this petition that:

"As the largest butter and milk powder manufacturer in the state, we cannot simply ignore the fact that our processing costs are higher than the manufacturing cost allowances in the Class 4a formula might suggest. We cannot overlook the implications that the static manufacturing cost allowances have on all California Class 4a and 4b operations."

Part 5. Summary of dry whey and cheese returns

HCC believes the importance of accurate, up-to-date make allowances for whey processing and cheese cannot be overstated. Reasonably efficient plants must be allowed to receive a return on investment today and going into the future until the next time manufacturing price formulas are addressed. The trade association proposal clearly falls short of this mark. The Department should not be considering massive whey value adjustments without considering the full Class 4b formula value.

Dry whey is not a good measure to value whey protein and lactose

The product revenue we generate from our cheese plant in Hilmar is not well correlated to dry whey and can at times greatly overvalue the whey stream relative cheese milk prices. Figure 8 shows, on a protein adjusted basis, that dry whey is a poor indicator of WPC values. If

anything, nonfat dry milk now tracks closer to WPC34, but again this is not a strong correlation. The price spread between protein adjusted dry whey and WPC34 has reached as high as $0.50 per pound in recent years, making WPC production risky with dry whey based on Class 4b whey factors. Also, comparing dry whey to lactose shows a volatile disconnect. For over a year, lactose prices have been below costs of production whereas the trade association proposal and temporary whey factor have still been applying positive value to the Class 4b formula most months.

HCC's competitors are not subject to minimum pricing regulations or can opt out of the regulated system

The cheese manufacturers in Oceania and Europe are not subject to minimum milk pricing regulations and instead purchase milk from dairymen based on actual commodity conditions for the products they sell and in relation to demand for milk in the area. They do not have to worry about mandatory minimum milk prices being driven by products they are not even producing. Further, when HCC's mandatory minimum prices are bound to our domestic market for cheddar cheese and dry whey, it makes it extremely difficult to compete in international markets and retain customers. For example, when international prices are lower than domestic, high regulated minimum prices push us out of those markets and in turn make it hard to get the business back when

international markets are in our favor.

Domestically, all of our major competitors are in unregulated areas, such as Idaho, or in Federal Orders that allow the milk to opt out of price regulation. These competitors can all choose not to pool, de-pool or otherwise pay below USDA Class III pricing. According to Western United Dairymen's CDFA testimony last year, Glanbia in Idaho pays on a formula that has averaged $0.50 below USDA Class III. This is despite Glanbia having lower transportation costs to eastern markets and likely lower manufacturing costs compared to California. Furthermore, the whey portion of Glanbia's pay price formula is based on lactose and WPC34 prices to better correlate with the actual products they sell, in effect giving them an advantage.

HCC's Dalhart plant in Texas in the Southwest Federal Order is a non-pool plant that regularly pays below USDA Class III and can adjust milk prices based on actual market conditions. In our California Federal Order testimony, we testified that the Dalhart plant bought billions of pounds of milk under class to clear the market in the past year. In addition to the ability to pay under class, Dalhart enjoys lower transportation costs to eastern markets, which increases our net cheese price and also has lower manufacturing costs. Recent *Dairy Market News* reports continue to mention milk selling under class in Federal

Order regions.

Another issue brought up in past hearings is the ability of cheese makers to switch to Grade B milk as an effective opt out of the regulated pricing system. This is not a realistic option for several reasons. First, it is the producer's choice, not the cheese plant's, whether their milk is switched to Grade B. Further, the producer has an incentive not to switch if they hold any quota or have concerns about having to get permitted again if they want to switch back to Grade A. Second, having a large Grade B milk supply will have a negative impact on our product values and limit our ability to sell milk and cream for balancing purposes. In unregulated areas of the US and Federal Orders, milk can be bought and sold outside the regulated pricing system while retaining Grade A status. It would be evidence of disorderly marketing conditions if most cheese plants in California were put into a position where they could only remain viable by buying Grade B milk.

Uncertainty surrounding Class 4b minimum prices stifles investment

The existing minimum prices and threat of higher minimum prices continue to drive investment outside of California. as a result of the continuing uncertainty surrounding the Class 4b price, HCC has directed investment in its cheese and whey business out of state. Investors

cannot make informed business decisions when the pricing structure is unstable and subject to frequent hearings and political pressure.

Proprietary cheese plants cannot pass on manufacturing losses to producers like a cooperative

Almost all of the cheese manufacturing in California is under proprietary ownership, meaning that business losses cannot be blended into lower than minimum milk prices. Instead, all losses must be concentrated onto the owners. Cooperatives can continue operating in an environment where minimum milk costs outstrip their manufacturing returns by simply re-blending their losses across all of the producers. This exact scenario unfolded in 2014 when a large cooperative in California had to pass on substantial losses to their members.

California's milk pricing system needs reform

The long term solution for the California dairy industry is to reform the pricing system to force all milk buyers to focus on growing the value of milk, not just leveraging the system to their advantage. When manufacturers can invest, create value for milk and compete for milk the producers will ultimately win. This is needed for the industry to survive and thrive in the future. Instead, the current regulated system has trained the stakeholders to fight over milk pricing formulas and has

given the Department power to choose winners and losers.

Conclusion

The trade association proposal does not allow for a fair return on investment for reasonably efficient plants. Adoption of the trade association proposal, or another solution that does not allow for a return on investment, would run contrary to previous CDFA precedent and constitutional standards for rate regulation. For this reason, we urge the Department to adopt the DIC proposal for liquid WPC, which does allow for a return on investment.

There is a low risk to the industry in setting minimum prices below the market clearing levels because premiums will tend to fill the gap. On the other hand, setting minimum prices too high risks severely damaging the processing sector for the short-term benefit of producers but the long-term detriment of the California dairy industry. Furthermore, with the three main cooperatives in California controlling roughly 75 percent of the milk supply, they have significant bargaining power and the ability to increase milk prices if they choose. Nothing prevents them from doing this and anecdotal evidence suggests this is already happening as milk supplies have tightened.

The integrity of CDFA's milk price control system could be severely damaged if the agency succumbs to pressure

to abandon its policy of reasonable returns on investment in fixing margins that may be retained by dairy product manufacturers.

Thank you for your time and consideration and I am requesting the opportunity to file a post-hearing brief, if necessary. I would be happy to answer any questions you may have.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

Questions from the panel?

MR. SHIPPELHOUTE: So you testify that our process essentially mirrors the Public Utilities Commission rate-setting process; is that correct?

MR. De JONG: In some ways it's almost a reverse. In utility rate -- in utility regulation it's the price of the input that's regulated and in a dairy it's almost flipped where the price of the milk coming in is regulated. So in that way it is similar to a mirror image.

MR. SHIPPELHOUTE: Similar. But what we are trying to establish is not the rate that may be charged or will be charged to the consumer, correct?

MR. De JONG: Correct, it has nothing to do with the selling price. Is that what you're getting at? I'm sorry. Is it the prices that a dairy manufacturer sells his products?

MR. SHIPPELHOUTE: What I'm getting at is a -- as I understand the Public Utilities Commission's role, their role is to authorize a rate that a utility company will charge for the energy that they are selling to their various customers. As opposed to our role here which is to try and establish a minimum price that processors will pay producers for market milk.

MR. De JONG: Yes, that is a difference. But I think the main point we are trying to make is if the regulated minimum price for milk is set too high, a reasonable return on investment cannot be obtained.

MR. SHIPPELHOUTE: I'm trying to think of anywhere in the Food and Ag Code that requires us to guarantee either a processor or a producer a profit. Are you aware of any?

MR. De JONG: To my knowledge there isn't in the California Ag Code but if you would like I could refer you to two California Supreme Court cases where pricing regulation was discussed and specifically regarding the need for a reasonable rate of return. I have those two examples written down.

MR. SHIPPELHOUTE: Were those relative to our system or Public Utilities Commission?

MR. De JONG: One was related to insurance rates and another one, I'm not sure what the other one is. I know one was insurance rates. Would you like to?

MR. SHIPPELHOUTE: If you could just provide the citation to those that's helpful.

MR. De JONG: Sure. The first is *CalFarm Insurance v.* -- and I can't pronounce the second name. It's spelled D-E-U-K-M-E-J-I-A-N. And that is a case in 1989.

MR. SHIPPELHOUTE: That would have been Deukmejian.

MR. De JONG: Yes.

MR. SHIPPELHOUTE: Who would have been our Governor at the time.

MR. De JONG: And then the second is *Galland v. City of Clovis*, the California Supreme Court 2001.

THE REPORTER: Could you spell the first name?

MR. De JONG: Galland, G-A-L-L-A-N-D.

THE REPORTER: Thank you.

MR. SHIPPELHOUTE: Another question just to make sure I understand your testimony regarding your operations in Dalhart. You mentioned that Dalhart is closer to eastern markets and therefore you receive a higher price for your cheese out of that plant?

MR. De JONG: Absolutely.

MR. SHIPPELHOUTE: Absolutely higher price. And you receive the milk at a lower price because it's unregulated?

MR. De JONG: Lower than Class III.

MR. SHIPPELHOUTE: Lower than Class III. I'm going to come back to that, I just want to reread this. If you have a question, go ahead.

MR. EASTMAN: I have a couple.

MR. SHIPPELHOUTE: Okay.

MR. EASTMAN: The first question I have is, currently is Hilmar primarily procuring its milk from its member-shippers or are they buying milk on the spot market or buying any milk from co-ops at this point?

MR. De JONG: No, pretty much all of our milk is internal from our own shippers.

MR. EASTMAN: And so I assume that that milk, you pay your producers based on your market basket formula.

MR. De JONG: Yes, it's the difference between the minimum regulated 4b price and our market basket, which implies then the premium.

MR. EASTMAN: The second question I had was a question I think I'd asked earlier. With regards to the marketing of dried whey products, the alternative proposal submitted by the Dairy Institute is based off of WPC34. In your experience or your knowledge as a WPC product of a higher protein concentration is produced, or even as you produce isolates, do you think the marketing of those products are similar to WPC34 based on some sort of factor or do they tend to be less related, less correlated?

MR. De JONG: I would say speaking to WPC80, which is our largest protein product, it is -- WPC34 is a better indicator. We'll often use it as a benchmark to compare against our WPC80 prices; so in that sense it's a lot better. But there are supply-demand conditions sometimes that can move those a little bit out of alignment and I think sometimes I think as Dr. Schiek mentioned that 80 prices can be set on longer term contracts like multiple months. So they can disconnect a little bit but I believe it's still much superior than dry whey.

MR. EASTMAN: What about for isolates?

MR. De JONG: Isolates is -- I haven't specifically looked at that but the isolate market is still more specialized, it hasn't become completely commoditized so I couldn't specifically say that, but my guess would be it's probably not very related to either dry whey or WPC34.

MR. EASTMAN: And then the manufacturing conditions of, say, WPC80 compared to the 34, are they fairly similar except for increased, you know, cost to concentrate to a higher level?

MR. De JONG: Yeah, there's -- Yeah, there's substantially more cost to concentrating.

MR. EASTMAN: Are they related in some sort of factor? Are they somewhat different in that aspect?

MR. De JONG: You mean like related like some kind

of mathematical conversion?

MR. EASTMAN: Right. As a rule of thumb do you normally see the cost related in a certain manner, sort of in a certain range, or can that totally vary?

MR. De JONG: Yeah, we do, we do have mathematical factors that look at that relationship but I am not willing to give you that exact formula.

MR. EASTMAN: Right.

MR. De JONG: To how we exactly compare it because it would kind of get into some proprietary areas.

MR. EASTMAN: Sure. And then on the figures that you have at the end of your testimony. I was wondering if you could just walk me through really quickly, just so I understand, what Figures 8 and 9 show, sort of how you got at what they show.

MR. De JONG: Okay, "Figure 8: Dry whey values are both volatile relative whey protein, and have increased in price relative when proteins. CDFA dry whey price adjusted to 34% protein equivalent." So I essentially take -- took the dry whey price, divided it by 12. And I choose 12 because it's assumed dry whey is 12 percent protein.

MR. EASTMAN: Hold on a second. So when you say "the dry whey price" are you meaning the monthly commodity average, which --

MR. De JONG: Yes, the --

MR. EASTMAN: -- is the *Dairy Market News* Mostly Price Series Western Area?

MR. De JONG: Yes.

MR. EASTMAN: Okay.

MR. De JONG: The CDFA published dry whey price divided by 12 and then multiplied by 34 to get a 34 percent protein equivalent.

MR. EASTMAN: Okay, gotcha.

MR. De JONG: And yeah, the graph is essentially showing that the relationship has become more volatile and that dry whey on a protein basis has been increasing in value relative to 34. And I think that just kind of speaks to the long-term trend of the industry. I think decisions to make higher value proteins, you know, were made, five, ten, more years ago. And as more people have entered that market I think the premiums have kind of eroded and you've seen dry whey kind of increase in value relative the whey proteins.

MR. EASTMAN: And then for Figure 9, although I think it's similar, why don't you go ahead and --

MR. De JONG: Yes.

MR. EASTMAN: -- just for clarity sake.

MR. De JONG: Yes. These numbers are completely unadjusted. It's just showing the absolute difference between the CDFA dry whey and the *Dairy Market News* Mostly

Lactose. And it's just showing that there's periods of disconnect where manufacturers can either make a profit or they can go backwards substantially.

MR. EASTMAN: Okay, thank you.

MR. SHIPPELHOUTE: Basically, if I summarize it in one paragraph here, you're testifying that in Dalhart you are able to buy milk at below the Federal Order Class III, you're able to process it -- your processing cost is less in Texas and you receive a higher price. So basically, Dalhart compared to Hilmar, you're much better off in all three, higher price for the cheese going out, lower price to process and lower price to buy the milk in the first place.

MR. De JONG: We do have a manufacturing cost advantage and we are getting a higher Class III price. I think the major point is that a Class III price or one that is close to it doesn't work in California like it does in Dalhart. Just saying that Dalhart, despite having those advantages, Class III is still a high benchmark over there.

MR. SHIPPELHOUTE: Okay. And you testified the founding of the company was by producers, the ideal that producers should receive a competitive market-driven price for their milk. And what I'm hearing the producers testify here today is that's exactly what their asking for on the use of the tables that they have presented. Could you comment on that?

MR. De JONG: Yeah. I think the idea is that milk, the Hilmar way is that milk is valued by what you can do with it. In Hilmar's instance, they were using a lot of Jersey milk, which has a cheese yield advantage in it and they were paying premiums for that. Whereas just continuing to increase the regulated minimums, it essentially overvalues the lower component milk, spreads it through the whole pool so you can't give a proper incentive to attract the milk you want for your plant.

MR. SHIPPELHOUTE: Thank you. No other questions.

HEARING OFFICER SUTHER: Thank you for your testimony, Mr. De Jong.

If we could, if you could please sign up at the back of the room if you are going to be a witness so we can kind of plan out the rest of our afternoon and evening.

Right now it's 3:40. Let's take a ten minute break and start over at 3:50, please.

(Off the record at 3:40 p.m.)

(On the record at 3:52 p.m.)

HEARING OFFICER SUTHER: We will now reconvene; it is 3:52.

Ms. McBride.

Ms. McBride, would you please state your full name, spell your last name and state your affiliation for the record, please.

MS. McBRIDE: Lynne McBride, M-C, capital B-R-I-D-E, and I am with the California Dairy Campaign.

Whereupon,

LYNNE McBRIDE

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or any other things you would like to enter into the record?

MS. McBRIDE: Yes I do, the statement I just passed out.

HEARING OFFICER SUTHER: The written testimony of Ms. McBride will now be received as Exhibit number 48 and you may proceed.

(Exhibit 48 was entered into the record.)

MS. McBRIDE: Mr. Hearing Officer and Members of the Panel, my name is Lynne McBride. I currently serve as Executive Director of the California Dairy Campaign. CDC is a grassroots organization representing dairy farm families throughout California. The testimony I will present today is based on positions adopted by the CDC Board of Directors.

I would like to begin by thanking California Department of Food and Agriculture Secretary Karen Ross for holding this hearing today to consider adjustments to the whey factor in the 4b price formula. Given that 4b milk utilization now totals over 46 percent of all pooled milk,

it is critical that the 4b price is equitable compared to other states. We join Milk Producers Council and Western United Dairymen in calling for an increase in the 4b whey scale to better reflect the whey value in the federal milk marketing order pricing system.

Milk production in our state is in decline.

According to the California Department of Food and Agriculture "Annual Review," milk production in California was down 3.4 percent in 2015 compared to 2014 and the decline in milk production continues to this day. For years, our state has produced more than 20 percent of the nation's milk, but for the first time in recent memory California milk production has dropped below 20 percent. For many a decline in milk production is simply a number to consider, but for the dairy farm families that we represent, the decline in milk production is a grim reality that has a ripple effect on the local, regional and state economy. Our dairy producer members continue to question their future in California due to the fact that milk prices in our state are routinely some of the lowest of any of the major milk producing states in the nation. While milk production is in decline here, other states are increasing their milk production due largely to more favorable pricing conditions in other parts of the country.

The CDFA "Annual Review," for 2015 indicated that

there are 1,438 dairies remaining in the state. Another 32 dairies went out of business in California last year. Over the last ten years more than 600 dairies in California went out of operation. We believe a significant reason for the decline in the number of dairies in California is due to the fact that dairy producers in our state are paid less than dairy producers in the federal milk marketing order system. Our organization strongly supports efforts underway by California Dairies, Inc., Dairy Farmers of America and Land O'Lakes, Inc. to establish a federal order for California to bring our state dairy producer pricing and the process for determining minimum milk prices in line with the rest of the federal order system.

According to the latest Statewide Cost Comparison Summary from the fourth quarter of 2015, the average cost to produce milk in California totaled $19.74 per hundredweight while the income received per hundredweight according to that very same report totaled $16.73 per hundredweight. The situation has only deteriorated on the income side since then. According to the latest CDFA data, the Overbase price for February totaled just $13.09 per hundredweight, well below average production costs. The last time the Overbase price was this low was in May 2010, a year when the average cost of production was $15.19 per hundredweight, much lower than the average cost of production in our state today.

Since late 2014, prices paid to dairy producers have been significantly below production costs leading to mounting losses for dairy producers throughout the state.

And Dairies Continue to Close

Since the last CDFA hearing, a number of our dairy producer members have closed their dairies across the state. I want to briefly talk about some of our dairy producer members who closed their operations to illustrate how rapidly dairy farming in California is changing. Last time I testified before this CDFA panel, I described how one of our long-time board members decided to sell his dairy in California and leave to start a dairy operation in another state. He continues to believe that it was the best decision he ever made because his new dairy is far more prosperous than the one he left behind in California.

Again this year, another long-time board member in our organization made the decision to sell his cows earlier this year. His dairy was a 600 cow Holstein dairy that had been in operation for generations. He is yet another example of a dairy producer in California who was a leader in our organization and within the industry as a whole who decided it simply made more sense to sell his cows than continue to incur losses on the dairy. He ran a highly efficient and modern dairy operation and had a real passion for dairy farming. However, he and his family could no

longer justify the long hours and the financial risk required to keep their dairy in operation.

Another dairy that closed since the last hearing was a 500 cow dairy in the Turlock area. The owners of this dairy were leaders in the dairy industry both at the state and national level. Both husband and wife testified before CDFA many times calling for more equitable dairy producer prices in California. Their decision to sell their cows was due to the fact that although their entire lives were spent dedicated to their dairy operation, they decided not to continue given that dairy prices are again so far below production costs.

Dairy cows that went up for sale just the other week were owned by a 900 cow dairy producer who wanted to stay in operation but was forced out due to a change in ownership on his rented facility. He made great efforts to find another facility but was unable to find another dairy operation to rent. As more dairies are bought up and converted to other crops, the scarcity of dairy facilities to rent is becoming more and more of an issue in our state. Some other recent dairy sales included dairies with 1,200 and 1,000 cows who decided that they were better of selling their cows because they could no longer justify the financial losses due to milk prices that do not come close to covering their production costs.

The stories continue to pile up of dairy producers who decided to sell out and each closure is a loss to the dairy industry in California and makes the future of milk production in our state all the more uncertain. The dairy farm families we represent work hard and make great sacrifices so that they can pass down the dairy to the next generation. However, given the chronically lower milk prices here and the high cost of production, many sons and daughters simply don't want to take on the stress, uncertainty and tremendous sacrifice to run a dairy in California.

And I did have a chance to, and I could elaborate on this in a post-hearing brief, but I did have a chance to talk to a representative from a major sales yard in California and he confirmed that the majority of cattle sale are leaving the state. Some of the states that he mentioned where they're going are Idaho, Utah, Texas and New Mexico. He considered the latter two because of the recent weather event. But he said also one of the sales that he is having this week, he normally would expect over 100 buyers to show up this week, he'll be lucky to get 15 or so. And it's just very indicative of what's happening in terms of cows leaving the state and milk production in decline.

According to the recent report published by the United States Department of Agriculture Economic Research

Service, dairy farming in the Unites States is "a highly specialized and very risky endeavor." We deem this description to be very apt, but consider dairy farming in California to involve much greater risk than dairy farming in the rest of the country. Our state is one of the most highly regulated states, be it air, water, labor or other regulations that significantly increase the cost to produce milk here. In addition, dairy producers in our state continue to confront unprecedented challenges due to the historic drought. Although precipitation was more plentiful this year, dairy producers will continue to face great uncertainty about water availability for the foreseeable future, yet another critical factor that will continue to affect the cost of production in our state. At the very least, dairy producers in our state should be paid prices that are in line with the rest of the country. But for far too long we have been at a great disadvantage compared to other states and the impacts are a decline in milk production in our state and the loss of dairy farm families.

California Producer Prices Fail to Cover Production Costs

According to the CDFA Annual Review for 2015, the average annual price paid to dairy producers was just $15.40 per hundredweight, the lowest annual average price since 2010 when milk production costs were far lower. As CDFA

determines whether to grant an adjustment in the 4b pricing formula, the income received by dairy producers relative to production costs is an important indicator to assess whether economic conditions merit an increase. The latest cost of production data available from CDFA, as has been mentioned before, is the fourth quarter of 2015 which reports the cost to produce milk in the state amounted to $19.74 per hundredweight. The California Overbase price for February was $13.09 per hundredweight, indicating that income that month was well below average production costs and prices paid to producers have continued to remain substantially below production costs. And according -- this has been mentioned before. According to Section 62062, the CDFA Secretary shall, "consider the cost of management and a reasonable return on necessary capital investment" when establishing prices. And we believe the current pricing formulas do not result in a price that is adequate to cover production costs, proving that an increase in the whey scale that we're calling for is more than justified.

On the last page of our testimony we have included a graph showing the percentage of dairies in the North Valley Cost Survey that have been operating at a net loss since 2008. We calculate this graph based on the CDFA Cost of Production Feedback sheets. As the graph indicates, since the first quarter of 2015 more than 80 percent of all

North Valley dairies have been operating at a net loss. The graph shows that the vast majority of dairies have been losing money because producer income has not been enough to cover production costs. The section of the graph showing 2015 data indicates that the economic situation for California dairies has deteriorated significantly and is most comparable to periods of negative margins in 2009 and 2012 when most dairies were operating at a net loss.

And we believe the disparity between our 4b cheese price and the equivalent Federal Order Class III price is a significant reason for the decline in milk production and the closure of dairies in our state. We appreciate and thank CDFA Secretary Karen Ross for focusing on the 4b price for this hearing today because it has been the greatest source of difference between California and federal order prices. As the CDFA analysis for this hearing indicates, the gap between the 4b and federal order Class III would have averaged $1.85 per hundredweight over the last five years under the permanent whey scale. We commended Secretary Ross for granting a 12 month increase in the whey scale last year but consider it critical that the whey value in the 4b formula is permanently raised so that it tracks the whey value in the federal order Class III formula.

The proposal we join with MPC and Western United in proposing to CDFA today would bring our 4b prices in

closer relationship with federal order prices and make it more responsive to changes in the whey market. Had our proposal been in place, the gap between the 4b and the Class III would have decreased to an average 46 cents over the last five years. And we consider our proposal to be a compromise proposal because over the last year, if it had been in place, the 4b price would continue to be 75 cents lower than the federal order Class III. However, it is critical that all steps are taken to bring California milk prices in line with prices paid in the federal order system.

We are opposed to the proposal put forward by the Dairy Institute that would incorporate a sliding scale based on whey protein concentrate values. Under the Dairy Institute proposal the gap between the 4b and the Class III would have averaged $1.53 per hundredweight over the past five years. Over the last year the gap would have been $1.23, a larger gap than the previous whey scale that was capped at 75 cents. We share the concerns raised in the last hearing panel report that implementing the WPC34 proposal would incorporate a different price series that will potentially move in an opposite direction. The Dairy Institute proposal would maintain a significant gap between 4b and Class III prices and create an even greater misalignment between 4b and federal order Class III prices and we urge CDFA to reject this proposal.

In conclusion, the increase called for in the petition we put forward along with MPC and Western United is supported by California Dairies, Inc., Dairy Farmers of America and Land O'Lakes and will ensure that the whey value in the 4b pricing formula more closely reflects the whey value in the federal milk marketing order pricing system. We believe adoption of our proposal is critical so that 4b prices are more equitable for California dairy producers who have continued to lose substantial income since milk prices dropped dramatically towards the end of 2014.

On behalf of the California Dairy Campaign I thank you for allowing me to testify today and I would like to request the ability to submit a post-hearing brief.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

Questions from the panel?

MR. MONSON: Thank you for your testimony, Ms. McBride. I was wondering if you could comment on what you think the impact of if CDFA were to adopt the proposal that you are supporting, that you put forward, in terms of the declining milk production as well as the loss of dairies that you referred to in your testimony.

MS. McBRIDE: Yeah, I think if you were to take the mood of the dairy producer members that we represent, it's very grim right now given where costs are and where

prices are. So I think that if the Secretary were to adopt the proposal that we have put forward it would really offer a lot of hope to these dairy farm families who literally, and you have heard testimony of this throughout the day, are making decisions about whether or not to continue to operate a dairy here in California.

And the situation has gotten very dire for -- again, leaders within our organization who really question, you know, what their future holds here. So I think, you know, at the very least if the whey scale could be -- it could be at an on par with the Federal Order Class III whey value, that would just be such an important signal that they should have hope moving ahead operating a dairy in California.

MR. MONSON: Thank you.

MR. EASTMAN: Would you go ahead and submit in your post-hearing brief the evidence of cows leaving the state. You mentioned that you would be willing to do that.

MS. McBRIDE: Yes.

MR. EASTMAN: That would be good for the record, I think. I don't have any other questions besides the ones we already asked you previously.

MS. McBRIDE: Yeah. So yeah. I'd hope to incorporate that into my testimony earlier. I just had a chance to speak with them recently but I'm happy to provide

information on that.

And just in terms, again, a number of our members do participate in these cow sales and that's the story that we're hearing back is that, you know, a significant number are leaving the state.

HEARING OFFICER SUTHER: Thank you for your testimony.

MS. McBRIDE: Thank you.

HEARING OFFICER SUTHER: Mr. Moore.

Mr. Moore, would you please state your full name, spell your last name and state your affiliation for the record, please.

MR. MOORE: I'm Mac Moore and the last name is M-O-O-R-E. I'm with Cacique, Inc., a cheese manufacturer.

Whereupon,

MAC MOORE

Was duly sworn.

HEARING OFFICER SUTHER: Mr. Moore, do you have any written statements or other things you would like entered into the record at this time?

MR. MOORE: The letter that I left with each one of you.

HEARING OFFICER SUTHER: Okay.

MR. MOORE: I would like to read that to you.

HEARING OFFICER SUTHER: Okay. Mr. Moore, your

written testimony will be Exhibit number 49 and you may proceed.

(Exhibit 49 was entered into the record.)

MR. MOORE: Mr. Hearing Officer and members of the Hearing Panel:

As an introduction, I am Mac Moore, Director of Business Development for Cacique, Inc. My dedication is to support Cacique's vision to be the largest, most successful and respected Hispanic perishable food company in the country. A cheese peddler, if you will. Cacique is a family-owned company, born of immigrants that came to America with little money, two suitcases, three children and one "on the way." They had a will to succeed and dreams of the promise of a country where hard work would be met with fair and just rules of governing. Cacique stands here today, in its second generation of ownership, as evidence of those proven truths.

Cacique, Incorporated was founded in 1973, has been a California cheese manufacturer for 43 years. With $800 raised and borrowed, Cacique was founded. Our beginnings were humble, rented bottling space in the back of a drive-through dairy, product sold from a Styrofoam cooler in the trunk of a teal green 1966 Pontiac, hard work are the Cacique genesis. We produced high quality cheeses and grew by selling an additional pound at each corner grocery store

every time they were serviced. Cacique was literally built one pound at a time. Today, after years of very hard work, some luck and excellent people, Cacique is America's most popular brand of Mexican cheese and creams as measured by nationally recognized auditors of such consumer demands.

We are over 300 California-based employees and 55 employees throughout the US. Over 80 percent of our workforce is of minority origin, including the ownership. Nearly every employee was recruited. We are truly a company with a "family" spirit and culture. For the record, Cacique is not a minimum wage company.

Cacique is a nationally recognized Hispanic brand of the food industry that sells into the retail, food service and prepared food industries. We compete nationwide. On average, Cacique processes about 1 million pounds of milk on any given production day and more than 300 million pounds of milk per year. Nearly half of that volume is shipped out of California as cheese, sour cream or yogurt. Our talents like in our ability to provide customers with quality solutions and services that will grow their business while delighting our consumers with an exceptional Hispanic food experience each and every time they buy our product. That is our pledge and that's our pride.

Higher quality and service can justify some costs

over the local competitors in other states that allows us to pay for the additional freight and handling associated with out-of-state markets. But that justification is very fragile and very razor thin. Our out-of-state competitors do not have the same costs for their milk, energy usage, labor nor rent that we incur because we manufacture our products in California. We struggle mightily to keep our costs down, without quality sacrifices to maintain our growth. The most vital costs and value to both us and our out-of-state competitors are our milk supplies. Their milk costs, as ours, are subject to the same movements of the Block Cheese trades on the Chicago Mercantile Exchange. When the CME moves, although our milk supplies are subject to different formulae, the net effect to our mutual costs is nearly the same. Our out-of-state competitors in federal orders can negotiate directly with their milk suppliers and pay below the FMMO Class III price, depending on market conditions in that region. This is a real advantage to those processors over fully-regulated cheesemakers. If any factor in the California Class 4b formula results in a milk cost that makes our products uncompetitive it will impact our ability to sell our cheese in the markets distant and nearby.

We are here today to discuss the value of whey, its revenues and how milk processors have the opportunity to

pass along profits associated with its sales. Whey to smaller operators like Cacique is a cost rather than a revenue stream that we strive to mitigate in order to stay competitive for our survival. We cannot afford the multi million dollars worth of equipment that is required to invest necessary to process whey into a tradable commodity. Our volumes are simply not high enough to get the depreciated value from the equipment before its longevity would require replacement. So for us, benchmarking milk pricing with a higher input for whey values is purely a net increase to our costs versus our out-of-state competitors. We need to pay to dispose of our whey; adding costs for whey to our milk pricing is untenable for operators like us.

Raising our costs unilaterally will cause us to raise our prices unilaterally in the markets, absolutely. Our competitors will be given a new price advantage allowing them to more easily move us out of their markets and more easily into ours. The volume and dollar loss to California dairies will be real. Unfortunately, for small operators like us it could be devastating.

Cacique strongly supports returning to the permanent whey formula as was in effect prior to this past August 2015. Any structural increases could cause us harm.

Thank you for your generous time and consideration in this matter.

HEARING OFFICER SUTHER: Questions?

MR. EASTMAN: So just for the record, what does Cacique do with its whey stream? Just for the record.

MR. MOORE: There are farmers that'll pick it up; they transport it for us. It's a cost to us. We have to -- we have to dry it up as much as we can because we can't just send them water, so we have to put in some equipment to dry it up a bit. Basically it's just a net.

MR. EASTMAN: Do you get any revenue back when you sell it or you just strictly are paying a cost for them to take it?

MR. MOORE: Just paying the cost for them -- well actually, yeah, we give it to them, they move it out.

MR. EASTMAN: Okay. And then you mentioned that nearly half of the volume of your product is shipped and supposedly sold outside of California.

MR. MOORE: That's true.

MR. EASTMAN: Is that just because that's where larger markets are or is the market in California saturated?

MR. MOORE: It's where -- we're Hispanic-based. That's an advantage we have over a lot of other -- but there are Hispanic manufacturers throughout the United States, we're not the only one. We'd like to be but we're not.

California makes up a very strong base of the Hispanic market but it's spread out through the Southwest,

Texas and into Colorado. So that's kind of -- I would say maybe even two-thirds of the volume of the consumers are out to the Mississippi. And then the last, the last efforts towards the last end.

MR. EASTMAN: Perfect. And then it appears that you are supporting no action, really. No action on behalf of the Secretary would mean that we would revert back to the permanent table that was in place prior to --

MR. MOORE: Exactly, that's what we --

MR. EASTMAN: -- the decision last summer.

MR. MOORE: Yes.

MR. EASTMAN: If the Secretary were to do something do you have a Plan B or you're just here to support "no action" pretty much?

MR. MOORE: Well, raise prices and hope for the best, you know. We're all subject to the real world. If we have to raise prices we have to raise prices and we'll fight to keep it. We're just saying it's a thin margin already and anything we give up starts coming back this way.

MR. EASTMAN: Thank you.

MR. MONSON: A quick question, Mr. Moore. Do you have any opinion as to using WPC34 as the input price versus dry whey in the formula?

MR. MOORE: Only that the WPC floats at, say, more of the whey stream. It's closer to the, let's say, not

value-added. And that's the trouble with the powdered whey and the isolates and things like that, they're value-added type of situations. And if the pricing is indexed to some value-added that somebody could get extra money for it's money we would never get anyway.

MR. MONSON: Okay.

MR. MOORE: It's kind of just like watching your price go up and there's nothing you can do about it.

MR. MONSON: Thank you.

HEARING OFFICER SUTHER: Thank you for your testimony, Mr. Moore.

MR. MOORE: Thank you.

HEARING OFFICER SUTHER: Mr. Garbani.

Mr. Garbani, could you please state your full name, spell your last name and state your affiliation for the record, please.

MR. GARBANI: My name is Pete Garbani, spelled G-A-R-B-A-N-I, and I am employed with Land O'Lakes. I am a Director in Member Relations.

Whereupon,

PETE GARBANI

Was duly sworn.

HEARING OFFICER SUTHER: Mr. Garbani, do you have any written statements or other things you would like entered into the record at this time?

MR. GARBANI: Only the testimony, the written testimony I just distributed to you guys.

HEARING OFFICER SUTHER: The written testimony of Mr. Garbani will be Exhibit number 50.

(Exhibit 50 was entered into the record.)

HEARING OFFICER SUTHER: You may proceed.

MR. GARBANI: Mr. Hearing Officer and Members of the Panel:

My name is Pete Garbani. I am here to testify on behalf of Land O'Lakes, Inc. My business address is 400 South M Street, Tulare, California, 93274. My current title is Director, Member Relations.

Land O'Lakes would like to thank the Secretary and the Department for calling this hearing, on its own motion, to consider amendments to the Marketing Plans. Specifically, we thank the Department for calling a hearing to consider adjustments to the current Class 4b pricing formula including adjustments to the whey factor. This hearing will address issues of critical importance to the future of both our California dairy producer members and the entire California dairy industry.

Land O'Lakes is a dairy cooperative with 2,200 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 several cheese, butter-powder and value-added plants in the Upper Midwest, East and California. Currently, our 185 California member-owners supply us with over 15 million pounds of milk per day that are primarily processed at our Tulare and Orland plants. We also operate a dairy dessert plant in Turlock.

Land O'Lakes supports the proposal submitted by the producer trade associations of Western United Dairymen, Milk Producers Council and California Dairy Campaign to modify the sliding scale that values dry whey within the Class 4b milk pricing formula. The proposed sliding scale closely approximates the whey formula incorporated into the joint proposal supported by the three cooperatives in hearing conducted by the USDA last fall to consider a California federal milk marketing order.

Land O'Lakes supports this proposal be adopted permanently to provide much needed financial support to California dairy farm families who have recently experienced narrowing margins over feed costs. Land O'Lakes agrees that overall market conditions support this adjustment to the 4b pricing formula. We encourage the Department to implement the proposed changes beginning as soon as possible.

First, I'd like to discuss the merits of using the whey sliding scale and making the proposed adjustments to it.

Merits of the Whey Sliding Scale

In previous panel reports the CDFA has clearly affirmed that using the whey sliding scale is a viable option to value whey in the Class 4b formula. In the CDFA panel report discussing the hearing of June 30 and July 1, 2011, the panel stated that the sliding scale had merit for the following reasons:

Reason 1: The sliding scale would allow the whey value incorporated into the Class 4b formula to be market-driven so that the whey value would rise and fall as the price of whey rises and falls in its market.

We agree that adopting the producer trade association proposal would be consistent with a market-driven approach.

Reason 2: The sliding scale could be updated.

We support this proposal that includes an updated scale which would better reflect whey's market value and more fairly incorporate the value into the Class 4b formula. The CDFA panel clearly envisioned the need for periodic updates as being one of the merits of this approach.

Reason 3: The majority of producers favored using a sliding scale as a method to value whey.

As you know, the overwhelming majority of California producers support the trade associations' proposal and continue to support the use of the sliding

scale.

Since adopting the whey sliding scale, the CDFA anticipated the continued use of it as a method to value whey in the Class 4b formula and for these three reasons we strongly encourage the Department to adopt this proposal.

Next I would like to offer some observations about the market factors that support the permanent adjustment to the 4b formula. These factors include the recent market trends in milk production, farm milk prices and the financial conditions of California dairy farmers along with some comments about the impact that the chronic drought conditions have had on our dairy members.

California's Milk Production Continues to Decrease Monthly

California's milk production has experienced year on year decreases during every month in 2015 and the first two months of 2016. In fact, since November 2014, California's milk production has decreased for 15 straight months. Comparing daily milk production in January 2016 of roughly 111 million pounds to the daily milk production in January 2014 of 117 million pounds reveals a decrease of 120 tanker loads of milk each day. Similarly, in February 2016, California's dairy farms produced 140 fewer tanker loads of milk each day - a decrease of nearly 7 million pounds of milk each day compared to the daily milk production in

February 2014.

By comparison, Land O'Lakes member milk production has also decreased; when comparing calendar years 2014 to 2015 by 5.2 percent, and when comparing the first two months of 2016 to the first two months of 2015 our production is down 4.8 percent. Even in light of the temporary increase to 4b pricing, effective August 1, 2015, our members' milk production has decreased 5.3 percent for the same period of August 1 through February 28 when comparing 2014/2015 to 2015/2016.

Our members' milk production appears to be responding to the combination of rapidly decreasing milk prices and increasing production costs which have put many of our dairy farmers under extreme pressure as their margins have narrowed to unprofitable levels.

Financial Conditions Challenging California Dairy Farmers

By any price measure, California's dairy farmers have received far less for their milk in 2015-16 even with the temporary 4b whey factor adjustment than they received in comparable periods in 2014-15. For example:

The statewide blend price received by California dairy farmers averaged $14.28 in the seven-month period August 2015 through February 2016. This is $4.16 less than the average of the statewide blend price for the same seven

month period August 2014 through February 2015.

California mailbox prices have followed a similar path downward. The California mailbox price averaged $15.63 per hundredweight in the five month period August 2015 through December 2015. During the same five month period August 2014 through December 2014, California mailbox prices averaged $21.23, representing a decrease of $5.60 per hundredweight.

California's overbase averaged $15.59 for the seven month period August 2015 through February 2016, compared to a seven month average of $19.68 during the comparable period August 2014 through February 2015. The overbase averaged $4.09 less per hundredweight in the seven months since the temporary 4b whey factor adjustment was adopted.

These farm level price decreases ranging from $4.09 to $5.60 per hundredweight have had a huge impact on the cash flow position of our state's dairy farmers. These decreases effectively cut our dairy farmers' gross pay by roughly 20 percent. Think how difficult that would be for anyone to experience that magnitude of a cut in their gross pay.

At this point, the CDFA has not released cost of milk production estimates for 2016. Based on the latest data available, some milk production costs increased in

2015. Specifically, hired labor costs increased 10.5 percent; operating expenses increased 1.6 percent, milk marketing costs increased 1.7 percent and herd replacement costs increased 23 percent as the demand for replacement animals increased. Summing up all the costs previously listed, the CDFA estimated that the total cost of milk production for the fourth quarter of 2015 was $19.74 per hundredweight.

Even though this milk production cost estimate was $0.35 lower than the estimate of one year ago, the margin measured by deducting the cost of milk production from milk prices has worsened drastically from year-ago levels. Comparing the most current milk prices with the 2015 fourth quarter cost of milk production reveals how devastating the drastic fall in milk prices has been. The cost of milk production exceeded farm level milk prices by the following amounts:

The statewide blend price received by California dairy farmers was $14.33 in February 2016. This was $5.41 lower than the $19.74 cost of milk production in Q4 2015.

California's overbase was $13.91 in February 2016. This was $5.83 lower than the $19.74 cost of milk production in Q4 2015.

Income over feed costs represents a commonly referred to economic metric when considering the financial

health of dairy farming. CDFA estimated that total feed costs averaged $11.23 per hundredweight in Q4 of 2015. Assuming that feed costs have remained flat since then and using the average overbase price of $14.60 per hundredweight for the first two months of 2016 reveals that income over feed costs have been narrowed by $3.37 per hundredweight - clearly a catastrophic margin over feed level for California dairy families.

Recall that the 2014 Farm Bill created the dairy Margin Protection Program. This new risk management tool for dairy farmers uses an income over feed cost level of $4 to represent the base insurance level that all dairy farmers can attain for no cost other than a $100 enrollment fee. This base level insurance is often referred to as a catastrophic margin coverage. In developing the components of this program, the National Milk Producers Federation concluded that when margins over feed shrink to the $4 level, dairy farmers' equity is at risk. Recall the market conditions of 2009 when margins over feed shrank to below this catastrophic level. As stated earlier, the average margin for the two-month period for January 2016 to February 2016 was $3.37. This is $0.63 per hundredweight lower than the $4 level. If the current level of dairy farmer margins continue into future months, California dairy farmers' equity will again be at risk.

In light of the severe financial conditions experienced in the past 18 months, most California dairy farmers have again taken the opportunity to enroll in the Margin Protection Program for 2016. The Farm Service Agency estimated that 78 percent of California dairy farms enrolled in the Margin Protection Program, representing roughly 89 percent of the total milk. It is important to note that nearly 10 percent more of California dairy farmers signed up for the MPP in 2016 - 69 percent of California dairy farmers purchased MPP insurance in 2015. Clearly, California dairy farmers have major concerns about the financial conditions of the dairy sector in 2016.

Unfortunately, the negative California basis, meaning that the California all-milk price falls below the US all-milk price, reduces the benefit to California dairy farmers from participating in this program. As you know, the US all-milk price represents the price used as the proxy for milk income in the calculation of the US dairy margin in the Margin Protection Program. For example, the California all-milk price averaged $1.69 lower than the US all-milk price - the California all-milk price averaged $15.31 compared to the US all-milk price that averaged $17.00 - in the first 14 months of the Dairy Margin Protection Program, January 2015 through February 2016. This means that when the US income over feed or margin is at a $4 level, the

California income over feed margin is $1.69 lower or $2.31 per hundredweight.

A significant portion of this negative California basis is attributable to the lower value for Class 4b milk and the lower value for Class 4b milk is directly attributable to the lower value of whey in the 4b formula. Thus, an additional benefit of the producer association's proposal is the narrowing of this negative basis. Closing the negative basis gap between the California all-milk price and the US all-milk price could enhance the benefit to California dairies who have paid the premiums to help them manage their margin risk by enrolling in the Dairy Margin Protection Program for 2016.

The challenging financial environment has directly contributed to the departure of 44 Land O'Lakes dairy members from our cooperative since August of 2012. The majority of these members are no longer in the milk production business. In total these 44 Land O'Lakes members represent a decline of nearly 20 percent of Land O'Lakes' California dairy farmer members in 43 months, from August 2012 through February 2016.

We are keenly aware that many of our members are currently operating with negative margins and several are considering exiting the dairy business. While many members are evaluating their exit strategies some are getting

pressure from their lenders to consider liquidation.

Adding to the challenging milk market is the chronic drought conditions. The drought has added considerable stress and cost to our dairy members. We know of many cases of dairy farmers taking steps such as idling cropland, drilling new, deeper wells or planting more drought tolerant crops like sorghum to manage their farms with less water.

While 2014 was one of the best years on record for dairy profitability, many of our producers were faced with reinvesting millions of dollars back into their facilities in the form of water wells and conveyance systems. These infrastructure investments not only required significant capital but the ongoing operating costs and impact to their ROI is burdensome even in the best of economic conditions.

Position on Alternative Proposals

We do not support the alternative proposal submitted by the Dairy Institute. Specifically, we have several concerns about using the WPC34 price as defined by the alternative proposal submitted and presented by the Dairy Institute. We have the following concerns:

1. The industry stakeholders do not know what volume of WPC34 products is represented in the suggested WPC34 price series. No data was made available about the volume of product traded in the USDA'S *Dairy Market News*

price series reported for the Central and Western regions.

2. WPC34 does not represent whey's most basic, unprocessed form. Neither the CDFA nor the USDA AMS Dairy programs, the administrator of the federal milk marketing program, have ever provided data on manufacturing costs of WPC34. There is no publicly available, publicly audited data on WPC34 manufacturing costs or product yields.

3. The WPC34 scale that determines the whey contribution to the Class 4b price caps out at much lower value than is fair and appropriate.

4. Within the CDFA's background materials for this hearing it's worthy of noting, the Dairy Institute's proposal using WPC34 reached its maximum value during 19 months, far more often than both the current whey factor and the whey factor proposed by the producer trade associations, suggesting far less value would have been passed back to California dairy producers.

5. Western pricing should be used in the WPC34 series, not Central region pricing or some combination of the two.

6. As noted earlier, the California dairy men and women continually battle "basis risk" when protecting their margins using the Margin Protection Program. They also battle the same basis risk when trying to hedge their milk price by using Class III instruments, specifically due to

the different values for whey in 4b compared to Class III. Using WPC34 in 4b pricing will further disadvantage California dairies with their risk management alternatives and further complicate an already volatile correlation.

7. The Hearing Panel Report from the June 3, 2015 hearing listed similar concerns about using WPC34 in the 4b formula including but not limited to: the appropriateness of using the *Dairy Market News* WPC34 price series, unverified WPC34 manufacturing costs and possible confidentiality issues with WPC34 manufacturing cost data. We are not aware that these same concerns have been resolved within the 10 months since our last hearing and believe moving to the use of WPC34 value in 4b milk price continues to be inappropriate.

Additionally, the Dairy Institute's proposal is inconsistent with our joint proposal that we supported at the hearing conducted by the USDA concerning the adoption of a California federal milk marketing order.

Land O'Lakes' support of the producer trade groups' proposal to the CDFA does not change in any way our continued support for the adoption of a California FMMO, which is presently in the post-hearing, briefing process. We and our partner cooperatives, DFA and CDI, remain fully focused on our joint effort but are hopeful you will support the proposal submitted by the three trade associations.

In conclusion, we thank the Secretary for calling this hearing. The California dairy farmers need this increase in the whey factor of the 4b formula in light of the dire financial conditions they have weathered since late 2014, worsening in 2015 and continuing into 2016. This increase has the potential to have a positive financial impact on California's dairy farmers at a time when they need it the most. We thank the panel for your consideration and Land O'Lakes would like to request the opportunity to file a post-hearing brief.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

Questions from the panel?

MR. EASTMAN: I have a couple of questions just for clarity's sake. On page 4 you mention some analysis of prices. You mention overbase price and California mailbox prices and the statewide blend price. I assume the statewide blend price is a blend price that's published by CDFA?

MR. GARBANI: Correct.

MR. EASTMAN: Okay. And then on the bottom of page 5 in that last paragraph you mention how there's been 44 California Land O'Lakes dairy members who have gone out of business in the last 43 months. Do you know what percent of the milk production those 44 dairies would represent?

MR. GARBANI: No, but I would be happy to give that to you in the post-hearing brief.

MR. EASTMAN: Okay.

MR. GARBANI: Not just off the top of my head.

MR. EASTMAN: That's okay, we'll forgive you this time. No, I'm just joking.

(Laughter.)

MR. EASTMAN: And then as one of the larger, as a large handler of milk in the state, as milk production has declined as you mentioned amongst your members, how has your business plan changed or how are you managing that with regards to milk that you process in your own plants and milk that you sell to your customers? How has that affected your business plan?

MR. GARBANI: Well I think it's very similar to what may have been -- I think Eric Erba from CDI described pretty similarly how we handle the same situation in that we use our manufacturing plants to balance our commitments to our customers. So our customers, we have contracts for volumes and we have to honor those commitments and so we take that milk, we run less milk through our plants.

MR. EASTMAN: Thank you; I think that's all I had.

MR. SHIPPELHOUTE: You run a cheese plant in Orland. I'm just curious how the changes last year with the temporary change to the whey factor, how that impacted the

Orland operation?

MR. GARBANI: In what regard? Our producers or --

MR. SHIPPELHOUTE: Financially. How that cheese, is that traded within your company, do you sell it on the open market, how do you market that product?

MR. GARBANI: Most of the time that cheese is used internally as raw material for another plant that we have within our system.

MR. SHIPPELHOUTE: Okay.

MR. GARBANI: You know, as far as how it impacted us. We had the same impact on our costs that everybody had. I think I heard $0.034 per hundredweight is what it cost a cheese manufacturer for the ten month period, roughly.

MR. SHIPPELHOUTE: So then you pass that on to your sister plant, if you will, for internal accounting purposes?

MR. GARBANI: Well, that's kind of proprietary.

MR. SHIPPELHOUTE: Okay.

MR. GARBANI: But I would tell you --

MR. SHIPPELHOUTE: Fair enough.

MR. GARBANI: I'll tell you no, we don't pass that along because it's based on market values.

MR. SHIPPELHOUTE: Okay. And earlier there was a reference to your whey coming out of Orland going down to Kern County. Was that presentation accurate?

MR. GARBANI: I think you need to ask Mr. Murphy about my business more than -- I would not have disclosed that proprietary information, to be honest, so I'm going to leave it at that.

MR. SHIPPELHOUTE: Okay, fair enough. No other questions.

HEARING OFFICER SUTHER: Thank you for your testimony.

Mr. Paris.

Mr. Paris, will you please state your full name, spell your last name and state your affiliation for the record, please.

MR. PARIS: My name is Joe E. Paris, P-A-R-I-S, and I am testifying on behalf of Rizo Lopez Foods in Modesto, California.

Whereupon,

JOE E. PARIS

Reaffirmed being previously sworn.

HEARING OFFICER SUTHER: And do you have any written statements or other things you would like to enter into the record at this time?

MR. PARIS: Yes, the testimony I just handed you.

HEARING OFFICER SUTHER: Okay. The written testimony of Mr. Paris will now be received as Exhibit number 51.

(Exhibit 51 was entered into the record.)

HEARING OFFICER SUTHER: And you may proceed.

MR. PARIS: I am representing Rizo Lopez Foods. I have had a consulting relationship with Rizo since 2006. I work with them on milk and cheese futures, options and other hedging strategies as well as supplying other market information when requested. I was instrumental in arranging the first milk supply that they ever had in their plant when they started out in Riverbank in the 1990s.

This testimony has been authorized and prepared under the direction of Ivan Rizo, CEO of Rizo Lopez Foods.

Rizo Lopez Foods moved to a new 130,000 square foot building located at 201 South McClure Road, Modesto, California, in 2012 as they had outgrown their original facility in Riverbank. The new facility was a multimillion dollar investment that included the land, empty building and much new equipment. Rizo Lopez employs over 200 people in the Modesto facility. Rizo Lopez Foods sells most of their products through a network of wholesalers who supply some of the finest supermarkets from California to Florida. These facts were testified to by Ivan Rizo in the June 3rd hearing in 2015.

Rizo Lopez Foods produces and markets various varieties of Hispanic cheeses and other dairy products under the Don Francisco brand and produce some conventional and

organic cheese. Rizo Lopez Foods have multiple class utilizations because of the variety of dairy products they produce, but over 90 percent of their utilization is 4b. Changes in the whey factor will change the costs on over 90 percent of their milk. Rizo Lopez buys their milk supply from local cooperatives.

Rizo Lopez supports the use of the whey factor that was in effect prior to August 1, 2015. Rizo is opposed to the producer proposal because of the financial harm it could do to their company. Since the implementation of the temporary whey factor on August 1 of 2015, Rizo's ability to extract value from their whey stream has diminished due to some issues in their cheese making procedure. Most of their whey is going as animal feed with little or no value. Had the whey price not remained low through most of the temporary pricing period, Rizo Lopez potentially could have suffered an increased cost of over $3.5 million with little chance of recovery. The national Hispanic cheese market does not respond quickly to the volatility of milk markets and passing along increased costs can take months. Changes, such as a temporary increase in regulated prices, can cause a lot of "heartburn" in specialty cheese markets like the Hispanic market. Many of the great people that buy Rizo's products are in one of the lowest income classes in America.

In summary, Rizo Lopez Foods strongly opposes the

producer group's proposal and asks for elimination of the temporary whey factor and resumption of the whey factor in the 4b formula that was used prior to August 1 in 2015.

This concludes my testimony and we thank you for the opportunity to express our concerns and we would like to request the ability to send in a post-hearing brief.

HEARING OFFICER SUTHER: Your request to send in a post-hearing brief is granted.

Any questions?

MR. EASTMAN: I have one question. You mention that had whey prices not decreased that the company could have potentially suffered a loss of or an increased cost of $3.5 million. How was that calculated?

MR. PARIS: That was estimated based on where they had figured the futures were going to take the whey. It didn't go that direction and we came up with the number. I got this from the Rizo Lopez financial people there.

MR. EASTMAN: Okay. So probably based on where whey futures were looking back when it was implemented last summer, possibly?

MR. PARIS: It was probably an indication of the temporary price. Prior to that time.

MR. EASTMAN: Okay, thank you.

HEARING OFFICER SUTHER: Thank you for your testimony.

Mr. Hofferber.

Mr. Hofferber, would you please state your full name, spell your last name and state your affiliation for the record, please.

MS. HOFFERBER: I am Scott Hofferber, H-O-F-F-E-R-B-E-R, and I am with Farmdale Creamery.

Whereupon,

SCOTT HOFFERBER

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or other things you would like to enter into the record?

MS. HOFFERBER: Yes, the statement that I've submitted to the reporter.

HEARING OFFICER SUTHER: The written statement of Mr. Hofferber will be Exhibit number 52.

(Exhibit 52 was entered into the record.)

HEARING OFFICER SUTHER: And you may proceed.

MS. HOFFERBER: Thank you. Good day, Hearing Officer and members of the Hearing Panel. I am Scott Hofferber, the Chief Financial Officer of Farmdale Creamery, Inc. and I am here at the direction and on the authority of our Board of Directors. Farmdale is a third-generation family-owned and operated dairy processing facility in Southern California. Farmdale is processing an average 28

million pounds of milk and cream per month into cheese, sour cream, WPC80 powder and buttermilk.

In June of last year Farmdale presented specific economic information that clearly described the dismal and worsening results from our very new and costly investment in a WPC80 processing facility. Our timing for making this investment could only have been worse if we had delayed the project another year from 2013 to 2014. Subsequent to that last hearing we have seen the WPC80 market erode even further, becoming the primary cause for us to have experienced our worst fiscal year results since 2006, the year leading to the total failure of the variable whey factor methodology in 2007.

The call of this hearing to discuss the continuation of a variable whey factor, intended to transfer alleged whey value from processors to producers, is highly unfortunate. It is not the Class III federal premium that is the root cause of the continuing disappearance of smaller, under-performing dairy farms. The producers' own "McKinsey Study" foresaw this collapse in their producer-purchased report; a report which was dismissed by the very people who commissioned it on no better grounds than sheer denial of the conclusions drawn. To paraphrase: "If some of you don't go out of business voluntarily, you will go out of business painfully." This is purely a supply and demand

observation that producers chose to ignore leading to the current conditions of farm reduction. However, with the reduction in farms, there has not been a commensurate reduction in milk supply, probably because the "haves" have bought up the viable assets of the "have-nots" and continued the oversupply situation.

Another unfortunate element of this particular hearing is the narrowness of its scope. Cheese and powder processors have not had a practical opportunity to bring the issue of make allowance adjustments to the table in deference to the political pressure to lay off the producer community during their tough times. The Department has specific information, amongst which is Farmdale's offering in Exhibit 1 below, as to the economic impact this delayed recognition has meant to the cheese community. Why, we ask, are we not talking about all aspects of the pricing structure under the so-called California Order System? The Department's own data clearly describes the under-funding, if you will, of the costs to manufacture the end product the producers designed for growth by creating the make allowance system in the first place.

Farmdale advocates for merely letting the temporary emergency whey scale expire. The emergency has shifted relative to the notion of whey being the bad guy to the producers. We, the processing community, are getting

the back of this bad guy's hand right in the mouth these days, with little to no relief in sight for quite some time. Here is where the producers in the room can think, "Well, it's about time somebody else took some of the pain." No argument. However, that sentiment doesn't do anything towards curing the inherent difficulties of maintaining a regulated pricing system based on end-product pricing. Further, acting on this narrow element without including the broader issues, including make allowance adjustments, is just as counterproductive, in our view.

Should the panel recommend something other than the expiration, as a member of the Dairy Institute of California we would support its approach to the whey valuation question over the unsupportable notions of whey value as offered by Western United Dairymen and others in this hearing.

Where we share the Secretary's concern for the welfare of the dairy industry entrusted to her care, we implore the Department to recognize the fragile nature of both sides of this coin, both producers and processors, and balance the needs of industry stakeholders. Let the marketplace determine the appropriate level of equilibrium in the price of 4b milk, not some arbitrary tinkering with an outmoded pricing model.

Respectfully submitted, us. And I request the

ability to file a post-hearing brief if Mr. Hyrum needs it.

(Laughter.)

HEARING OFFICER SUTHER: Your request for a post-hearing brief is granted.

Questions from the panel?

MR. EASTMAN: I have a couple of questions. First I just want to walk through the table on the last page just to make sure that I get it.

MR. HOFFERBER: Sure.

MR. EASTMAN: It looks like you're comparing the cheese cost, per pound cost as released by CDFA, with make allowances in the formula and then you are just simply multiplying that by the pounds of cheese you produced.

MR. HOFFERBER: Correct.

MR. EASTMAN: Okay.

MR. HOFFERBER: Yeah, it's very straightforward like that.

MR. EASTMAN: Okay.

MR. HOFFERBER: The only assertion is what my WAG at 2015 will turn out to be based on the progression of the previous years.

MR. EASTMAN: Right, okay. And then on page 1 of your testimony you mentioned how the WPC80 market eroded. Are you referring to the market price of the finished product in the marketplace?

MR. HOFFERBER: Yes.

MR. EASTMAN: Okay. Do you have any sense of what that is, maybe on percent terms or sort of what you could share in terms of --

MR. HOFFERBER: Yeah, we haven't traditionally been one to really stand on ceremony about confidentiality and all that stuff. Our market price for that product has gotten as low as $1.10 a pound; it cost me $2.50 to make it.

MR. EASTMAN: And where were prices, maybe, in the recent past?

MR. HOFFERBER: We've gotten it up to around $1.50 for whey that we are going to sell in May, plus or minus 5 or 6 percent of that number. My guys are out negotiating LTL deals all the time for this stuff trying to move it at an ever-better price but we are so far behind cost it's ridiculous right now.

MR. EASTMAN: Great. We appreciate that information, even though sometimes it's held close to the vest, there's not a lot of public outlets for that where it's published.

MR. HOFFERBER: I understand.

MR. EASTMAN: And then I was sort of -- not confused but you mentioned how -- at the bottom of page 1, the beginning of page 2 of your testimony, that there has been a reduction in dairy farms but not the commensurate

reduction in milk supply. What do you mean by that, exactly?

MR. HOFFERBER: Well, what it appears to me is if you took a pure percentage reduction in the number of farms, you are not seeing that same similar 14 percent, 16 percent kind of reduction in the milk supply. And the only conclusion I can make is it's little under-performing farms going out with very few cows that are -- yes, we are reducing milk supply but not nearly at the same rate, percentage-wise, as we are reducing farms. So it becomes a little bit inaccurate to equate the loss in percentage basis of farms to what's really going on in the milk supply.

MR. EASTMAN: Gotcha.

MR. HOFFERBER: That's, I guess, my point there.

MR. EASTMAN: Thank you. Those were my questions.

MR. SHIPPELHOUTE: So before you put the investment into the WPC80 processing facility what were you doing with your whey and what would have been the impact to your company had you not done that?

MR. HOFFERBER: So not to go on for too long but prior to 2007 as that initial variable whey factor that was instituted, I don't know, back in '03, I think. At that time we were roller drying and making popcorn animal feed whey. This product we were selling at something like 80 percent of the Mostly market for dry whey plus we were

paying the freight to ship it to the Midwest; so it was definitely a whey disposal expense being feathered back into the cheese side.

As we were close to being put out of business in 2007 when the dry market went north and everything, you know, just went south for all of us, at that point in time we went to a fixed whey factor, which as far as we're concerned as a smaller cheese maker, pretty much saved us. We recovered from that, became, you know. Again as I said, we had some more profitable years than we had had in 2006. And we were continuing to make the animal feed whey once we were down to a very -- somebody said earlier, kind of a base level cost of the whey stream.

And back in the '07 hearing what was testified to there by us and others was what had come out of Wisconsin's John Umhoefer regarding $0.10 kind of a value of the protein, where we had settled on a $0.25 number in the 2007 hearing. The December 1 fixed factor came out at $0.25. There was even testimony the value should have been $0.10.

So if we really want to talk about the value of the whey stream let's talk about what's it worth in its raw state when it comes off the cheese plant. Because everybody is making so many different kinds of things, how in the world can you pick one product to try and price everything back into the milk from that?

Which has, again, been our repeated testimony at this thing. Just knock the price down, let us go out and figure it out based on true end-product value what that particular whey stream is worth at that cheese plant. For Cacique, you know, they're saying they're selling it off as animal feed. How are they going to achieve the same sort of value that we theoretically would be getting?

Or to go back to your question, the base model that we had to decide to build the whey plant presumed a $3 minimum price for WPC80. And now we're getting the numbers we're getting and we're getting slaughtered.

That was probably more information than your question presumed.

MR. SHIPPELHOUTE: No, that's great, thank you.

MR. HOFFERBER: But there you go.

HEARING OFFICER SUTHER: Ms. Taylor.

Ms. Taylor, could you please state your full name, spell your last name and state your affiliation for the record, please.

MS. TAYLOR: Certainly. It's Sue Taylor, T-A-Y-L-O-R, and I'm with Leprino Foods, L-E-P-R-I-N-O Foods.

Whereupon,

SUE TAYLOR

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written

statements or other things you would like entered into the record?

MS. TAYLOR: Yes I do; I have two documents that I have distributed to each of you. The first one is titled "Statement of Sue M. Taylor" and is dated April 11th, 2016 and the second is the post-hearing brief for the Federal Milk Marketing Order hearing for California.

HEARING OFFICER SUTHER: The written testimony of Ms. Taylor will be Exhibit number 53.

(Exhibit 53 was entered into the record.)

HEARING OFFICER SUTHER: And you may proceed.

MS. TAYLOR: Thank you. I am Sue Taylor, Vice President of Dairy Economics and Policy 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. Whey from our California plants is processed into protein concentrates and lactose. Concentrated retentate from one of the plants is shipped to another of our California plants for final processing. The other two plants fully process both the retentate and permeate. We are one of the largest dairy manufacturers in California, purchasing well over 10 percent of the milk produced in the state.

I am testifying today in support of the Dairy Institute of California's proposal for whey valuation in the

Class 4b formula. I fully support Dr. Bill Schiek's testimony presented at this hearing. This proposal appropriately updates the whey factor in the Class 4b formula based upon the value for liquid concentrated whey priced relative to the Whey Protein Concentrate-34 market, the most common basis for value creation by cheese plants that do not have the scale to make full whey processing economically feasible. It reflects recent advances made by some of those cheesemakers and increases the Class 4b price consistent with those advances.

I am also testifying today in opposition to the Class 4b formula whey valuation proposed by Western United Dairymen, California Dairy Campaign and Milk Producers Council. The Western United *et al.* proposal is even more onerous than the policy that existed prior to December 2007. The pre-December 2007 valuation contributed to the closure of several proprietary cheese plants, producer payment defaults and eventual sale of a cheese company, and divestiture of some cheese plants by cooperatives. The Western United *et al.* proposal values whey at $0.40 to $0.58 per hundredweight higher than the pre-December 2007 valuation and does not provide for any structural reform that would allow the outcome to be any different than existed under the pre-December 2007 hearing. This proposed whey factor exceeds the Federal Order whey valuation,

disregarding the fundamental location value of milk related to proximity to market and ignoring the significant difference in how CDFA and Federal Orders apply the price to cheese milk.

Roughly ten months have passed since the last CDFA Class 4b hearing. During that time, given the nine week USDA Federal Milk Marketing Order hearing, much has been debated but little has changed in a meaningful way relative to the ability to extract value from whey in the marketplace. In fact, the ability of cheese manufacturers to capture value in the marketplace has become more challenging, given a global surplus of milk that has pressured global cheese prices below US prices. Although US prices for skim milk powder have been pressured down to global levels, cheese prices have remained above global levels. Cheese and whey exports each declined by 14 percent in 2015. Cheese exports are down another 13 percent year-to-date through February of this year. Although these trends will eventually reverse themselves, this decline in exports and downward price pressure is likely to last over a more extended period than recent downturns due to structural issues contributing to the global imbalance. The current pain is shared across the supply chain and milk production in California has also declined as drought impacts on water and feed availability and costs take their toll on the

producer sector.

Largely, the key policy-shaping factors remain the same and are consistent with my June 3, 2015 testimony and my Federal Order hearing testimony and post-hearing brief, attached for reference.

Specifically, whey valuation in a regulatory context remains challenging.

1. Whey processing is highly capital intensive and is not economically viable on a small to medium scale basis.

2. With whey driving up regulated minimums by over $3 per hundredweight at times in 2007, plants without processing capacity struggled and some were shuttered. The financial stress was reflected in some plant closures, three cheese plants being placed on the ineligible list for the Producer Security Trust Fund, and the sale of a proprietary cheese company.

3. It was clear that CDFA had overvalued milk to cheesemakers before the December 2007 formula change due to the crisis amongst cheesemakers just noted, in combination with the stimulation of increased milk production that led to disorderly marketing conditions, including milk being sold out-of-state, to calf ranches and being disposed of in manure lagoons.

4. The table on page 6 of CDFA's "Background Materials" made available for this hearing shows that only

12 of the 59 cheese plants in California have the ability to process at least a portion of their whey. These 12 plants include processors who only have concentration capacity and cannot produce a finished dry product.

5. Testimony at USDA's California Federal Order hearing, recapped on pages 12 to 21 in the attached post-hearing brief, confirms that:

a. Several small/medium size cheese producers - Cacique, Marquez Brothers, Farmdale, Pacific Gold - do not have the ability to fully process the whey stream.

b. Several large cheese producers - Leprino, Saputo - transport liquid whey long distances for final processing.

c. Scale barriers to whey processing are not unique to California cheese makers. Preliminary results from a survey of cheese makers across the country conducted by Dr. Mark Stephenson of the University of Wisconsin were consistent with California's whey processing challenges. Completed survey results from 62 cheese plants showed that:

> "Not surprisingly, all of the plants processing less than 100,000 pound of milk per day are selling or disposing of all of their whey. Fifteen percent of plants processing from 100,000 to 2 million pounds of milk per day process a portion of their whey into some form of product

for sale. Eighty-three percent of plants processing more than 2 million pounds of milk per day are processing some or all of their whey into a final product for sale. Of the plants not processing a final product, about 15 percent are disposing of whey by land spreading or fed to local livestock. All plants disposing of whey incur the hauling cost but some also pay to dispose of the whey beyond the cost of hauling. The average distance to dispose of whey was about 85 miles although some plants had options as close as 20 miles. The remaining plants not processing a final product are selling or transferring whey in various forms to another plant. These plants averaged about 65 miles to the receiving destination but the range was from 2 to 250 miles."

d. This problem exists throughout the country, even in Wisconsin where the density of cheese plants has facilitated whey consolidation. Two Wisconsin cheese makers, Steve Buholzer of Klondike Cheese and Steve Stettler of Decatur Dairy, testified at the Federal Order hearing. Klondike ultrafilters the whey stream to 34 percent protein and utilizes reverse osmosis to concentrate it prior to shipping. The whey must be commingled with larger volumes

of other whey given its acid level associated with Feta production. Klondike's whey revenue fell $0.65 per hundredweight milk short of the Class III valuation in 2014. Decatur is located close to a whey processor willing to accept warm whey. Their returns were $0.71 per hundredweight below the Federal Order Class III assumption -- whey assumption in 2014 and $0.0676 below year-to-date through September 2015. The Wisconsin Cheese Makers Association responded to USDA's call for comments on small business impacts in early 2015 with comments outlining the challenges for small cheesemakers to achieve the whey returns assumed in the Federal Order Class III price. Wisconsin's higher location value of milk due to its closer proximity to the large demand centers of the East provide a partial offset to the whey overvaluation, but it does not negate the fact that the Class III formula overvalues whey.

Dairy Institute's Proposal Values Whey Most Appropriately

The Dairy Institute proposal to value the whey portion of the Class 4b milk formula relative to its liquid whey value replaces the existing sweet whey factor with a more relevant factor for today's marketplace. It reflects recent advances that have facilitated investment in concentration capacity by some cheesemakers that did not previously have it and increases the Class 4b price

consistent with those advances.

The WPC34 price index is the most common reference used for the sale of liquid concentrated whey by cheese plants that do not have the scale to make full whey processing economically feasible. As many witnesses testified at this hearing, the prices received for that liquid whey are discounted to reflect that the liquid concentrated whey requires additional processing with highly specialized and capital intensive equipment in order to produce a full value product. The Dairy Institute proposal reflects a survey of cheese plants that was corroborated by industry consultants working with many of the cheesemakers with insufficient capacity to have economically viable whey processing operations producing dry whey.

The Dairy Institute proposal appropriately caps the whey contribution in the Class 4b formula at $1.50, in recognition of the Class 4b milk that is not even recovering a liquid whey value. The viability of some of those plants will likely be threatened by the increased cost burden related to a product that they cannot, even under best management practices, extract a value from.

Western United *et al.* Proposal Was Proven Untenable in its Less Onerous Version

The Western United proposal attributes more value to whey than the Class 4b formula did before December 2007,

when overvaluation led to the financial difficulties and closure of cheese plants, three cheese plants being placed on the ineligible list for the Producer Security Trust Fund for failure to pay timely, and the sale of a proprietary cheese company referenced above. In fact, the proposal even values whey at a level as much as $.12 per hundredweight milk higher than it is valued in the Federal Orders, a regulatory structure for which participation is voluntary for cheesemakers. Even with the safety valve that is provided through the voluntary application of the Federal Orders to cheesemakers, the level established in the Federal Order Class III formula is problematic.

It is not difficult to anticipate the damage that would be done if the Western United *et al.* proposal is adopted. The proposal once again sets up the scenario of signals to producers to increase milk production while signaling to cheesemakers to reduce manufacturing capacity. Based upon history, that signal will be once again manifested in increased bankruptcies, plant closures and a shift in manufacturing volume from California to other states by multistate operators. The proposal would set up a scenario in which even those of us with the scale and capability to economically process whey would be better off shifting production. In addition to our cheese making assets, we have invested hundreds of millions of dollars in

capital to produce specialized whey products in our California plants and continue to need to reinvest in order to maintain markets in a highly dynamic marketplace.

Adoption of the proposal would, over the long term, result in a loss of reinvestment in California facilities and their eventual obsolescence and closure.

The Current Class 4b Formula Overvalues Cheese

The Department's March 8 Notice of Hearing limited this hearing to a temporary or permanent alteration of the whey factor in the Class 4b formula, eliminating the opportunity to review the Class 4b formula more holistically. The proposals being considered today conform to the restrictions outlined in the Notice. However, any decision the Department makes from this hearing should not be done without consideration of the implications of the clear overvaluation of the cheese component of the formula based upon the Department's own cost and "prices received" data. The current make allowance of $0.1988 per pound cheese is $0.0367 per pound cheese below the Department's cost study published in December 2015. Additionally, the f.o.b. factor of -$0.0252 is slightly understated based upon the Department price data released in October 2011 covering sales from September 2009 through August 11. That data showed a deteriorating trend with a $0.0237 cent discount to the CME in the first 12 months and a $0.0281 discount in the

second 12 months. Giving the benefit of the doubt and using the $0.0259 cent averaged combined with the updated cost data indicates that the Class 4b cheese value is $0.38 per hundredweight milk higher than is being achieved by California cheddar plants. This overvaluation makes upward adjustments in the whey factor an even greater threat to the viability of cheese manufacturing assets in California. It is critical that the Department make a decision that is economically sound in this broader context.

Conclusion

Milk used for manufacturing, whether for cheeses or for butter and dry milks, is the primary method for California diary farmers to market the volume of milk that is produced beyond the higher valued and more perishable Class 1, 2 and 3 products. The utilization of nearly 80 percent of California's milk production in Classes 4a and 4b highlights the importance of these manufacturing outlets in marketing California's milk production. Because of the critical role that Class 4 products play in marketing farm milk beyond the borders of California, it is crucial that the price formulas remain market-oriented, reflecting the values of California-manufactured products.

The policy challenges associated with incorporating an explicit whey factor tied directly to market movements in a minimum regulated milk price that

obligates businesses that may not have a viable mechanism through which to recover the whey value are no less today than in 2007. The Department must be careful not to recreate the financially tenuous environment that existed in 2007 and jeopardized both cheese processors and the outlet they provide for California-produced milk.

The Dairy Institute of California proposal does the best job of balancing producer interest and market realities. The Department should accept Dairy Institute's proposal and reject the Western United proposal and the entire industry should dedicate its energy and efforts toward longer term policy reforms that will benefit all sectors, including producers.

Thank you for your time and consideration. I respectfully request permission to file a post-hearing brief.

HEARING OFFICER SUTHER: Your request to file a post-hearing brief is granted.

Questions from the panel?

MR. EASTMAN: I guess I'll go first; I have a couple of questions. On the second page of your testimony on bullet point number five you highlight some pages that confirm what a few California cheese processors are doing with their whey stream. Your post-hearing brief for the federal order matter, did you submit that primarily just for

that citation or are there other parts that you think would be applicable to our matter here today? Or it just an overall general manifesto of how you view sort of the California industry, maybe?

MS. TAYLOR: I think it provides some good, broader context on the Class III formula. But the pages that I called out, pages 12 through 21, are specific to the whey factor so most specific to the matters at this hearing.

MR. EASTMAN: Perfect, thank you.

And then on sub-bullet B, I guess. No, on A, I'm sorry. You mention that those entities don't have the ability to fully process their whey stream. What is your definition or what do you mean by "fully process the whey stream"? What do you need to do to fully process it?

MS. TAYLOR: It would be processing into finished dry product the entire whey stream, so a combination of both the whey proteins and the carbohydrates. So some of those are producing only liquid concentrated whey, some are producing finished WPC80, but not doing anything with the carbohydrate stream. And the costs associated with disposing of that carbohydrate stream are degrading their returns from the 80.

MR. EASTMAN: That's all I had.

MR. SHIPPELHOUTE: So when we put the current table into the market order for August there was a price

increase for the month of August. How did that affect your company? Were you able to absorb that, did you pass it on to your customers? And if you passed it on to customers did you do it on the cheese side, the whey side? If you could elaborate.

MS. TAYLOR: We, concurrent with the CDFA decision implementation, did go to customers, certain customers. We did seek a premium adjustment. I would say, as I have always said, that the competitiveness of the national marketplace disciplines the passing on of costs like that to customers and I think that our conclusion, in fact, is that remains the case. We were successful in passing on a premium adjustment with some customers where, quite frankly, we had undervalued the cheese. We had expanded our capacity in Colorado and had, to some extent, bought some sales through aggressive pricing. And in that case where we were pricing probably below the overall marketplace we were successful in increasing our premiums. But we have also lost some volume in that attempt and in many cases we are not able to pass on any of that cost.

MR. SHIPPELHOUTE: And so those customers you went to were your cheese customers not your whey customers?

MS. TAYLOR: That's correct.

MR. SHIPPELHOUTE: That's all I had.

MR. MONSON: Ms. Taylor, on the top of page 2 you

talk about export markets in decline and downward price pressure and that's likely to last longer due to structural issues. Can you clarify what you meant by that?

MS. TAYLOR: Sure. On the demand side the Russian embargo has displaced tremendous volumes from the EU. They are normally cheese volumes that are normally exported into Russia. Although that is scheduled through this August there are very few people who think that it will be lifted until 2018 at the earliest. And there is also a question of whether once they lift the embargo the demand will resume to the pre-embargo levels because of damage that's occurred within the Russian economy itself.

The other structural issues, mostly in New Zealand and in the EU. The New Zealand dairy industry with the high profitability that's come in recent years has seen a lot of investment and that investment has come into -- has stimulated the development of more specialized dairy assets than what they ordinarily would have and more complex ownership structures, so we are not seeing the supply retraction that you ordinarily would expect from New Zealand, which has usually been quite quick to react to profitability.

The EU situation is related to the elimination of the production quotas in March of 2015. And similarly there has been a lot of new investment in dairy farm

infrastructure and given that new investment it's a little stickier. Even though a lot of those folks are underwater it's a little stickier in terms of getting the supply response and the retraction that you would expect just because they're concerned about debt servicing.

MR. MONSON: Thank you. That's all I have.

HEARING OFFICER SUTHER: Thank you for your testimony.

MS. TAYLOR: Thank you.

HEARING OFFICER SUTHER: Mr. Vandenheuvel.

Mr. Vandenheuvel, will you please state your full name, spell your last name and state your affiliation for the record, please.

MR. VANDENHEUVEL: The full name is Rob Vandenheuvel, V-A-N-D-E-N-H-E-U-V-E-L, and I'm with Milk Producers Council.

Whereupon,

ROB VANDENHEUVEL

Was duly sworn.

HEARING OFFICER SUTHER: Do you have any written statements or other things you would like entered into the record?

MR. VANDENHEUVEL: I do, the written testimony I just handed you.

HEARING OFFICER SUTHER: Thank you.

Mr. Vandenheuvel's written statement will be Exhibit number 54.

(Exhibit 54 was entered into the record.)

HEARING OFFICER SUTHER: You may proceed, please.

MR. VANDENHEUVEL: I'd ask for your indulgence; I have about a one hour presentation. I'm kidding.

(Laughter.)

MR. VANDENHEUVEL: I'll move through this quickly, as quickly as I can.

Hearing Officer and Members of the Panel, my name is Rob Vandenheuvel, I am with Milk Producers Council. We are a non-profit trade association with office locations in Ontario, Bakersfield and Turlock, California, representing a voluntary membership of dairy families throughout the State of California. My testimony today is based on positions adopted by the MPC Board of Directors.

Our dairy families appreciate the Secretary calling this hearing on her authority under the California Food and Ag Code, hereafter called the Code. We believe the testimony we are about to give, as well as the testimony of the other producer groups and cooperatives, will provide ample evidence that a permanent modification to the Class 4b monthly milk price calculation is warranted.

Before going into the details of the producer-sponsored proposal, the Hearing Notice published by CDFA

asked that we address, "at a minimum, the economic conditions that would support extending the effective date of the temporary dry whey scale or adjustment to either the temporary or permanent dry whey scales contained therein."

The most logical place to start is an analysis of CDFA's published "Cost of Production," compared to the average prices paid for milk throughout the state. In fact, as referenced in CDFA's Notice of Hearing, Section 62062 of the Code specifically directs the Secretary to consider the "reasonableness and economic soundness" of California's milk prices - the combined income from all classes - in relation to the cost of producing and marketing that milk. It's worth noting that Section 62062 of the Code goes on to specifically note that, "In determining the costs, the Secretary (sic) shall consider the cost of management and a reasonable return on necessary investment."

The table below displays the statewide cost of production for the past eight years as well as the average milk prices received, as published by CDFA's Cost of Production Unit. And these numbers are just reorganizing numbers that are from CDFA's own data that you see there. Cost of Production, that's statewide, and the Milk Price Received from that same report.

The next table applies these figures to a sample dairy with 1,000 milk cows, producing an average of 70

pounds per milk per cow per day. And so all that table is there is applying the table from the page before to that production profile. So you take the per hundredweight and you get a Gain or a Loss Total for each of those years, with a Cumulative 8-Year Total of over $2.2 million lost.

Plotting these data points on a line chart gives us a glimpse into what dairy farming in California has been like the past eight years. You can see that line graph there showing a steep collapse in 2009, some small recoveries in '11 and '14 but not really making up ground from what we lost there in '09.

As this chart based on CDFA's data clearly demonstrates, while 2014 was by all measures a year of strong milk prices that exceeded the cost of producing that milk, in the context of the past several years we are still very much an industry trying to recover.

Some might point to the general US dairy market trends as a source of the volatility in producer profitability over the past several years. While there is certainly a cyclical nature at play generally in the US dairy industry, California's dairy families have been consistently realizing lower milk prices than our out-of-state colleagues. CDFA maintains data on mailbox milk prices in California compared to other select regions of the country and below is a summary of that comparison.

I believe that data was reported earlier by Mr. Hollon as well but this is 2015 Mailbox Milk Price comparison between California and the other regions that CDFA monitors.

As demonstrated by this information, the current state of California dairy families isn't simply a story of a national trend downward, but rather a story of a significant disadvantage to our out-of-state competition. When competing with dairy industries in other states, whether that be for animals or for feed, our California producers are at a significantly weaker relative position than our competition. In addition to price alone, another strong indicator of this is the comparison of California's production growth compared to other states.

And this is very consistent, that table there, with previous data you've seen showing that California has really struggled in terms of our milk production growth. There has really been no growth. We produced less in 2015 than we did in 2008 while the rest of the United States continued to see growth cumulatively.

The past 15 months has been a period of particularly strong downward production trends. And we've heard about that 15 straight months of year-over-year declines in milk production here. And I point to that just as further evidence of the financial impact. We believe

this is a direct result of the many years of financial stress being on dairies here -- applied to California dairies in the previous tables.

A Reasonable and Sound Economic Relationship with the Federal Milk Marketing Order Prices

As has been referenced many times in previous hearings before this panel, producers interpret Section 62062 of the Code as a clear directive that CDFA must establish "methods or formulas" that shall be "reasonably calculated to result in prices that are in a reasonable and sound economic relationship with the national value of manufactured milk products." While Milk Producers Council certainly continues to believe this legal standard exists in CDFA's task of establishing our minimum milk prices, it is worth noting that there is a real-world logic to that directive as well, beyond just being a legal requirement.

California producers do not operate on an island. We operate within the context of a national, and increasingly international, industry. The prices we are paid for our milk are in large part affected by the cumulative decisions of tens of thousands of dairies throughout the US, not to mention the overseas competition as well. Further, the dairy commodity markets on which we rely on in setting our regulated milk prices are national markets, which have been extremely volatile in the past

decade and show no signs of slowing down.

California producers have been at a distinct disadvantage through that volatility as our mailbox milk prices have consistently lagged below that of our competing dairy producers in the rest of the country. In short, California's milk price "peaks" have been smaller and our "valleys" deeper than that of our out-of-state competition.

Looking at our state's milk producers as a whole, this reality has meant two things: 1) When California producers are losing money, often producers in other parts of the country are not, resulting in financial stress on California producers but no reasonable hope for a timely national supply response to low operating margins; and 2) When California producers are benefiting from higher prices, such as 2014, we are still falling behind most of the producers around the country in our relative position as they are experiencing even higher margins, better preparing them for any future financial challenges.

The point is that while the Legislature has given CDFA and the Secretary significant discretion in establishing regulated milk prices, they recognized the risk of putting our state's producers at a disadvantage to our out-of-state competition, and specifically included a directive in the Code to maintain a "reasonable and sound economic relationship."

The producer proposal put forth for this hearing is based on our premise that: 1) the Legislature was correct in prioritizing that reasonable relationship in establishing our regulated milk prices; and 2) that the monthly minimum prices used by the 10 current Federal Milk Marketing Orders provides us with the best benchmark available in determining the representative value for significant volumes of milk sold around the country.

The Producer Proposal

Given all the discussion above, MPC would have certainly liked to present a permanent proposal that would result in a Class 4b price equal to the monthly Federal Milk Marketing Order Class III price. However, given the specific limitations included in the hearing notice that all proposals address only the whey-related calculations in the formula, we testify today in full support of the joint proposal submitted by California Dairy Campaign, Western United Dairymen and ourselves. Testimony has already been provided earlier today by Annie AcMoody of Western United Dairymen, delving into the details of this unified producer proposal. Therefore, I would simply echo Ms. AcMoody's comments with regard to those details.

As for the impacts the proposal would have had on California's prices, I would refer to the *Summary Analysis of Estimated Impacts of the Alternative Proposals on*

California Class and Pool Prices published by CDFA in preparation for this hearing. Table 1 of that analysis notes that under the producer proposal, average Class 4b prices over the past five years would have been $1.38 per hundredweight higher than under the current permanent whey scale. Along the lines of my earlier testimony about the relationship between California's Class 4b price and the Federal Order Class III price, Table 2 indicates that under the producer proposal California's 4b price would have averaged $0.46 per hundredweight below the Federal Order Class III price. This CDFA data is consistent with our own internal analysis, which shows that addressing only the whey-related portions of the formula would continue to result in a lower Class 4b price, relative to the Federal Order Class III price, albeit a much smaller difference than we have seen in recent years.

And that's a point that really needs to be amplified. That CDFA's analysis, our own internal analysis, it's clear that even under the producer proposal the regulated price -- the processors buy milk. They don't buy whey, they don't buy cheese, they buy milk. And the regulated price they pay for that milk under the producer proposal would be a lower regulated price than the Federal Order Class III price. When I hear things like, the producer proposal would cross the line of rational economics

and some of the other extreme talk that we've heard today that this producer proposal is some sort of Armageddon for our cheese making processors here in the state. There is apparently no recognition that we, even under the producer proposal, no one has advocated today on the producer side for a price above or even equal to the Federal Order Class III price. There would continue to be a discount regardless of whether that producer proposal was put in place.

The Dairy Institute Proposal

In addition to the unified producer proposal, MPC has had an opportunity to review and analyze the proposal submitted by the Dairy Institute of California on behalf of the dairy manufacturers they represent. We are opposed to this proposal for two primary reasons: 1) We believe there are significant problems associated with using WPC34 as an "end product" in the Class 4b milk price calculation; and 2) The real-world impact of the DIC proposal falls significantly short of what producers believe is appropriate.

First, the use of WPC34. The DIC proposal aims to utilize the market value of Whey Protein Concentrate 34% in calculating the Class 4b price. This concept was proposed in the last hearing before this panel and rejected due to significant questions regarding its implementation. MPC would echo the previous panel's position rejecting the idea

of using WPC34 as the surrogate price in the Class 4b calculation. While all the concerns raised by the Panel Report were certainly valid, the most significant reason for MPC's objection is the potential it creates for added volatility in the relationship between California's Class 4b price and the benchmark Federal Order Class III price.

In addition it is also worth noting that embedded in the DIC's proposal is the theory that WPC34 is a better surrogate because, quote, and this is from the proposal: "The whey scale currently used in the Class 4b formula ... is based on dry whey prices and costs that are no longer representative of the whey values received by cheese plants operating in California." End quote. Without conceding that point I would note that there is no requirement that the end products within the California minimum price formulas be representative or even close to the market prices received by California's manufacturers. I would point out that according to CDFA's *Dairy Information Bulletin*, cheddar cheese made up only 15 percent of all cheese manufactured in California in 2015, and that included all types of packaging, from 40 pound blocks to be sold at bulk prices to individually packaged finished products sold at higher prices per pound. Mozzarella actually made up nearly 59 percent of all cheese manufactured in California last year. So under that DIC's logic in their proposal, is

it still appropriate to use 40 pound blocks of cheddar cheese sold in 40,000 pound lots at the Chicago Mercantile Exchange as the "end product" in the Class 4b formula when a majority of the actual cheese being produced is mozzarella, a higher-valued product with significantly more moisture, resulting in higher yields of cheese per 100 pounds of milk? That's obviously outside the scope of this hearing but it's a question worth asking in the context of DIC's supporting statements for their proposal.

Second, the analysis of DIC's impact. CDFA's own analysis of the impact that the two proposals would have had on California milk prices over the past five years was very telling. When compared to the current permanent whey scale, the DIC proposal would have resulted in a lower Class 4b and Overbase milk price over the past year. This at a time when California producers were hemorrhaging milk production and experiencing year-over-year production declines for 15 straight months. Further, even in previous years, the increases over the permanent whey scale would have been modest, leaving California's Class 4b prices more than $1.50 per hundredweight on average below the Federal Order Class III price.

In addition, while CDFA's analysis compared this proposal to the current permanent whey scale, I also took the opportunity to compare it to the current temporary whey

scale. Over the past five years from March 2011 to February 2016, the DIC would have reduced the Class 4b price by $0.65 per hundredweight when compared to the current temporary whey scale.

To put it bluntly, we are a state that is in the process of bleeding off its valuable milk producing investment - reducing milk supplies that are essential to the continued success of DIC's own members - and any proposal that attempts to structurally reduce our regulated milk prices beyond today's formulas should be firmly rejected.

In conclusion: The financial challenges facing California's dairy families are well-documented, backed up by CDFA's own data and now clearly resulting in significant reductions in milk production. In a State Milk Marketing Order that was set up to "enable the dairy industry, with the aid of the state, to ... bring about and maintain a reasonable amount of stability and prosperity in the production of market milk", there is ample evidence that a significant upward pricing adjustment from the current permanent whey scale is justified. We greatly appreciate Secretary Ross' initiative in calling this hearing and we encourage both the Secretary and the Hearing Panel to strongly consider the joint producer proposal in establishing the whey portion of the Class 4b formula.

And before I close, because I have 3 minutes and 30 seconds, I wanted to read an excerpt here from a *Hoard's Dairyman* editorial. And take it with a grain of salt, it is an editorial so it is not a factual-based article, but it's an accounting of a meeting that the editors had recently attended. And I read this because as I listened to testimony today - and we all come here armed with the best data that supports our cause - it is worth noting that that doesn't always reflect the discussions that happen outside of this room.

"Federal Orders Have Not Impeded Dairy Sales"

"It was refreshing to hear a global dairy processor suggest that Federal Milk Marketing Orders and the associated regulations have not prevented his company from growing in the United States. This dialogue took place as fellow dairy processors continued to harp on federal milk pricing rules as a market impediment during the largest gathering of North American dairy manufacturers."

"Granted, Lino Saputo, CEO of Saputo Inc., has a far different perspective from his American counterparts. Based in Canada, Federal Milk Marketing Orders appear more like a single strand of a chain compared to Canada's supply management

system that resembles a much stronger chain-link fence. "It's regulatory and market access to milk that is key to us," Saputo said, when discussing where his family business might pursue its next dairy plant acquisition."

"When stating that access to milk is key to his growing business, Saputo and his 75-year-old company back up that statement with action. Starting in 1980, Saputo acquired its first two US plants. Since then that number has grown to 24, now outranking the company's total in Canada. That list includes Stella Foods, Treasure Cave, Nauvoo, the Land O'Lakes West Coast industrial cheese business, Fairmount Cheese Holdings and Morningstar Foods. The boldest move took place in 2008 when Saputo purchased controlling interest in the Alto Dairy Cooperative, the nation's 19th largest farmer-owned business."

"To say the least, Saputo has repeatedly voted with its wallet, reconfirming that the US is a place where the company can grow and market regulation is not a hindrance. "Our job is to be the best processor," said Saputo of his organization's focus. "Our job is not to change regulations."

And the editorial goes on but it's mostly about Fairlife after that. I bring that up because I think we all get very comfortable with our own rhetoric about the barriers to growth. I've heard numerous times today that if the producer proposal is put in place it will be the end of some small to mid-sized cheese manufacturers.

And I think it's important to take all of this rhetoric in context and look at the facts, which is why I brought up the fact that even under the producer proposal there would be a lower regulated milk price.

You could parse it out on the whey factor, the cheese component, the make allowance, whatever. The end resulting, regulated milk price that a plant has to pay when you make cheese in California would be lower under the producer proposal than in the federal order system. That's an important fact.

So with eight seconds remaining I thank you for the opportunity to testify, happy to answer any questions and request the opportunity to submit a post-hearing brief.

HEARING OFFICER SUTHER: Your request to submit a post-hearing brief is granted.

Questions from the panel?

MR. EASTMAN: Would you, just for the ease of handling the information, do you want to include in your post-hearing brief what you read or the portion of that

article that dealt with that issue.

MR. VANDENHEUVEL: Happy to, yes.

MR. EASTMAN: Was there any reason you didn't include that in your testimony or it just didn't make it in?

MR. VANDENHEUVEL: I didn't think about it until I was sitting here.

MR. EASTMAN: Hopefully there's not a huge copyright issue or something.

MR. VANDENHEUVEL: I already put it in our newsletter with permission from *Hoard's Dairyman* so I've gotten their permission to use that for our use.

HEARING OFFICER SUTHER: Thank you for your testimony.

MR. VANDENHEUVEL: The beauty of going last, you're worn out.

HEARING OFFICER SUTHER: I would like to remind you that the post-hearing briefs will be due by 4:00 p.m. on Monday, April 18th.

Is there anyone who has not testified who wishes to do so at this time?

Not seeing anyone else. All persons present and desiring to testify have done so and no additional evidence to be presented, this hearing is now closed at 5:54 p.m. on April 11th, 2016. We are off the record.

(The public hearing adjourned at 5:54 p.m.)

CERTIFICATE OF REPORTER

I, RAMONA COTA, a Certified Electronic Reporter and Transcriber, do hereby certify that I am a disinterested person herein; that I recorded the foregoing California Department of Food and Agriculture consolidated public hearing; that I thereafter transcribed the recording.

I further certify that I am not of counsel or attorney for any of the parties to said public hearing, or in any way interested in the outcome of said matter.

IN WITNESS WHEREOF, I have hereunto set my hand this 18th day of April, 2016.

Ramona Cota

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