STATE OF CALIFORNIA

DEPARTMENT OF FOOD AND AGRICULTURE

DAIRY MARKETING BRANCH

CONSOLIDATED PUBLIC HEARING TO CONSIDER TEMPORARY 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

FRIDAY, DECEMBER 21, 2012

7:00 A.M.

ACCELERATED BUSINESS GROUP

(916) 851-5976

A P P E A R A N C E S

CDFA Panel

John Rowden, Hearing Officer
Emergency Management Coordinator, Dairy Marketing Branch

Candace Gates, Branch Chief
Dairy Marketing Branch

Hyrum Eastman, Dairy Economic Advisor
Division of Marketing Services

Kevin Masuhara, Director
Division of Marketing Services

CDFA Staff

Michele Dias, Deputy Secretary, Chief Counsel
California Department of Food and Agriculture

Michael Francesconi, Supervising Auditor
Dairy Marketing Branch

Karen Dapper
Dairy Marketing Branch

Also Present

Gary Stueve
Perry Tjaarda
Dairy Farmers of America

Michael Marsh
Annie AcMoody
Western United Dairymen

Eric Erba, PhD
California Dairies, Inc.

William Schiek, PhD
Dairy Institute of California

Barry Murphy
BESTWHEY, LLC

Also Present

Lynne McBride
California Dairy Campaign

Scott Hofferber
Farmdale Creamery, Inc.

Thomas Wegner
Land O'Lakes, Inc.

Rien Doornenbal
R. Doornenbal Ranches

Rob Vandenheuvel
Milk Producers Council

Sue M. Taylor
Leprino Foods Company

David Ahlem
Hilmar Cheese Company, Inc.

Antoinette Duarte
Duarte Dairy, Inc.

Loren Lopes
Lorinda Dairy

Barbara Martin
Tony Martin Dairy
Dairy Goddess Farmstead Cheese
Dairy Goddess Pork

Linda Lopes
California Dairy Women Association

Jose T. Maldonado
Marquez Brothers International, Inc.

Geoffrey Vanden Heuvel
J & D Star Dairy

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E X H I B I T S

E X H I B I T S

P R O C E E D I N G S

7:05 a.m.

HEARING OFFICER ROWDEN: Before we start the hearing I want to go over important details that will help ensure that this hearing will be as productive as possible.

First, please turn off your phones so they don't disrupt the hearing.

Second, anyone planning to testify must sign in on 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. There will be no post-hearing brief filing period for this hearing. Witnesses will be called in the order they signed up. The time clock to my right has been established to assist you when testifying. You will be testifying from that chair where Mr. Francesconi is sitting. You talk into the microphone in front of you and we record it.

Fourth, if you want to submit an exhibit, please bring it up to me after you speak.

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

The restrooms are outside. Make a left and they'll be right to your right.

We will probably break for lunch around noon, depending on the flow of the 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, Friday, December 21, 2012, beginning at 7:00 a.m.

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

The Secretary has called this hearing on her own motion to consider proposed amendments to the Class 1, 2, 3, 4a and 4b milk prices for a period not to exceed six months.

Specific proposals need to adhere to the scope of the hearing and may only increase or decrease the per pound component prices of Class 1, 2, 3, 4a and 4b by a specific amount or for a period not to exceed six months.

All parties wishing to submit information germane to the call of the hearing must submit eight copies of that information either here at the hearing or via email to dairy@cdfa.ca.gov or faxed to 916-900-5341 by the close of the hearing. 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 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 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. The panel is composed of members of the Department's Division of Marketing Services and Dairy Marketing Branch and includes Candace Gates, the Branch Chief of the Dairy Marketing Branch, Hyrum Eastman, Dairy Economic Advisor, and Kevin Masuhara, Director of Marketing Services Division. Again, I am not a member of the panel and will not be taking part in any of the discussions having to do with this hearing.

The hearing is being recorded by the firm of Accelerated Business Group 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 this 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 as it relates to the exhibits.

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

MR. FRANCESCONI: My full name is Michael Francesconi; the last name is spelled F-R-A-N-C-E-S-C-O-N-I.

Whereupon,

MICHAEL FRANCESCONI

Was duly sworn.

HEARING OFFICER ROWDEN: Please proceed.

MR. FRANCESCONI: Hello, Mr. Hearing Officer. As I just stated, 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 1 through 34. Relative to these exhibits, previous issues of Exhibits 4 through 34 are also hereby entered by reference.

The exhibits entered here today have been available for review at the office of the Dairy Marketing Branch since May 24th -- excuse me, December 20th, 2012.

An abridged copy of the exhibits is available for inspection at the back of the room. A copy of the exhibit list is also available at the back of the room.

Additionally I would like to enter some individual documents we have received, either by email or letter, and I'll bring those up as I enter those.

I would like to enter an email communication received from Dairy Goddess/Farmstead Cheese dated December 20th, 2012, sent by Barbara Martin as Exhibit 35.

I would also like to enter a letter received from Stiefel Dairy dated December 20th, 2012 and signed by Marcia Crouse as Exhibit 36.

I would also like to enter an email communication received from Jim Bylsma Dairy dated December 20th, 2012 and sent by Lori Bylsma as Exhibit 37.

I would also like to enter a letter received from Alfred Soares Dairy dated December 17th, 2012 and signed by Alfred and Reis Soares as Exhibit 38.

I would also like to enter a letter received Walter & Wilhem Law Group dated December 20th, 2012 and signed by Riley Walter as Exhibit 39.

I would also like to enter a letter received from Western Dairy Advisors dated December 20th, 2012 and signed by George Salsa as Exhibit 40.

I would also like to enter a document received from the California State Grange as Exhibit 41.

I ask at this time that the composite and the individual documents submitted as exhibits be received.

Mr. Hearing Officer, this concludes my testimony.

HEARING OFFICER ROWDEN: All right, thank you.

Are there any questions of the Department's witness?

(Off mic discussion between Mr. Eastman and Mr. Francesconi.)

HEARING OFFICER ROWDEN: Mr. Francesconi is going to clarify the record.

MR. FRANCESCONI: The date I said that the exhibit was available was not December 20, it should be December 14.

HEARING OFFICER ROWDEN: Okay, I am going to read into the record 1 through --

MS. GATES: You don't have to.

HEARING OFFICER ROWDEN: We're good?

MS. GATES: We're good.

HEARING OFFICER ROWDEN: Okay, we're good.

(Exhibits 1 through 41 were
received into evidence.)

HEARING OFFICER ROWDEN: Let's proceed with the rest of the hearing then.

I will now call on the representatives from Dairy Farmers of America. Please state your name and spell your last name.

MR. STUEVE: Gary Stueve, S-T-U-E-V-E.

HEARING OFFICER ROWDEN: Again, identify who you are representing.

MR. STUEVE: Dairy Farmers of America.

HEARING OFFICER ROWDEN: Will you both be testifying at the same time?

MR. STUEVE: Yes.

HEARING OFFICER ROWDEN: Okay. Please.

MR. TJAARDA: Perry Tjaarda, T-J-A-A-R-D-A, dairyman, representing Dairy Farmers of America.

HEARING OFFICER ROWDEN: Recorders, is it okay for them to --

THE REPORTER: The spelling of his first name, please

HEARING OFFICER ROWDEN: Please spell it..

MR. TJAARDA: Perry, P-E-R-R-Y.

HEARING OFFICER ROWDEN: Can you tap on your microphone in the front.

MR. TJAARDA: Is that better?

HEARING OFFICER ROWDEN: Yes.

Whereupon,

GARY STUEVE

PERRY TJAARDA

Were duly sworn.

HEARING OFFICER ROWDEN: Okay, please proceed.

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

I am Gary Stueve, I am the Vice President of Operations for the Western Area of Dairy Farmers if America, Incorporated. Along with me today is Perry Tjaarda, a DFA member and Board Director. On December 18, 2012, the DFA Western Area Council, whom I am representing, unanimously approved the position that I will be presenting today.

I want to thank the Department for calling this hearing in recognition of the needs of our members and the state's dairy farmers. We will offer a proposal with supporting testimony and evidence.

Dairy Farmers of America is a Capper Volstead milk marketing cooperative. We are a national cooperative of more than 15,000 member owners and represent approximately 315 farms that market milk in California. DFA's monthly marketings represent approximately 20 percent of the state's milk production.

We market milk to 30 buyers in the state and operate two plants. Our facility at Hughson, California is primarily a Class 4a facility and our plant at Turlock, California is primarily a Class 4b facility. Several of our members operate dairies in California and in states where the Federal Milk Marketing Order system administers prices. Several of our customers operate plants in California and in regions of the country within the Federal Order system. As a cooperative with members, customers and manufacturing plants operating within California and also throughout the country, DFA is well-qualified to submit testimony and evidence to the Secretary on the matters of this proceeding.

Our proposal is offered as within the framework provided by the California Food and Agriculture Code Division 21, Marketing, Part 3, Marketing Laws Regarding Particular Products, Chapter 2, Stabilization and Marketing of Market Milk. In particular our proposal recognizes and complies with the code sections listed on our Exhibit 1 attached.

Support for the Proposal.

The Hearing Panel report for the November 2009 emergency hearing gave consideration to several factors in its recommendations that we will support for this proceeding in order that it may proceed on an emergency basis. They include:

One. The price changes in that decision would not affect the underlying price formulas and be an ad-on value to the component and carrier values.

Two. The changes made would be temporary and expire on a fixed date.

Three. Rationale for the changes made from the 2009 decision included the relationship of the respective class price to either a contiguous market, in the case of Class 1, or a national market price in the case of all other prices.

Four. All class prices should bear some responsibility for temporarily augmenting producer revenues during the period of stressed margins.

our proposal follows this pattern. It does not alter the underlying price formulas and offers temporary adjustments to the existing component and carrier values. We have studied the comparative prices for each class and offer proposed changes that follow the rationale of the 2009 hearing and supports change in each class price.

Farm Margins.

Dairy farm margins have been under extreme stress for many months. Feed costs have been and are likely to stay well above historical norms. Evidence demonstrating the stressed margins faced by California family farms includes noticeable disruptions to the long-term trend of increasing milk production in California. Chart 1, NASS Monthly California Milk Production 2000-2012, through October, shows the change in trend between the periods 2000-2008 and 2009-2012 to date. The compound annual growth rate for California milk production for the first period is 3.1 percent per year and for the second period, 1 percent. November milk production was released on December 19 and the downward trend in California milk production was continued. NASS reported that November milk production was 2.3 percent below 2011 levels. A lack of farm profitability is the primary reason for the reduced milk production.

Date from Third Parties.

Table 1, extracted from the semi-annual publication *Dairy Farm Operating Trends - June 30, 2012* from Frazer LLP, shows stressed farm margins is an issue within several milkshed regions in California. Frazer LLP is a certified public accounting firm providing dairy farm accounting and consulting for 2.9 billion pounds of milk nationwide and accounting for 273,000 cows. Their work is well-known in the industry. They gave permission for their data to be used as a part of this record. The net income per hundredweight for California dairies for the first six months of 2012 shows considerable losses in all regions. Losses ranged from $0.92 per hundredweight in the Kern

County area to $1.75 per hundredweight in the San Joaquin area and $2.24 in the Southern California area. Note that all of the financial computations are made on an accrual basis and not a net cash operating basis, which would yield even more difficult results. Also note that while margins do cycle, all regions experienced significant losses in 2009. Based on our members' communications, few have repaired their equity positions to any extent since then, making them even more vulnerable to any future stress period. The relative financial position of dairy farm economics demonstrated by this data must give some guidance to the Secretary with regard to the size of any temporary price adjustments that she may allow.

Data from DFA Sources.

The ultimate end of margin stress is the closure of the business. We have seen an abnormal exodus in farm counts within our membership in 2011 and 2012. In calendar year 2011 our data indicated 20 farms went out of business; and through 11 months of 2012, 34 farms have failed or exited under stressful conditions. The exodus of farm owners is a real loss of productive capacity, management and industry and community infrastructure.

Data from California Department of Food and Agriculture Sources.

Table 2 was extracted from the third quarter CDFA

Statewide Cost Comparison Summaries. This data parallels the Frazer LLP numbers and would substantiate why DFA has had very few new farm starts over the past two years. Table 2 shows computations for total feed costs and income over feed costs taken directly from the statements. Adding the two figures should result in total income to the farm operation. Netting the Total Income against the Total Costs and Allowances figure from the summary yields the margin data shown in Table 2. The third quarter positions are all negative. For the North Coast the result is -$0.34 per hundredweight, for the North Valley -$2.23, for the South Valley -$4.03, and for Southern California -$2.89. The average for all of California was -$3.19. This is a $4.50 per hundredweight negative turn from 2011. It is very difficult to suggest how any business could make adjustments to operations to account for this magnitude of change. Surely the Secretary when viewing her own cost and return data can clearly see the situation and offer temporary adjustments that will meaningfully help the industry deal with the current margin situation.

Price Comparisons by Class.

A key comparison metric used by the hearing panel from the 2009 hearing to arrive at an acceptable price adjustment level is the relationship of California prices to other market prices for the same class of milk. We averaged the monthly differences between CDFA class prices and surrounding market prices for calendar year 2012 using the same comparison points made by CDFA. Since this hearing is limited to only price changes with a maximum duration of February through July, we think the most recent-year price comparisons are the most valid. For December the Federal Order final price for Class II, III and IV and CDFA Class 4a and 4b will not be announced until after the hearing, so for our calculations we made forecasts for those prices. Comparisons for the five class prices and its comparable market for 2012 are summarized in Table 3 and 4.

Class 1 Prices.

For 2012 the comparison of the Southern California to Phoenix Class I price showed an average that the Phoenix price was $0.48 per hundredweight higher for the period. The comparison of Southern California to Las Vegas showed that the Las Vegas price was $0.47 per hundredweight lower. The Northern California to Southern Oregon comparison showed that Southern Oregon was $0.30 higher than the Northern California price. For Class 1 we note that the differences calculated are virtually the same as was present in 2009.

Class 2 and 3 Prices.

For Class 2 and 3 we compared the differences between the CDFA prices and the Federal Order Class II price. The difference for CDFA Class 2 and Federal Order

Class II averaged $0.45 per hundredweight for the Federal Order for 2012. We made the same comparison for CDFA Class 3 and Federal Order Class II. That difference averaged to $0.57 per hundredweight, again the Federal Order price was higher.

Class 4a and 4b.

For Class 4a we calculated the 2012 Federal Order Class IV price averaged $0.39 per hundredweight higher than the CDFA 4a price. And for Class 4b we calculated the difference to be $1.93 per hundredweight higher in the Federal Order.

Rationale for Proposal Choices.

For the purposes of proposal we set the component price changes for Class 1 markets to be the same level as those announced in the 2010 decision. Our primary rationale for choosing this level was that we see virtually no difference in the contiguous markets price comparisons, so the logic as espoused by the Department then should still be reasonable now. The component price changes we propose would yield an approximate $0.35 per hundredweight increase to Class 1 price levels and $0.05 per hundredweight to the producer price pool.

For Class 2 and 3 prices the component change we propose would result in per hundredweight increases of approximately $0.48 per hundredweight for Class 2 and Class

3. These increases are in line with the price comparisons shown for calendar year 2012 for these classes. These prices would yield an approximate 2 and 1 cent respectively per hundredweight increase to the producer price pool.

For Class 4a prices, the 2012 comparison revealed a $0.39 per hundredweight price shortfall when compared to the Federal Order Class IV price. Our proposal calls for a Class 4a price increase of $0.25 per hundredweight. The reason we chose to scale back the value is recognition that exports are a component of the end products derived from 4a milk supplies and we do not have complete price data needed to make the comparison. The price change would yield an approximate $0.08 per hundredweight increase to the producer price pool.

For Class 4b the 2012 comparison revealed a $1.93 per hundredweight difference between the CDFA 4b price and the Federal Order Class III price. This sizable difference has been the focus of much discussion in the California dairy industry. Clearly any meaningful enhancement, temporary or otherwise to producer prices, will come from alterations in the Class 4b price. Also as indicated by the $1.93 spread in prices, there exists substantial competitive room for a price change. To derive our proposed price changes we calculated the 2012 prices using the whey bracket as offered in the December 3, 2012 hearing request from

California Dairies, Inc., Land O'Lakes and Dairy Farmers of America, Inc. Comparing the formulas in place in 2012 with the result that came from using the revised whey bracket, resulted in a difference of $1.54 per hundredweight. Our proposed component adjustments for fat and solids-not-fat values result in a per hundredweight price increase of approximately $1.54. This is accomplished by using the fat price arrived at by the change proposed for Class 4a, thus assuring as is now the case that the fat price is the same for both classes, and the change in solids-not-fat as we propose. The result of the changes to the Class 4b prices would contribute approximately $0.69 per hundredweight to the producer price pool.

The hearing notice indicated that proposals for price adjustments should be for no more than six months in duration. Our proposal is for the adjustments we suggest be made for the period February through July 2013 in order to allow producers to have some confidence in the supplemented prices and the ability to convey that to their lenders. Also it would give buyers the knowledge of the duration so that they can plan their business pricing strategies.

Proposal.

Following the format prescribed in the hearing notice our proposal is:

After the computations in Article III Section 300, Paragraph (A), (B), (C), (D) and (E) have been completed, amend section (H) as follows:

(H). The minimum prices for components used for Class 1, Class 2, Class 3, Class 4a and Class 4b as set forth respectively in Paragraphs (A), (B), (C), (D) and (E) of this section shall be increased only for the period February 1, 2013 to July 31, 2013 by the following amounts:

One. For Class 1 milk fat, three and five-tenths mils per pound.

Two. For Class 1 milk solids-not-fat, two and ninety-eight hundredths cents per pound.

Three. For Class 1 milk fluid carrier, nine-tenths mils per pound.

Four. For Class 2 and Class 3 milk fat and milk solids-not-fat, three and nine-tenths cents per pound.

Five. For the Class 4a milk fat and milk solids-not-fat, two and five hundredths cents per pound.

Six. For Class 4b milk fat, two and five hundredths cents per pound; and for Class 4b milk solids-not-fat, sixteen and eighty-nine hundredths cents per pound.

Impact.

Our proposal would have the following estimated impacts for the six month period:

Class 1 prices would be increased approximately $0.35 cents per hundredweight.

Class 2 prices would be increased approximately $0.48 cents per hundredweight.

Class 3 prices would be increased approximately $0.48 cents per hundredweight.

Class 4a prices would be increased approximately $0.25 cents per hundredweight.

Class 4b prices would be increased approximately $1.54 cents per hundredweight.

The producer price pool impact of these changes would be an approximate increase of $0.86 more per hundredweight.

Again I would like to thank you for the opportunity to testify today. I would request at this time that Mr. Tjaarda be given an opportunity to present his perspective and then we may try to answer any questions the panel may have.

MR. TJAARDA: Mr. Hearing Officer and members of the Hearing Panel, I would also like to thank the Department for calling this hearing and hope you will give proper consideration to our proposal. My name is Perry Tjaarda. I am a producing member of Dairy Farmers of America and have additional responsibilities, sitting on both the DFA Western Area Council and the DFA Board of Directors. I also sit on the Board of Directors for the California Milk Advisory Board.

I am a co-owner with my father, Ed, in Tjaarda Dairy. Dad started the business in 1964 in Southern California. In 1983 we moved the business to Kern County and have been operating at our current location since 1999. We currently are milking 3200 cows and farm 800 acres of ground. I view our dairy operation as a model that uses size and management to attain efficiency. However, today we have serious financial stress being placed on our operation due to the low value being placed on our milk from the current milk price discovery mechanism.

In 1998 when our family decided to build a new, modern dairy facility, we determined that Kern County was the right place to build. Although we considered other locations we felt that the availability of feed, water, land and weather made for a sound business model. We also believed that the California milk pricing system allowed for the growth of both dairy and processing facilities. Sadly that has changed. As was referenced in Mr. Stueve's earlier comments, dairies in Kern County that traditionally efficiencies as a means to survive are losing significant equity in their operations under the current price being set for our milk. The renewable fuel standards legislation, the shift in agricultural land to higher value crops, the business of regulation, among other things, have all contributed to the current state of our industry.

In the last four years our dairy has lost more money than it has made. That's like working for four years without a paycheck. More than that, we have had to reach deep into our pockets to help pay for that privilege. In the last six months two employees have left us, one of whom left for a better paying job in the oil fields. They have not been replaced. We have equipment that needs to upgraded or replaced next year, either because of regulation or simply being work out. Currently that is not in the budget.

There are some that believe additional processing capacity in our state will create more competition for milk, thus raising prices paid to producers. It is my opinion that this will only happen if it is market driven, value added and allows for a significant pass-through of dollars to dairymen. This can be part of the discussion for long-term solutions. By serving as a director for DFA on the national level it is clear to me that California dairies are not being properly compensated for the wonderful product that we all produce.

Dairy Farmers of America's proposal, if approved and implemented by the Department, will allow much needed, albeit temporary, price relief. Although the call of this hearing was for temporary measures, the industry requires long-term solutions. We look forward to, anticipate and expect that in the future the necessary permanent measures will be constructed to strengthen and preserve this industry. There is a well-known saying that folks will quote from time to time, "a rising tide lifts all boats." I feel like I am hand-cuffed to the boat used for target practice. I challenge all of you on the panel to do everything you can to restore my family's faith in California. Thank you.

HEARING OFFICER ROWDEN: Questions from the panel?

MR. EASTMAN: I have a few questions. When I was reviewing the information and data that you provided for alignment and then compared that to your proposed changes to the class prices I noticed that based on your analysis, and when you compare the alignment over the -- in our class prices compared to Federal Order class prices for 2012 and then compare the effect of your proposed changes, it appears that the effect or impact of your proposal will bring our alignment closer together, yet it still seems to provide a result where our California class prices will still be on average a little bit lower than the corresponding Federal Order prices. Was that done on purpose? Was there a reason why you left those a little bit lower than the corresponding Federal Order class prices?

MR. STUEVE: I think that primarily what -- what you're probably referring to may be the 4b price, that was probably the largest one. We really just wanted to maintain consistency with what we had proposed in our earlier petition along with CDI and Land O'Lakes. Our numbers really focused on the whey factor as opposed to other factors that may be also included in the 4b formula.

Class 2 and 3, we arrived at a number that was the same for Class 2 and 3 for fat and solids-not-fat that came the closest to the numbers that we had in our charts. So really the intent there was to try to, as closely as we could, follow the format from the 2009 hearing.

MR. EASTMAN: Okay. I have a follow-up question then. Generally speaking, when comparing California class prices to the corresponding Federal Order class prices, oftentimes that's a measurement of the competitive advantage or disadvantage that California would have compared to neighboring states. And so I noticed that based on your alignment figures California, in terms of class prices, has a competitive advantage because on average, based on your numbers, California class prices are lower, and as a result of your proposed changes those class prices remain a little bit lower. And so the question I have is, was that done on purpose to allow California manufacturers, for example, to still maintain some sort of competitive advantage?

MR. STUEVE: No, I think it was more a matter of trying to be reasonable in our assessment and to put forth numbers that we felt were reasonable and attainable at the level -- we didn't ask for more than we thought we would end up getting. We thought -- we asked for exactly what we think we need to get and should get.

MR. EASTMAN: Great. And then I have a question on Table 1 where you present information, cost information from Frazer Torbet. Was this information as it relates just to producer members of Dairy Farmers of America or is this maybe a report of all of their clients in California, of all of their clients in the western region? Exactly who is -- which dairies are a part of their sample here.

MR. STUEVE: This would represent more than just Dairy Farmers of America members. I don't know whether it includes all of their data. I would assume it does but I don't know that. But it does include more than just DFA members.

MR. EASTMAN: Got you. Do you have a sense of, in terms of the dairies that would be included in the survey, if there is a decent cross-section of dairies of all sizes? Do you know if these are primarily larger dairies or smaller dairies? I mean, in size.

MR. STUEVE: Without examining the exact data from them in terms of the individual members, the take I got on it from them would be that it does represent a cross-section.

MR. EASTMAN: I have a couple more but do you guys want to --

MS. GATES: Go ahead.

MR. EASTMAN: Okay. I noticed that on your chart that shows milk production it does show that California milk production in the two periods that you list are different in the sense that over the last -- let me see on your table. It looks like milk production has trended down. I think it's really clear, public data shows that since July of this year when you compare the current month to the previous month the last year, California milk production has been decreasing. And so from your perspective as a relatively large organization that covers approximately 20 percent of the milk, like you state, what do you see in terms of the supply conditions of our milk production in the state compared to demand? Do you think that those are in balance? Do you think milk is short or long? What is your sense of that?

MR. STUEVE: My sense, and you brought up July as a reference point. From July through the fall, I would say in general, and I can't certainly speak for everybody else but I would say in general the plants have not gotten as much milk as they would like, whether that's proprietary or cooperative-owned plants. That they have not gotten as much milk as they would like to run at optimum efficiencies.

MR. EASTMAN: Have you seen then a competition amongst these plants trying to get more milk or procure more milk?

MR. STUEVE: Well, if you look at how California is structured, we are very consolidated. We have a lot of large plants and a lot of those are cooperative owned as well. Contractually, most proprietary plants have contracts with cooperatives to supply them. So is there intense competition amongst proprietary plants? That really is just based on their relationship with their supplier. And if their supplier is supplying them milk and pulling milk out of other cooperative-owned plants then that competition may not be there between the different proprietary plants.

MR. EASTMAN: So you don't necessarily see since earlier this year to the present if there has been a big change in terms of that competition in or the way the manufacturers have tried to procure milk, in lieu of our decreasing milk production?

MR. STUEVE: I wouldn't say there's no change in the way they procure milk. Most large proprietary plants are nervous about milk supplies. Are seeking assurances that milk supplies will be there, when in the past they took for granted the milk would be there. So there is, I would say, a very real nervousness, particularly at the manufacturing class level, about the availability of supplies.

MR. EASTMAN: So does that mean that -- normally you would expect when milk gets short that, obviously as you mentioned, manufacturers might get nervous about having a supply of milk. Has there been any outreach or any sort of offerings of higher premiums to try and ensure that the milk supply will be there for any of your clients?

MR. STUEVE: Yes there have, there have been. And that's -- the ability to increase premiums is a long-term process. It's not something that can be done unilaterally overnight by one milk supplier. There are efforts that have taken place and that are still taking place to move premiums up. That's a very long-term process. Because everybody has contracts and those contracts are all different and they all vary in the requirements and the timing and the dates. So I think there is efforts underway but that's really a long-term process. And by long-term, maybe years before substantial improvements are made, although some may be made in the interim.

And I think, I think part of the challenge is, when it comes to premiums, is that we're looking at the possibility or it's being suggested sometimes that we make up the difference in the regulated price from California to elsewhere through premiums. And conceivably we would have to make up that difference with premiums and then still have premiums on top of that to be competitive outside of

California. So I think it really does boil down to a combination of improved regulated prices and premiums.

MR. EASTMAN: So does that mean then -- so is the reason why that period of time in order to negotiate premiums is so long is that sort of to match the, does that fall in line with the long-term contracts, supply contracts that you tend to enter in? Is that why it takes so long or is there some other reason why it takes so long?

MR. STUEVE: That's a big part of it, contracts that are in place, competitive conditions. Again, I don't think anybody can unilaterally take one customer up if the marketplace doesn't move up so there's timing involved. And a part of that is contractual obligations.

MR. EASTMAN: Got you. Okay.

MS. GATES: Okay, I have a couple of questions. On Table 1 when you are -- sorry, not Table 1, it's Table 2. Your Total Income, how did you derive at that? Was that overbase price, was that mailbox price, that kind of thing. It's like how, how did you derive at that hundredweight price?

MR. STUEVE: On Table 2?

MS. GATES: Yeah.

MR. STUEVE: Yeah. Those numbers are taken straight from the CDFA Cost Comparison Summary.

MS. GATES: Okay, that's where you got that from, okay.

In 2009 we saw co-ops step up and offer 25 cents to 50 cents a hundredweight like in retains back during the month as opposed to waiting until the 13th check/end of the year, to do that. Did your co-op, seeing as everyone is referencing 2012 to 2009, did DFA do any of that?

MR. STUEVE: Did we make special payments or -- is that what you were referring to?

MS. GATES: Right.

MR. STUEVE: I would say we didn't have a specific special payment similar to 2009 but we did on a monthly basis make every effort to get every penny back to members that we could.

MS. GATES: I guess I have to ask, what does that mean?

MR. STUEVE: Well, in terms of -- you know, the cooperative is money in and money out. We made sure and did everything we could to make sure that everything that we could possibly pay out to members we did and there wasn't anything held back. But in terms of a special payment, no, we did not.

MS. GATES: Okay. Just, I guess, to follow up on what Hyrum was asking on premiums that are paid in the marketplace. Just trying to understand a little bit more. You know, like Hyrum said, when milk is short plants have to have enough milk, you know, to run their plant. You mentioned that they got nervous and certain things were going on. Did you see direct offers from your customers that you're supplying milk to to attract that milk?

MR. STUEVE: We have worked jointly with our customers.

MS. GATES: Okay.

MR. STUEVE: We did not receive unsolicited offers for additional funds. But we did work jointly with more than one customer in trying to move premiums up.

MS. GATES: Well as a co-op do you see it is in your members' best interest to negotiate those? You're saying that they didn't come to you. But wouldn't you be the one that would be the one saying, hey, we're charging this at this point in time?

MR. STUEVE: Right.

MS. GATES: I mean, knowing full well that production is down, milk is short.

MR. STUEVE: No, you're right and we have been very aggressive in having discussions with customers on premiums. And to the extent that we are able to contractually move premiums upward we have made every effort to do that.

MS. GATES: Thank you.

HEARING OFFICER ROWDEN: All right, thank you very much. The testimony from Dairy Farmers of America will be Exhibit 42.

(Exhibit 42 was received into evidence.)

HEARING OFFICER ROWDEN: Okay, next I'd like to invite up the representatives from Western United Dairymen.

For the record, please state your name and spell your last name.

MR. MARSH: Good morning. Michael Marsh, M-A-R-S-H.

MS. AcMOODY: Annie AcMoody, A-C-M-O-O-D-Y.

HEARING OFFICER ROWDEN: And also for the record state again who you are representing.

MR. MARSH: Western United Dairymen.

HEARING OFFICER ROWDEN: Please proceed.

MR. MARSH: Mr. Hearing Officer and members of the Hearing Panel.

My name is Michael Marsh. I am the Chief Executive Officer of Western United Dairymen. Joining me today is Annie AcMoody, our Director of Economic Analysis. Our association is the largest dairy producer trade association in California, representing approximately 900 of 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 we will present here today at a special board conference call held on December 13, 2012.

We would like to thank Secretary Ross for the call of this hearing. Western United Dairymen petitioned for price relief on August 6, 2012 and continues to believe that price relief is necessary. Dairy families in the state have struggled in 2012, especially in the second half of the year. While we appreciate the Secretary's goal of finding a long-term solution, we need dairy families to make it through these difficult financial times.

To expand on this issue, Western United Dairymen respectfully submits a proposal to consider amendments to the Stabilization and Marketing Plans for the Northern and Southern California Marketing Areas. Specifically, we propose a temporary price increase in Class 1, 2, 3 and 4b formulas. For Class 1 milk fat, one and five hundredths cents per pound; for Class 1 milk solids-not-fat, eight and ninety-three hundredths cents per pound; for Class 1 fluid milk carrier, twenty-six hundredths cents per pound; for Class 2 and 3 milk fat and milk solids-not-fat, eight and two tenth cents per pound; for Class 4b milk solids-not-fat, eleven and five tenth cents per pound. The temporary increases sought are for a period of six months. The appropriate changes to the plans are presented in Appendix A attached to our testimony.

Given current condition 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 state have to deal with. Aside from this regulatory burden, costs of production on the dairy have increased significantly. The Secretary, with the appointment of the task force, understands the challenges ahead and the need for a long-term solution. In the meantime, dairy producers are facing tough economic times. If the producer is to make it through these difficult times, price relief is needed.

To understand why dairy families are in such a precarious situation a little historical perspective is helpful. As everyone well remembers, producer milk prices fell significantly through most of 2009, posting an overbase price of only $9.60 per hundredweight in July 2009, compared to $17.35 per hundredweight the prior July. For the second half of 2009 prices slowly increased to $14.47 per hundredweight by the end of the year. However, prices dropped again to the $12 to $13 per hundredweight range for the first part of 2010. With a statewide average cost of production of $15.02 per hundredweight for the first quarter of 2010, the financial situation for dairy producers was unbearable. After prices softened through the first half of the year they showed signs of improvement by the end of summer when the August 2010 overbase price reached $14.84 per hundredweight. The overbase price made it all the way to $15.94 per hundredweight in October. With the statewide average cost of production of $15.13 per hundredweight for the third quarter of 2010, some producers were likely experiencing positive margins once again.

However, while milk prices were improving, the cost of production was also increasing. Improving dairy prices is good news, but it will take a prolonged period of improved margins for dairy producers to recover the immense losses and eroded equity that arose from the economic disaster of 2008 to 2010. Revenues per cow in 2010 did not come close to the losses per cow incurred in 2008 to 2009. 2011 was an improvement but 2012 has proved to be financially challenging for a lot of dairymen. After all, the aforementioned losses, another downturn proved unbearable for many.

Just in our association membership, 50 dairy sell-outs occurred in the last eight months. In addition to these disturbing figures, the number of family dairies having filed for bankruptcy in recent months is overwhelming. The following quote from a *Fresno Bee* article dated August 19, 2012, highlights the increase in bankruptcy filings:

"Things are ugly and getting uglier," said Riley Walter, a Fresno bankruptcy attorney representing many financially distressed dairymen. In the past eight months, 28 San Joaquin Valley dairies have filed for bankruptcy in the U.S. Bankruptcy Court's Fresno office, up from 24 in 2011 and 10 in 2010. Most bankruptcy filings this year have been since April and many more are expected, Walter said. "This is devastating to so many families," Walter said. "And it is not over. Court records show that farmers, several who have multiple dairies, owe more than $100 million to lenders, feed companies and other dairy suppliers, putting some suppliers at financial risk as well." Riley Walter added in a conversation this week that he has seen 61 cases so far. Not all are bankruptcy filings as some cases end in liquidation. He currently has fourteen Chapter 11 filings pending, four Chapter 12s and six Chapter 7s. Those are not positive statistics.

Conversations with a few dairy producers seeking bankruptcy protection revealed that attorneys cannot keep up with the dairy demand. You know there's an issue when bankruptcy attorneys can't keep up with the number of requests they are getting from a specific industry. After all, they are lawyers.

The number of dairy farms in distress is not surprising if you take a look at financial data compiled by the accounting firm Frazer LLP. In Appendix B you can clearly see that for the first half of 2012 dairies in Southern California, Kern County and the San Joaquin Valley have lost a significant amount of money, with average net incomes of -$2.24 per hundredweight, -$0.92 per hundredweight and -$1.75 per hundredweight respectively.

A comparison of California overbase prices to the average cost of production in California since 2001 reveals the challenge faced by producers. Productions costs were on a steady upward trend until the beginning of 2009. At the same time prices were not only volatile but far below costs in many months. The difference between the cost of production and overbase price in 2009 is striking evidence of the catastrophe that occurred for California's dairy families. Please see Table 1.

A disturbing fact about this picture is the trend that clearly stands out. Clearly, margins have been deteriorating.

A minimal softening in feed costs have 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. Feed costs dropped to an average of 56.5 percent of the cost of production for the second quarter of 2010; lower but still historically high. The slow decline in feed costs was short lived. Since fall 2010 feed prices have skyrocketed and reached a record high in the third quarter of 2012 at $12.09 per hundredweight. This caused a record high cost of production of $19.94 per hundredweight. Figure 2 shows the dramatic increase in feed costs experienced at the dairy.

In 2011, estimates from USDA reported the corn ending stocks-to-use ratio at its lowest level since 1995/96. This outlook has led to dramatic increases in feed prices, further eroding already tight margins. The issue remained throughout the year as feed costs represented an ever-increasing share of total cost of production, 63.9 percent, 64.7 percent and 65.3 percent for the second, third and fourth quarter respectively. In the third quarter of 2012, that percentage reached 65.4 percent. The significant declines in overbase prices combined with fairly steady record high feed prices struck California dairy families this summer in a way no one could see coming. The drought that plagued most of the US. this summer, creating a never-before seen feed price escalation, is a rather unusual situation. Figure 2 illustrates the anomaly quite well. Extreme weather resulted in poor corn yields, which in turn sent corn prices skyrocketing.

The following figure illustrates the spike in corn prices that resulted. While corn is not the only part of the feed cost on a dairy, most feed followed a similar trend, so it serves as a good proxy to show the trend.

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, giving 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."

The cite is to Section 60262 of the Food and Ag Code.

At the hearing this summer we testified that while production was increasing at the time, base programs had been put in place in the state to take care of potential plant capacity issues. Keeping a lower milk price in our state, we argued, would only contribute to the financial plight of dairy producers. This is exactly what happened.

The combined impact of our proposed changes would result in an approximate 80 cent increase in the overbase price. While this is not enough to recoup the immense losses incurred earlier this year, it will help bridge the gap between the cost of production and milk revenues for the first half of 2013.

MS. AcMOODY: Based on Table 2 below, one can see that California has had a competitive edge for Class 1, 2 and 3 prices. We recognize that if California were to completely lose its competitive edge, sales of products made from these classes could decrease, which could cause California producer revenues from these classes to shrink. But being that our proposal is temporary in nature, it will not have a long-term adverse effect on dairy producers that could be caused by a potential loss of higher valued classes.

The following excerpts from the 2009 emergency hearing shows that the Panel agreed with the necessity of temporary price relief. The similarity between now and then is striking and in bold you can find our comments updating to the current situation.

"California milk production has declined dramatically in the last year and has corrected the milk supply imbalance that caused the previous processing capacity issues. Department data show that California milk production has declined every month from October 2008 to September 2009 **(and in the present case, as has been said before, since July 2012)** when compared with the same month in the previous year. [...] The current milk production decrease is a major departure from the long-term increasing production trend the California industry has experienced for various decades now. It appears this current trend of decreasing milk production will continue for at least a few more months. Further, Department data and anecdotal evidence does confirm that the state currently has processing capacity not being fully utilized and processors have recently had some difficulties in procuring sufficient milk supplies to match their business needs. During the October 2008 hearing, the Panel had expressed concerns about the loss of Class 1 sales to a Nevada fluid milk processing plant. The out-of-state processor had gained market share because of its access to surplus California milk supplies that could be procured below regulated Class 1 prices, which provided the opportunity for the firm to sell below the finished prices of most California fluid products."

And we add: The concern regarding this Nevada fluid milk processor has disappeared since it is no longer in business.

And the quote starts again:

"Considering the historical precedence of previous hearings called on an emergency basis and taking into account the changes in the California dairy industry and the reasons cited for not making permanent changes in the pricing formulas, a temporary price change is appropriate and warranted. The hearing record shows that producers, processors and representatives of other business sectors associated with the dairy industry all acknowledge that 2009 has been a financially difficult year for dairy producers. Department data and anecdotal evidence strongly corroborate this assertion **(and I will add that all will most likely recognize again today that 2012 has been a financially difficult year for dairy producers and our data and anecdotal evidence also strongly corroborate this fact)**. [...] The Panel agrees that providing price relief has merit but it should be temporary in nature.

The relief will aid some dairy producers to weather the financial storm until their situation improves, but it will not be large enough to recoup all of the financial losses from the past year."

In this case, six months seems to be an appropriate time period to implement a temporary price increase. This should assist producers in weathering the current financial crisis while providing an opportunity for the Secretary to work with the industry task force on longer term solutions. Anecdotal conversations with lenders and producers shed light on the fact that many dairies are barely hanging on right now. A temporary increase may be what allows them to convince their lender they can make it through.

Marketing conditions of high valued products from Class 1, 2 and 3 differ from the manufacturing classes of Class 4a and 4b. By knowing ahead of time what one's competitors are paying for milk, a Class 1, 2 or 3 processor is better positioned to weather a price increase. Class 1, 2 and 3 processors should also be able to pass along the price increase more readily to the marketplace. The presence of the "Real California Milk" seal on dairy products in Class 1, 2 and 3 would make it more difficult for processors and retailers to suddenly change their suppliers. Appendix C highlights the impacts of the seal and the number of products that are carrying it.

Class 4a and 4b tend to be market-clearing classes. Therefore, impacting these plants with higher minimum prices could pose some added risk. One major concern is that it is difficult to pass on increased raw product costs to buyers of manufactured products. These products are sold regionally, domestically and globally. The temporary increase proposed for Class 4b is to get to what the producer side of the industry has been advocating for almost two years now, a fair pool value from cheese making revenues.

The changes resulting from the May 31-June 1, 2012 hearing and implemented on August 1 were a minimal improvement for producers. The whey value was now allowed to reach 75 cents instead of the previous 65 cents. However, while Western United appreciated the modification, we believe it still fell short of a fair value for whey in the Class 4b formula. While we understand the Secretary believes the dry whey issue shouldn't be the only factor to look at when providing price relief, we continue to believe the whey factor should more closely reflect the whey value generated by the current Class III formula. The difference between California's whey value and federal orders since the new sliding scale's implementation has averaged a staggering

$1.69 per hundredweight. California dairy families clearly need a better means to capture whey value.

We stressed the imperative of resolving this issue sooner rather than later and impressed upon the Secretary that waiting would not work. Our board was not going to give up on lost producer revenue, and as you are aware, decided to support legislation to fix that issue. In the meantime, we propose a fixed price increase as mentioned above.

When looking at the last 12 months of data, Federal Class III has averaged $2 per hundredweight higher than 4b. The deviation between Class III and 4b was caused by several factors. Notably, formula differences such as price series, CME versus NASS, make allowances, yield and formula construct, all contribute to the divergence. But the whey value is what creates the most variance between the two class prices and this is a significant concern to our members. According to our analysis, since April 2011 (sic), over 80 percent of the difference between Class 4b and the Federal Class III was attributable to the whey value.

More specifically, assuming the current formulas had been in place since the beginning of the year, the average difference between Class III and 4b would have been $1.87 per hundredweight. Of that amount, $0.21 per hundredweight would be due to formula differences other than the whey factor. The remaining $1.66 per hundredweight is due to the difference in whey value. With whey values that follow market movements in Class III and a sliding scale value in Class 4b capped at $0.75 (sic) per hundredweight, such a discrepancy was not unlikely to occur.

We would much prefer a formula that allows the value of whey to fluctuate with prices, hence achieving a closer relationship between Class 4b and Federal Class III and removing the potential for unbearable discrepancies in the whey portion of Class 4b. But considering the scope of this hearing, we believe increasing the Class 4b price is as close as we can get to consistency with this idea.

The concept of pooling was created to allow sharing of revenues among producers. This is what has allowed producers shipping to different plants to get the same price for the same commodity, regardless of where they ship their milk to. An any given month, depending on where class prices settle, some plants need to pay more into the pool than the average overbase price, whereas some other months they pay less. To give an example, the first month of 2012, a producer shipping to a cheese plant got an overbase of $15.55. The cheese plant had to contribute $13.42 to the pool. Without the pool the plant would have been required to pay the producer at least the minimum price of $13.42. This year, the 4b price has been lower than the overbase price in five months, whereas in 2011 it was lower in all but one month. By not including a fair whey value in the Class 4b formula, Class 4b plants are not sharing into the pool like other classes are. Producers shipping to cheese plants benefit from higher blended prices from Class 1, 2, 3 and 4a when the Class 4b price is lower than the overbase, but the Class 4b plant does not share the full value of what it processes into the pool.

Finally, we include in Appendix D three letters received from concerned consumers. These people were disturbed by the plight of dairy families and were seeking ways to help dairy producers' financial difficulties. The Secretary has authority to implement a temporary price increase that would help dairy families. And below are the Code sections that pertain to that authority but I will not read them because it is not very exciting.

So now a break from what's written down and just to conclude. According to your analysis I would just like to point out that the overbase price for December looks like it will be $1 lower than where it was in November. And looking at the futures market, it looks like January and February will be another $0.50 to $0.75 lower. With the current price of feed, dairy families cannot afford that so we ask for price relief.

This concludes our testimony and I guess we will not be asking for a post-hearing brief.

HEARING OFFICER ROWDEN: Panel?

MR. EASTMAN: I guess I've been designated to ask questions first. I have a few questions with regards to your proposed changes. I noticed that you list what the estimated impact would be on pool prices but I see -- I don't see where you have showed where the individual class price is, what the effect of those would be. Did you actually calculate those? Do you know what those are?

MS. AcMOODY: Yes. The increase would be $1 on 1, 2 and 3 and $1.25 on 4b.

MR. EASTMAN: Okay. So that was $1 on 1, 2, 3 and then for 4b it was what?

MS. AcMOODY: $1.25.

MR. EASTMAN: $1.25.

MS. AcMOODY: I just thought you could mentally calculate that from the component prices.

(Laughter.)

MR. EASTMAN: Actually I can but I wanted you to just state it for the record. I appreciate that.

MS. AcMOODY: Okay.

MR. EASTMAN: Another question I have is, how did you arrive at that specific number? Was there some sort of formula or specific data set or methodology of analysis that got you to arrive to those specific numbers?

MS. AcMOODY: Well -- do you want to go?

MR. MARSH: Yes. It was based upon the board conference call we had. The board felt that those relative price increases could be something that could be borne by the processing side of the industry at this time, for a period of six months.

MR. EASTMAN: All right. So it's based on what they felt that the manufacturing side of the industry could bear.

MR. MARSH: Yes.

MR. EASTMAN: But it wasn't based on any specific data set or analysis or formula or anything like that?

MR. MARSH: No, it was not.

MR. EASTMAN: Okay. And then I noticed that you proposed increases on four of the five class prices but leave Class 4a the same. Was there a specific reason for that?

MR. MARSH: Yes. There was a concern, I believe, expressed by our board of directors that with regard to 4a, that it's very challenging for a plant to manufacture a product, hold it in inventory at a higher price than the market will bear. Hold that product in inventory until such a time as that price would recover enough for that plant to go ahead and move that in, into the market place. So as a consequence our board felt that it was, it was probably not appropriate at this time to increase the Class 4a price.

Whereas on the other hand with regard to Class 4b, there has been a significant variance between the price that has been paid or pooled under our marketing system for quite some time and what the actual value is for that milk in the marketplace.

And, of course, I think it got more into the issue also of pooling. When we look back -- as Annie indicated in her testimony, when we look back in 2011, in 11 of those 12 months in 2011 the overbase price was significantly higher than the Class 4b price. And as a consequence there was a contribution by Classes 1, 2, 3, 4a into the pool that was then distributed to producer -- to plants handling 4b milk, milk that was going to cheese processing.

At the same time when we look at 2012, in five of the months so far this year again we have had the same situation where there has been a significant contribution, actually the entire contribution from 1, 2, 3 and 4a have gone into the pool with very little of the total value of milk going into 4b processing ever making it into the pool.

MR. EASTMAN: What do you mean by "the value of 4b milk not making it into the pool?"

MR. MARSH: The value is in cheese.

MR. EASTMAN: It seems like cheese, any cheese plant that would be a pool plant would be paying into the pool.

MR. MARSH: The value of cheese. Again, and including the whey value. Because that has really been the component that's been lacking. So for quite some period of time we have seen a lot of money flowing into the pool and out to handlers of 4b milk that could be distributed to their producers. But at the same time, because of the difference in whey value that we've got in our formula, unfortunately those revenues aren't being pooled, they are just not being shared with the rest of the dairymen in the state.

MR. EASTMAN: Okay. And then at the beginning of that answer you mentioned that -- for Class 4b products you mentioned that those manufacturers, it would be difficult for them to pay a higher price.

MR. MARSH: Class 4a.

MR. EASTMAN: For 4a?

MR. MARSH: Yes.

MR. EASTMAN: So they'd make the product, then they'd have to store it and wait for a higher price, I believe is what you said. Wouldn't that also be applicable to 4b processors? Do they not make cheese or store it? Would it not apply to them in the same fashion based on your rationale?

MR. MARSH: Yeah, you're exactly correct.

However, at the same time, because there has not been the same value contributed into the pool, it does appear that there needs to be more value contributed to the pool from 4b.

MR. EASTMAN: Got you. With regards to your proposed changes in the class prices. Did you look -- I notice in your testimony you mentioned that obviously the alignment that California class prices would have with Federal Order class prices with competitors in other states, is an issue that you recognize. Was that any part of your analysis when proposing your class price increases? Did you look at alignment or does that just go back to the feeling of your board of what could be borne by manufacturers?

MR. MARSH: Yes we did.

MR. EASTMAN: And how did that work out? In terms of the comparison, how class prices are now compared to what class price alignment would look like, if your proposed changes were to be implemented?

MR. MARSH: Well, we recognize that for Class 1, 2 and 3 for that period, for the six month period, it would put us out of alignment with surrounding states. At the same time with regard to 4b, we would still be below regulated minimum prices for milk going into cheese plants in surrounding states.

MR. EASTMAN: So do you believe that it would be more important that there be more of a competitive advantage for cheese plants by keeping that price a little bit lower compared to Classes 1, 2 and 3?

MR. MARSH: Today there exists a significant competitive advantage because of the fact that whey is not -- the value of whey in our formula is not reflective of the actual value of the product nationally.

MR. EASTMAN: I'm sorry, let me rephrase the question, I might not be asking this correctly.

MR. MARSH: Okay.

MR. EASTMAN: In essence, based on what you state, the proposed changes would be about $1 per hundredweight on 1, 2 and 3, which would then put California at a competitive disadvantage based on what you stated, and then the $1.25 per hundredweight increase on 4b prices would still allow a competitive advantage for California.

So the question I have is it seems that if the Department were to implement your proposed changes, Class 1, 2 and 3 manufacturers would very -- they would be at a competitive disadvantage for the six months whereas 4b manufacturers would not. And so the question I have is, do you think it's more important for Class 4b manufacturers to not lose their competitive advantage compared to Class 1, 2 and 3, who apparently would?

MR. MARSH: To respond I'd say yes. However, with regard to the short-term duration of the changes we're requesting in 1, 2 and 3, I think that our manufacturers would -- our processors would be able to still retain their customer base.

MS. AcMOODY: We feel that six months is not long enough to basically cause them to lose their customers.

MR. EASTMAN: Do you think if you would have pursued a larger increase on 4b that there would have been a more disruptive impact? That maybe the cheese industry wouldn't be able to keep their customers?

MR. MARSH: Yes.

MR. EASTMAN: And then I just have a couple of questions regarding your figures just to make sure I understand them. One of them is a little visually --

MS. AcMOODY: Appealing is probably the word you're looking for.

(Laughter.)

MR. EASTMAN: Yeah. I was thinking visually busy. So I guess that's Figure 3 on page five. It looks like that's just temperature anomalies for the United States. What does that show or how does that contribute to what your argument is today?

MS. AcMOODY: It's just to show how 2012 was an anomaly in terms of weather on the country and how the drought has impacted feed prices. You can just see the line on top is 2012. Clearly it stands way out of what's happened in the last, I think it's 100 years on this chart so -- since 1895. So just to show how 2012 is an anomaly for feed in the country.

MR. EASTMAN: Great. And then on page five still. Figure 4 lists some corn yields and the next page there's some corn future prices. Where did that data come from, what was the source?

MS. AcMOODY: I should probably put that down. The corn yield is USDA data so that's NASS data and the corn futures is based on the CME, but those are extracted from the University of Wisconsin dairy data website.

MR. EASTMAN: And then -- I'm sorry, I'm going, I'm backtracking here. On page four for Figure 2, the California feed costs. The source of that data was?

MS. AcMOODY: It's the California Department of Food and Ag so it's the cost production unit data.

MR. EASTMAN: I think those are my questions, thank you.

MS. GATES: With Western United's makeup of its members, what percentage do you attribute to co-op members versus proprietary plant shippers?

MR. MARSH: Oh, heavens.

MS. GATES: If you had to guess. I mean, I know I'm kind of --

MR. MARSH: I would guess it's about two-thirds/ one-third. Two-thirds cooperative --

MS. GATES: Co-op.

MR. MARSH: Yeah. That's probably fairly close.

MS. GATES: Okay. With the amount of utilization going into 4a, just a little bit more on why you chose to stay away from that. You know, when you're looking at total impact that would be back to producers.

MR. MARSH: Right. Well, Ms. Gates, let's say, for instance, you're manufacturing a pound of butter.

MS. GATES: Um-hmm.

MR. MARSH: And you add an additional charge for a period of six months of another 20 cents a pound. You start out at $1.50. The market is only going to pay you $1.50 for that butter. So if you pass that cost on to the plant or the manufacturer, that additional 20 cents, they're simply going to have to hang on to that butter until the market would respond above the $1.70 that consequently they would have paid before they could either release that product into the market or else take the inventory loss. So it's very challenging. And the same would go with regard to the nonfat dry milk.

MS. GATES: And I guess applying that to Classes 1, 2, 3 and 4b, how would that be different?

MR. MARSH: Clearly it's different because our 4b price does not reflect the actual value of cheese.

MS. GATES: Okay, thanks.

MR. MARSH: You're welcome.

HEARING OFFICER ROWDEN: All right, thank you very much.

MR. MARSH: Thank you.

HEARING OFFICER ROWDEN: The testimony from Western United Dairymen will be Exhibit 43.

(Exhibit 43 was received into evidence.)

HEARING OFFICER ROWDEN: Okay, next I would like to invite up the representative from California Dairies, Inc. For the record, please state your name and spell your last name.

DR. ERBA: My name is Eric Erba, E-R-B-A.

HEARING OFFICER ROWDEN: And the organization you're representing, again for the record.

DR. ERBA: California Dairies, Inc.

Whereupon,

DR. ERIC ERBA

Was duly sworn.

HEARING OFFICER ROWDEN: Okay, please proceed.

DR. ERBA: 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 415 producer-members located throughout the state of California and collectively producing almost 17 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 380 million pounds of butter and 780 million pounds of powdered milk products in 2012.

On December 18, 2012 the Board of Directors for California Dairies approved the concepts contained in the testimony that I will be presenting here today. Our proposal is consistent with the guidelines given in the Food and Agricultural Code, Division 2, Part 3, Chapter 2, starting with Article 1 and including Article 9 that discusses establishment of minimum prices.

We thank the Department for calling this milk pricing hearing and allowing us the opportunity to present our alternative proposal to changes to the milk pricing formulas that will provide California dairy producers the relief that they need. As everyone associated with the California dairy industry is painfully aware, California dairy families have been and continue to be under a great deal of financial stress, some unable to achieve a margin substantial enough to remain in business. Some of the financial pressure being experienced in California can be attributed to the drought in the most significant feed-growing regions in the US, leading to escalated feed costs. The Department's own data shows that feed costs are up by 55 percent since 2010, and feed costs make up about 70 percent of the cost of producing milk.

As you might expect, the financial pressures are having an effect on milk production. We can verify that after extraordinarily high levels of milk production in the spring months, we have witnessed an unprecedented drop-off in milk production. California Dairies' daily milk production hit its peak in March 2012, but in September we fell to the lowest level of milk production since 2005, about 13 percent lower than our peak month this year. We have recovered minimally since then and are still 12 percent lower than our peak. For a full-service cooperative with customers throughout the world, these milk production statistics are unnerving. We are beginning to question how well we will be able to follow our various milk and dairy product marketing plans if milk production continues to fall well below our projections. In response to the question asked of our members about when milk production will return, the answer is invariably, "When the milk price comes back up."

We recognize that attempting to fully recover the losses sustained by producers as a result of high feed costs is problematic for both producers and processors in California. We have chosen not to pursue that agenda. Instead we are proposing what we believe is a reasonable approach that will provide dairy producers with a higher milk price temporarily and one that can be justified based on the market conditions facing the dairy industry. We are also confident that our proposal is reasonable for all classes of milk, falls within a desirable parameter space and is immediately actionable by the Secretary.

The hearing notice on December 6th set forth the guidelines for proposals that will be considered at this hearing. With our proposal we have given a good faith effort to present an alternative that can be acted on without modification and yet still accomplishes the goal of providing dairy producers with a temporary increase in their milk price. Again, as requested, the proposal was designed to follow the format found in Article III, Section 300, paragraph (H) of the Stabilization and Marketing Plans for Market Milk for the Northern California and Southern California Marketing Areas.

California Dairies proposes that the minimum prices for Classes 1, 2, 3, 4a and 4b be increased for the six month period February 1st, 2013 through July 31st, 2013 by the following amounts:

For Class 1 milk fat, three and five-tenths mils per pound.

For Class 1 milk solids-not-fat, two and ninety-eight hundredths cents per pound.

For Class 1 milk fluid carrier, nine-tenths mils per pound.

For Class 2 and Class 3 milk fat and milk solids-not-fat, two and five hundredths cents per pound.

For Class 4a milk fat and milk solids-not-fat, eight and two tenths mils per pound.

For Class 4b milk fat, eight and two tenths mils per pound.

And for Class 4b milk solids-not-fat, five and forty-two hundredths cents per pound.

As proposed, the projected effect would be expected to increase the Class 1 price by $0.35 per hundredweight, increase the Class 2 and Class 3 prices by $0.25 per hundredweight, increase the Class 4a price by $0.10 per hundredweight, and increase the Class 4b price by $0.50 per hundredweight. Cumulatively, the proposal is projected to increase pool prices by about $0.31 per hundredweight for the six month period.

Please note that the temporary increases on fat and solids-not-fat for each class of milk are nearly identical to those prescribed for the three month period of January 1st, 2010 through March 31st, 2010. These price increases were adopted purposefully by California Dairies' proposal, as these represent price increases that the dairy industry has already endured on a temporary basis. The only difference found when comparing our proposal with the price increases actually implemented in 2010 is the additional increase placed on Class 4b solids-not-fat.

The Class 4b solids-not-fat component bears a larger increase for three major reasons. First, as we have argued in the past, the sliding scale that determines the contribution of the value of whey to the Class 4b formula does not come close to matching the value placed on whey in federal milk marketing orders, especially at current market prices for dry whey. Second, two large cheese plants representing approximately 20 percent of the milk produced in the state and 40 percent of the milk processed as Class 4b products in California have been voluntarily paying on the order of $0.50 to $0.60 cents per hundredweight to producers since September. Irrespective of what the additional money being paid to producers actually represents, it does suggest that there is additional revenue in Class 4b that is not being captured by the regulated milk pricing formula. Third, when comparing federal announced minimum prices for milk with those in California over the last two years, all California class prices have been within the range of $0.25 to $0.50 per hundredweight lower than their federal counterparts except Class 4b, which is closer to $1.80 per hundredweight lower than the federal Class III price.

Being a large and prominent butter and milk powder processor, California Dairies has fundamental concerns about the consequences of instituting higher milk prices for Class 4a milk. Because nearly all butter and powder processing facilities are owned by producers and not proprietary companies, increasing the Class 4a price only functions to redistribute money from the producers who have made investments in butter and milk powder processing facilities to those producers who have not. This is entirely counter to the concept of increasing milk prices temporarily to provide equitable milk price assistance to all producers. However, having stated that, the California Dairies' Board of Directors recognizes that the dairy industry is in difficult financial straits and has decided to step up and contribute to the solution, even though implementation of the proposal will have a direct negative financial impact on each member of California Dairies. We do offer the caution that the higher the increase on the Class 4a milk price, the less equitable the temporary milk price assistance becomes when comparing the members of cooperatives who own processing plants and all other types of dairy producers in the state.

We are mindful of the Secretary's efforts to forge a foundation for a stronger and more viable dairy industry in the future, and California Dairies understands its obligation to be engaged in the process. However, our members need to survive in the short term first. Our proposal provides a reasonable and actionable method 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 industry.

Thank you for your attention and I look forward to any questions you may have.

HEARING OFFICER ROWDEN: Questions from the panel?

MR. EASTMAN: Thank you, Dr. Erba. I do have a few questions that are pretty much the same questions that I asked of the representatives from DFA. As the largest California cooperative you move such a large percentage of the milk. And so you mentioned how your milk production has definitely decreased. I think on the first page of your testimony you mention that the milk production for CDI is 12 or 13 percent lower than your peak month.

DR. ERBA: Correct.

MR. EASTMAN: So that's comparing to the peak month of 2012?

DR. ERBA: That is correct.

MR. EASTMAN: So the question I have is, oftentimes when reviewing milk production, obviously there is a seasonality to milk production. And so how does your reduced milk production compare to possibly the same month of say, last year or prior years, in order to correct for seasonality?

DR. ERBA: We're running about four to five percent behind what we were last year. Probably more like six to eight percent where we have been at our most productive, most productive year, which would have been 2007.

MR. EASTMAN: Okay, so you said four percent from probably last year and you said six percent?

DR. ERBA: Right.

MR. EASTMAN: And so obviously CDI processes a certain percent out of this milk and then has milk customers.

DR. ERBA: That's right.

MR. EASTMAN: Have your milk customers been asking for milk? Have they been nervous about getting enough milk, do you think? How do you view that or how do you view our milk production or milk supply compared to the demand that is out there, so to speak?

DR. ERBA: I think the witnesses from DFA actually covered this pretty well. A lot of the milk that we sell is on contract and so we are obligated to sell that milk to them and we provide it to them and that's our first obligation. If there is going to be a shortage the shortage occurs at our plants, not to our customers.

For the spot milk that we do sell, there is that concern about is there going to be enough milk and how much more do I have to pay for it? That's been ongoing since probably June of this year. Where we had extraordinarily high milk production we didn't have that issue. Since then we have been able to extract more money from the market for not just milk but for cream and condensed and our other dairy products as well. But there has been a concern among our customers who are not under a contract to what they are comfortable with, continuing to receive the milk they need.

MR. EASTMAN: With regards to your regular members -- your regular customers, I'm sorry, that have milk supply contracts with CDI. Do you find that the testimony of the representatives from DFA are accurate with regards to being able to negotiate premiums in the short term or the short run or does CDI do that in a different fashion?

DR. ERBA: That opportunity is out there and we have actually just recently sent letters to our major cheese customers explaining our situation. And also as I indicated in my testimony, indicated to our other buyers that we have had some customers step up and voluntarily pay premiums that they were not required to pay via contract and ask that they consider our situation, the impact on our members, and consider doing the same thing. We have contacted them formally to do that.

MR. EASTMAN: Thank you. And then obviously no one has a crystal ball and we can't predict what will happen in the future. But we have heard testimony already this morning about how obviously feed costs are higher, it's having an impact for our dairymen. Going into the future, there are some predictions that feed costs will remain at high levels and basic economic theory would suggest that that would affect milk production.

But there has been other anecdotal evidence of things such as a lot of placement heifers available. There has been anecdotal evidence that maybe some dairymen dried up some of their cows a number of months ago that are going to be coming fresh again, that are going to start milking again. There are some that believe that milk production might even increase or sort of rebound as we go into the beginning of next year into the spring flush. Do you have any sense of whether that's true or what you could predict?

DR. ERBA: As you pointed out, milk production is seasonal. We definitely see that in our cooperative, as you would see across the state. So we would expect to see milk production climb from now until March or April. We typically hit our peak in March or April every year. That's not going to be that unusual, to increase from now until then.

I guess, Mr. Eastman, to answer your question, the thing that we look at the most is what is the health of our individual members and how many members are resigning every month. We have lost about 20 members in the last six months, about 30 dairy farms, and we don't see that trend stopping anytime soon.

MR. EASTMAN: In the past oftentimes in the dairy industry we have noticed the consolidation on the farm level where traditionally if you go back decades, the number of dairy farms have been on the decline and the relative size of dairies, on average, have increased. And so I don't -- we haven't heard from any members of the processing side of the industry yet but there could be an argument that maybe we're just in the same sort of circumstance we have always been in, that dairies always go out of business.

And what could end up happening are that other dairies that will survive will just take on the cows and the net result is the same, where there is no change. Do you believe that is a part of what's happening or do you not believe that's going to be true, say, the next year going and throughout the next year, year and a half or so.

DR. ERBA: That probably is going to continue in the background no matter what the circumstances are. But we are far above a level that you could say it's only a matter of we're just consolidating and that's the way the industry is going. We've got some very -- or had -- some very large, good, profitable producers that just said, forget it, I'm done with this industry. It's too up and down for me, I can't predict where I'm going. They are not being forced out necessarily financially, they just had enough of this industry and have gotten out. And as I said, very large facilities. Not on the order of a couple of hundred cows, these are facilities that are a couple of thousand cows. Well-established families, a lot of farm ground. No real reason to exit the business other than they've had enough of it. So it's a different circumstance for us.

You're going to have the consolidation that you speak of. We will see that continue, I'm sure. The one thing we have noticed is that in the past when dairies go out of business the cows typically don't leave. Now what we're seeing is a number of those cows end up in the slaughterhouse. They didn't have any option other than go to the slaughterhouse. And that's not something we typically have seen. So those two factors by themselves would indicate to me we are not in the same place we have been in the past.

MR. EASTMAN: I felt like I had one more question, I felt like that wasn't enough. Actually, if you want to --

MS. GATES: Dr. Erba, in 2009 when we saw the worst financial condition that dairy farmers were in, like I'd asked DFA, most of the co-ops had stepped up and returned the retains during the month -- during the year every month as opposed to waiting to the end of the year. Did CDI step up and do that at that point in time, this summer?

DR. ERBA: We -- this summer?

MS. GATES: You know, throughout this year.

DR. ERBA: Yes. We have made small payments to our members each month this year. We have tried to make payments twice a year that are a little larger than that, an early advance of dividends. We were not able to do that after the first six months. We had to prolong it until later in the year because our financial position at the co-op wasn't sufficient to do that. But the board of directors did take action to make a payment in addition to the small monthly payment, an additional payment to our members in December.

MS. GATES: Comparing this year to 2009, are you looking at that as kind of comparable as to the financial duress or one higher or lower than the other?

DR. ERBA: I would put them on the same plane. I think the difference, the distinction I would make is in 2009 I think the lending institutions were a lot more willing to let producers stay around and continue to produce, hoping that they would produce out of the situation that they are in. After they got through that period in 2009 it was pretty clear that most lenders were not willing to do that again and they have taken action against, financial action against our members. And I wouldn't say "forced them out" but don't leave them a lot of alternatives but to get out. So we are not having the support from the lender side that we had in 2009. And to put it in very anecdotal terms, they don't seem to have the patience that they did in 2009.

MS. GATES: In 2009 we saw lower milk prices than we see in 2012 here, which the market seems to have rebounded quite a bit with $18, $19 milk. So I am trying to understand the difference between those two time periods.

DR. ERBA: Well they pay attention to margins just as our members do and the milk price today by historical standards is pretty good, it's actually quite good. The margin is not there, just like the margin wasn't there in 2009, and that is, you know. Even though people talk about milk price the real key now is milk margin. If it's not there, like it isn't right now, there will be action taken.

MS. GATES: Thank you.

HEARING OFFICER ROWDEN: All right, thank you very much. The California Dairies, Inc. testimony will be Exhibit 44.

(Exhibit 44 was received into evidence.)

HEARING OFFICER ROWDEN: I invite up the representatives from Dairy Institute of California.

Okay, for the record, please state your name and spell your last name.

DR. SCHIEK: My name is William Schiek, that's S-C-H-I-E-K.

HEARING OFFICER ROWDEN: And please let us know who you represent.

DR. SCHIEK: The Dairy Institute of California.

Whereupon,

DR. WILLIAM SCHIEK

Was duly sworn.

HEARING OFFICER ROWDEN: Please proceed.

DR. SCHIEK: Okay. 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 on the Institute's behalf. Dairy Institute is a trade association representing 30 dairy companies which process approximately 75 percent of the fluid milk, cultured and frozen dairy products, over 85 percent of the cheese products and a small percentage of the butter in the state. Member firms operate in both marketing areas in the state. And the position presented at this hearing was approved and adopted by Dairy Institute's Board of Directors.

Dairy Institute appreciates the opportunity to testify at this emergency pricing hearing to propose a temporary and modest adjustment to certain prices under the California Food and Agricultural Code, Division 21, Part 3, Chapter 2, Articles 1 through 9.

Skipping down to Current Milk Situation.

There is no question that producers are now facing challenging times in the face of extreme volatility of both milk revenues and input costs. During much of 2012, prices have been below average milk production costs. This situation has led to financial losses and erosion of equity for many producers. While these struggles are undeniable, it is important to recognize that there is tremendous diversity with respect to the financial position of individual dairymen, as evidenced by the cost of production feedback data recently released by the Department. The third quarter of 2012 milk production costs for the Department's sample of conventional dairies ranged from $14.76 per hundredweight to $29.47 per hundredweight. When feeds grown by the dairymen are evaluated at their grow cost as opposed to their market price, it is likely that these spreads become even wider.

It is important to note that 2012 follows what was for many dairymen a very profitable year in 2011. Cycles in profitability have been a feature of the dairy industry for many years. What is different today is that our exposure to the world marketplace has increased the amplitude of those cycles. Another important context is that the financial pressures facing dairymen are not unique to California. They are playing out in other parts of the US, Europe, South America, Australia and in any region where grain concentrates are fed. Only grazing production systems seem exempt from the current dairy financial crunch.

The primary culprit behind these difficulties has been the high feed costs that have resulted from increased demand new uses for feed crops, both domestically and globally. While these forces elevated feed prices in the spring, summer saw the worst drought in 25 years take hold in the central part of the United States; driving feed prices, which had started to decline, to new heights. Once the extent and severity of the drought became clear, corn prices shot upward to $8 a bushel. And while they have declined some in recent months, nearby futures prices are still close to $7 a bushel. These impacts stem from what has been an event of global reach. Unfortunately, our regulated pricing system is not capable of mitigating such events, nor was it designed to do so.

Milk Production.

Since July, California milk production has been below year-earlier levels. This decline follows a period of very strong production growth where plant capacity was inadequate to handle the milk produced in the state. To some degree, a reduction in milk supply was needed to restore orderly conditions to the market, but the painful way it came about was not desirable. Negative on-farm finances were obviously a factor in the production adjustment but not the only one. The problem was made worse by the rapid expansion of milk output that occurred early in the year, which led to the re-implementation of base plans, and in some cases, marketing penalties for producers who exceeded their base. In August, California experienced a severe two week heat wave that reduced production substantially. The largest negative impact on milk output was seen in August, but milk production stabilized in September and October. The USDA data just released for November showed solid improvement in California milk output, not surprisingly, coinciding with higher milk prices. In terms of cow numbers -- Oh, and that pricing, that production chart is shown as Exhibit 1-A in the list of exhibits. In terms of cow numbers, California has fared better than the nation as a whole, showing a fairly stable milking herd, whereas the rest of the US saw its milking herd contract for several months before increasing a bit in November. And that's shown in Exhibits 1-B and 1-C.

Looking ahead, it seems likely that California milk production will remain below year-earlier levels through the first part of 2013, in part because milk output was so strong in early 2012; however, the situation could change quickly if large numbers of replacements enter the herd. The information currently available does not point to production falling off a cliff, at least not based on the trends we have seen so far. The production data, bankruptcy and herd sales reports and dairy cow slaughter information all seem to suggest that the industry is undergoing another round of consolidation, moving milk production unto fewer but larger farms.

Milk price.

While milk prices, as measured by the statewide blend, fell during the first part of 2012, reaching a low point in May, they have rebounded sharply since then, as shown in Exhibit 1-D. By October, prices had risen almost 40 percent from their springtime lows. Slowing milk production growth has been noted in many countries during the second half of 2012 and slower overall global growth is expected in 2013. These contractions in the global milk supply growth are expected to move dairy commodity prices higher again by the second quarter of 2013. And this is discussed in an article from a press release by Rabobank, it's contained as Exhibit 2. Given these changes, we are anticipating more profitable pricing in the coming months.

At past hearings there have been proposals that would substantially increase the regulated prices paid by milk and dairy product plants. We urge the Secretary to show restraint in responding to such proposals. Processors and manufacturers simply do not have the margins to support large, unilateral revenue transfers to producers, nor are they able to get such revenues from the market in today's competitive environment. While producers' costs have been higher than their revenues in recent months, it is important to note that milk prices are not, and should not be, determined by milk production costs alone but by supply and demand in the marketplace. Actions by individual states to deal with low prices that result from the natural working of supply and demand risk being ineffective at best, or more likely, harmful to the industry. State-mandated regulated price increases do not create new money but transfer it from processors to producers. There is no way for a state to increase its regulated prices without making the state's processing industry less competitive. In so doing, the state risks losing dairy product sales and processing or manufacturing investment. If California increases its regulated prices and other states do not, and we know of no plans by the Federal Orders to do so, California processors will lose sales and overall demand for California milk will fall. There is no way to raise California's regulated minimum prices without doing some damage to the processing side of the industry and consequently hurting producers in the long run.

We continue to stress that regulated prices should be minimum prices that serve to stabilize and underlay the market. Minimum prices should be set at levels that still allow the market to set the actual prices at which milk and dairy products trade, so that supplies are correctly allocated to their highest and best use. Regulated prices that are set too high interfere with market signals. Currently, production is down in California from where it was last year. However, reduced production is not necessarily an indication that regulated prices should be raised. Reportedly, market-based, over-order premiums have been increasing to ensure that milk moves to where it is needed, and this development is precisely what should happen in a properly structured market.

Any action taken by the state as a result of this hearing, or indeed any pricing hearing, will not reverse the structural changes facing the industry today. The California dairy industry's success has been built in large part on scale economies at the producer level, utilizing inexpensive, purchased feed. Clearly, feed is not cheap today. It is difficult to see feed costs returning to their historic price levels, given the changes that have taken place in feed demand and the income growth that has occurred in emerging markets. These changes mean that it will be difficult to remain profitable with a production model that relies exclusively on purchased feed. No sustainable changes to regulated prices exist that can alter the ramifications of structurally higher feed prices that are likely with us for the long run.

Globalization impacts are driving a new economic reality that will stress the industry. A key point here is that the shocks that are global in their market impact are largely responsible for increased price volatility and additional cost pressures. California dairymen used to compete with dairymen in the Midwest and Northeast and win easily due to their production cost advantage. Today, California dairymen are competing with milk producers in New Zealand, Europe, Australia, South America, as well as other regions of the United States. There is more pressure than ever to increase productivity and efficiency. But while globalization of dairy markets creates challenges it also creates opportunity. The US is selling a significant amount of product abroad and volumes are expected to continue growing in the future. Worldwide dairy demand is expected to grow faster than supply at current prices, and therefore, higher prices will be necessary to ration demand and bring more product to the market.

Taking advantage of the rising global demand means we must have an industry and a policy environment that encourages the investment needed to access, serve and thrive in the global marketplace. We continue to believe that fostering a policy that supports our international marketing efforts is crucial. Conversely, simply raising the regulated price as an ongoing strategy to improve incomes for dairymen is like putting the proverbial cart before the horse. It is a policy that will fail. A better solution is to put the horse before the cart, or in other words, to attract and encourage the kind of investment that yields higher returns so that increased demand for California dairy products will lead to higher demand and greater competition for milk, and ultimately, higher prices. Investment must come before higher returns or prices, not the other way around. Dairy Institute supports the CDFA Dairy Task Force and its efforts towards reforms that will deliver more for the industry over the long run. We urge the Secretary to consider the impact of proposed pricing changes on the ability of California processors to compete and sell product, both nationally and globally.

Government mandated increases to regulated prices cannot give lasting relief to producers and run the risk of hurting the industry's market opportunities. We maintain that the real solution to producers' financial nightmare is a rebound in the market price. I think you just heard that as well. As we have already noted, the market responds to tighter financial conditions and shorter milk supplies through increases in dairy commodity prices, which results in higher prices for milk. We have seen the market-based relief in action during the second half of the year. The market also responds to tightening local milk supplies by delivering premium dollars, which increase as market conditions warrant. Tightening milk supplies in California this summer led a couple of major milk buyers in the state to increase premiums paid to their milk suppliers. Finally, for the market to deliver the maximum possible to producers there must be adequate investment as we noted earlier. The regulated pricing structure that is most encouraging of investment will do a better job of delivering higher and sustainable returns to dairymen.

We continue to believe that in general the market signals that come via changes in commodity price levels should be allowed to bring about the milk supply changes that are needed. The lower prices lately for butter and cheese are a reflection of changes in the balance of supply and demand and those signals need to be transmitted through the marketplace. However, the anticipated brief period of lower prices that we expect early in 2013 could be bridged by a modest and temporary increase to the state's regulated prices without too much market distortion and would be acceptable in light of the financial difficulties California dairymen have faced this year.

In light of the foregoing, Dairy Institute proposes that prices for Classes 4a and 4b milk be increased by $0.10 per hundredweight for the three month period beginning February 2013 and continuing through April 2013. Because the current plans calculate Class 2 and 3 prices by referencing prior months' Class 4a prices, any increase in the Class 4a price levels will be passed through to Classes 2 and 3, albeit with some delay. We have intentionally excluded Class 1 from the proposed increase. Class 1 processors already pay the highest price into the pool by virtue of the higher of feature of the Class 1 pricing formula. In addition, Class 1 sales are struggling. They are down two percent for the year to date and have posted monthly year-to-year decreases for much of the past several years. Also, current Class 1 prices are already high and we do not want to exacerbate sales losses by increasing prices even more.

Stabilization Plan amendments.

All of Article III, Section 300, Paragraph (H) in the current Northern and Southern California Stabilization Plan shall be deleted and replaced with the following text in both plans:

"(H) The minimum prices for components used for Class 4a and Class 4b, as set forth respectively in Paragraphs (D) and (E) of this Section, shall be increased only for the period of February 1, 2013 to April 30, 2013 by the following amounts:

"(1) For Class 4a and 4b milk fat and milk solids-not-fat, eight and two-tenths mils per pound."

Our proposed increase will impact roughly 87 percent of the milk in the pool, the combined usage of Classes 2, 3, 4a and 4b. The increase in pool prices will provide more than 9.2 million additional dollars to the pool by our estimates, which are contained in Exhibit 3. The amendments we have offered here no doubt will fall well short of what many hope or expect, However, we continue to believe that the market is a better mechanism for income relief and have the expectation that the global supply contraction will deliver higher commodity prices by the second quarter of 2013. If supplies in California become further challenged because of continuing financial hardship on the dairies, we have no doubt that additional premium monies will be paid if revenue is available in the marketplace. In such a turn, plants will pay what they can so that milk production in California remains viable. We have advanced a modest proposal because of competitive concerns and we note that USDA currently has no plans to provide emergency price relief through amendments to Federal Order price formulas. Put another way, our competitors are not seeing higher costs due to increased regulated prices, so we believe any regulated price increases for California should take competitive concerns into account.

Efforts by California to unilaterally raise the state's regulated milk prices by amounts that are anything close to what has been proposed at recent hearings will disadvantage California processors and manufacturers relative to their counterparts in other states, likely resulting in fewer sales of California dairy products and diminished market opportunities for producers. Dairy Institute's proposal is an option that is both modest enough in its price impact and short enough in duration to limit the negative damage that will result from a unilateral state action to increase prices. If the Secretary feels she has no choice but to increase regulated prices then the Dairy Institute proposal is one that should be considered. However, we reiterate that true price and income relief for producers must come from the market. That relief is on its way as evidenced by rebounding milk prices and additional premium monies paid to dairymen and milk suppliers. We urge the Secretary not to take any action that would significantly impede California processors' ability to compete in the marketplace or disrupt needed signals regarding the balance of supply and demand in the market. Thank you for the opportunity to testify and I am willing to answer any questions you may have.

HEARING OFFICER ROWDEN: Panel?

MR. EASTMAN: Dr. Schiek, with regards to your proposed increases in the Class 4a and 4b prices. It appears they mimic the same increases that were implemented back as a result of the November 2009 hearing.

DR. SCHIEK: Um-hmm.

MR. EASTMAN: Is that the only way at which you derived the level of those proposed price increases or did you look at any other data, formula or some other source of income that led you to that number?

DR. SCHIEK: We did review the existing price relationships between the California and Federal Order prices. But we also looked at the marketing environment that California processors have and the cost environment that they operate in and believed that this type of increase is one that there's room for. But, you know, just looking at price parity and saying there's room to increase to a comparable price we don't believe is accurate because of the difference in the cost environment and the structure of the industry in California.

MR. EASTMAN: What types of costs are you referring to?

DR. SCHIEK: Operating costs, labor costs, environmental costs, various regulatory costs, workman's comp.

MR. EASTMAN: So you build -- you view those costs as higher in California compared to other states, is that what you're referring to?

DR. SCHIEK: Yeah. And I think, you know, at the last couple of hearings I submitted as an exhibit a ranking of states by business costs and California routinely ranks as one of the highest. I think there was another -- I think CNBC or another organization ranked states by their sort of business friendliness and California ranked near the bottom. So yeah, those are pretty well established.

MR. EASTMAN: With regards to the supply, the California milk supply in relation to the demand. We've had producer cooperative and producer trade association representatives explain that it appears that there appears to be an imbalance, so to speak.

DR. SCHIEK: Um-hmm.

MR. EASTMAN: Is that how your members view the current situation as well?

DR. SCHIEK: You know, I heard most from my members regarding a supply back in August when the heat wave hit and we were down five percent relative statewide, on a statewide basis. And I know that in some cases there are some plants that would take more milk if they could get it but I haven't heard anyone saying that they are crucially short. Of my membership. Now you're hearing from some of the cooperatives, they can speak to their own processing operations. And you'll hear from some of my members today, You can ask that question directly to them and probably get a better, more complete answer.

MR. EASTMAN: Okay. With regards to your proposed increases. I know that based on competitive advantage and marketing conditions, et cetera that you mention, you purposely stayed away from any proposed increases on Class 1, 2 and 3. So the question I have, you do mention that you feel that some sort of relief is warranted to producers, hence why you propose some changes on 4a and 4b. The question I have is, all manufacturers need the milk, all manufacturers have to have milk in order to meet their business needs, which would include 1, 2 and 3. So why would you expect that, say, Class 1, 2, 3 manufacturers, albeit just for a temporary period of time, shouldn't also provide some sort of price relief through a temporary price increase on the milk they purchase?

DR. SCHIEK: Good question. I think -- maybe I didn't make this clear in my testimony. But I think what we are anticipating is that a 4a increase becomes a 2 and 3 increase, just because of the way the formulas work. If you add a 2 and 3 increase on top of that, then you'll get an additional bump from whatever 4a increase is proposed. So we are anticipating 2 and 3 to pay more just might not happen coincidentally at the same time as 4a and 4b.

The Class 1 situation, yeah, we've had -- it's been a while since we've had a Class 1 hearing. But one of the things that we've argued for a long time is that for a state with such a low Class 1 usage, our Class 1 differential or Class 1 premium in the regulated structure relative to the manufacturing price levels, is considerably higher than other Federal Order regions in places that have a similar kind of low Class 1 utilization.

So I think there is some sense -- and if you talk to Class 1 members of mine I think they would say that they feel like they have been contributing to the pool probably in excess of what, you know, would be happening in other regions in terms of a premium amount. So there's that aspect. But, I mean, you guys have the sales data that's in the div (phonetic) and you can see Class 1 has just been beaten up for the last two or three years. We're losing sales. Consumers are price sensitive. I think the idea that we have this great inelastic product and you can charge whatever you want and the market will just take it is not being borne out today, in part because there is a lot more substitutes out there.

And then you have the anti-milk crusaders that are out there trying to get milk, chocolate milk out of schools. Well, if you take chocolate milk out of schools kids don't drink as much white milk so you have a loss of sales there. You know, it's just there are a lot of challenges for that segment and we just feel like another price increase on top of all the challenges that they are facing, given that they already contribute the highest price in the pool, doesn't really make good policy sense.

MR. EASTMAN: Okay. With regards to market adjustments that you mentioned. Obviously you can refer -- you did refer to how minimum class prices have increased since the summer because commodity prices have risen.

DR. SCHIEK: Right.

MR. EASTMAN: So there has been a market movement there. Has there been any market adjustments with regards to over-order premiums paid by your members as well?

DR. SCHIEK: Yeah. I know of a couple of cases where some of the larger, some of the larger cheese maker members have stepped up and increased their premium levels. There was allusion to that from the DFA witness, you know. I think that's a good question. Keep asking, again, other processor members who will be up here testifying today. But we have seen, we have seen premium levels increasing, you know, starting with when the heat wave knocked milk production back in August.

MR. EASTMAN: And were those premium increases across all the classes or primarily just focused on 4b manufacturers?

DR. SCHIEK: The one I'm -- the ones I'm aware of are 4b. There may be others but those are the ones I'm aware of.

MS. GATES: Dr. Schiek, I'm assuming that your members have picked three months for a reason and not looked at anything farther. Do you think that your membership could take it a little bit father out besides three months?

DR. SCHIEK: Could they take it out? I suspect that if it's modest enough, yes, they could. I think the reason we picked three was, one, for the competitive concerns, and two, because that's kind of the range of the gap. We see a first quarter gap in pricing where we're kind of coming down off the fall seasonal, the holiday seasonal demand. But we see global milk supply contraction occurring and we expect prices to begin increasing later in the spring so we're kind of trying to bridge that gap.

MS. GATES: Okay. And I think you explained the Class 1 question that I had pretty thoroughly with what Hyrum had asked you. I think that's it, thank you.

HEARING OFFICER ROWDEN: All right, thank you very much. The testimony from the Dairy Institute will be 45a and the exhibits will be 45b.

(Exhibits 45a and 45b were received into evidence.)

HEARING OFFICER ROWDEN: Okay, next up I'd like to invite the BESTWHEY, LLC representative.

For the record please state your name and spell your last name.

MR. MURPHY: Barry Murphy, M-U-R-P-H-Y.

HEARING OFFICER ROWDEN: Again, for the record, state who you are representing.

MR. MURPHY: BESTWHEY, LLC

Whereupon,

BARRY MURPHY

Was duly sworn.

HEARING OFFICER ROWDEN: Please proceed.

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

My name is Barry Murphy. I have spent the last 25 years in the cheese and whey processing business, in corporate management positions and for the past 12 years as a consultant to investors with a desire to develop cheese and whey products businesses in California and throughout the United States.

While this hearing is focused on temporary price relief amendments to all milk classes, my expertise and testimony is limited to the California Class 4b milk pricing mechanism and how this impacts the medium and small cheese producer. Over the long term, protectionism has not worked when global and free markets dictate the value chain. We must move toward free market pricing if we are to capitalize on the current and long-term global opportunities open to California's dairy industry. California's minimum milk price system works if milk premiums are used effectively to balance supply and demand dynamics in normal markets. However, the minimum price system does not work in over-supply situations such as those during the serious milk over-supply periods seen in recent times. California's large cooperatives, DFA, CDI and Land O'Lakes, are not using the milk premium above minimum pricing opportunity effectively, and thereby, in my opinion, are directly responsible for lower incomes to dairies. Their focus is on clearing milk rather than creating markets for milk use. For example, these large cooperatives could easily be in the whey products business through milk protein fractionation into casein, milk protein concentrates and isolates, and thereby using the permeate or whey fractions to manufacture whey products.

My position regarding a temporary amendment to Class 4b milk pricing is that there should be no change. No change is justifiable since Class 4b milk has already seen a significant increase in the whey factor this year with the small and medium sized cheese plants already paying $0.75 a hundredweight for milk or $0.075 per pound of cheese. The whey factor assumes that all small and medium sized cheese plants are manufacturing whey products; and for most small cheese plants in California, this is absolutely not the case. For example, while a small cheese plant with a five truckload use of milk per day, this plant is currently paying $47,000 a month in whey factor, plus $19,000 to dispose of that whey. These plants are too small to extract even whey cream or to invest in a whey processing plant. As a small cheese plant grows to, say, over 25 truckloads of milk a day, the economies of scale will work to invest in a whey protein plant. But at a minimum investment cost of $25 million and using the current whey factor and whey markets, this still accounts for the dairies receiving well over 50 percent of the net profitability from these investments, without any investment on the part of the dairies. Even with a whey protein plant, more than 50 percent of the total solids-not-fat in raw milk is disposed of to animal feed at a financial loss.

Most of California's cheese plants are small and medium sized operations and these operations are under severe financial pressure with the 4b whey factor. California's specialty cheese industry has seen little growth relative to Wisconsin, where Wisconsin now produces about 50 percent of the nation's one billion pounds per year of specialty cheese, and California has about 10 percent of this market. Federal Milk Marketing Order pricing mechanisms are broken. And for those cheese plants playing those levels -- what I mean by this is in Wisconsin or Minnesota, they are marginally profitable on cheese with zero profits on the whey protein side. And what this leaves for them is the only opportunity for them to move forward is to invest -- is to invest significant dollars with very high risk to build permeate and lactose plants, from which to draw income.

California's cheese industry is at a crossroads. The last major investment in California's cheese industry was over ten years ago by Land O'Lakes in Tulare. This resulted in several years of financial losses and the eventual sale of the entire plant because it was not profitable. Shortly after the 2007 milk price hearings, F&A Cheese sold out after a few years of financial losses as a direct result of the 4b whey factor, which at the time was similar to the Federal Milk Marketing Order. Lactalis USA is closing its specialty cheese plant in Tipton next year to move its operations to unregulated Idaho. Gossner Cheese specialty cheese plant in the Imperial Valley is in jeopardy of closure but is not closing its unregulated Utah plant and Cantare Cheese in San Diego went bankrupt a little over a year ago. In the meantime the cooperatives are expanding their milk powder operations at the expense of income to dairies.

Regulatory stability is imperative if the investment community is to commit to expanding California's cheese and whey products industry. Without a stable milk pricing policy environment investors cannot move forward with cheese and whey expansion, despite the major global opportunity available to California's dairy industry. This regulatory instability is stunting the significant potential demand growth for milk in California.

In conclusion and in the interest of preserving California's cheese industry while providing an incentive for future investment, the CDFA should not amend the 4b milk price. Thank you.

HEARING OFFICER ROWDEN: Questions from the Panel?

MR. EASTMAN: I just have a couple of questions. Are you currently working with any cheese plants here in

California to develop whey processing facilities?

MR. MURPHY: Yes, about four companies.

MR. EASTMAN: How would you characterize their size? Are they the small and medium size type plants or larger?

MR. MURPHY: Yeah, it's very difficult to do it with less than a million pounds of milk per day; very difficult to make the economies work. And you can't, you can't really go in on process -- I indicated in my testimony that about 50 percent of the solids-not-fat in raw milk still ends up as animal feed. I'm talking about relatively small just whey protein plants where you're taking out -- say, of the 3.2 percent protein in raw milk you're taking 0.6 percent of that protein, that's really all you're isolating.

MR. EASTMAN: So besides -- you don't have any other affiliation with any other organizations that, say, lobby on behalf of producer or processing interests? You're just simply a consultant?

MR. MURPHY: No, no, I'm an independent. I work on cheese and whey development projects with investors.

MR. EASTMAN: Got you.

HEARING OFFICER ROWDEN: All right, thank you very much. The testimony from BESTWHEY will be Exhibit 46.

(Exhibit 46 was received into evidence.)

HEARING OFFICER ROWDEN: At this time we are going to take a break for 15 minutes so we will reconvene at 9:35.

(Off the record at 9:20 a.m.)

(On the record at 9:35 a.m.)

(A moment of silence was observed for the victims of the Newtown, Connecticut shooting.)

HEARING OFFICER ROWDEN: I would like to invite up the representative of the California Dairy Campaign, please.

Okay, please state your name for the record and spell your last name.

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

HEARING OFFICER ROWDEN: And the organization that you are testifying on behalf of?

MS. McBRIDE: California Dairy Campaign.

Whereupon,

LYNNE McBRIDE

Was duly sworn.

HEARING OFFICER ROWDEN: Please.

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 member organization of California Farmers Union, which represents more than 1,400 farmer and rancher members statewide. CFU is a state chapter of the National Farmers

Union, which represents 250,000 farmers and ranchers nationwide. The testimony 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 amendments to the class prices.

The publication *Hoards Dairyman* most accurately and effectively described the situation facing California dairies in their September publication. The headline read, "Whatever you have heard about California's dairy situation, it is worse." *Hoards Dairyman* began publication in 1885 and it takes a measured view on most issues and does not speak in hyperbole, making this statement all the more striking. The publication went on to state, "The industry is crippled, it will likely get worse and it may never recover." Since early in 2012 I have heard similar descriptions from our dairy producer members about the ongoing crisis they face, which the Associated Press called the "double whammy: exorbitant feed costs and lower milk prices." The AP went on to explain, "The Midwest drought has led to corn and soybean costs increasing by more than 50 percent this summer, stressing dairymen from Wisconsin and Minnesota to Missouri. But in California, milk prices have also lagged behind those in the rest of the nation, exacerbating the crisis." Numerous news stories in the media have clearly stated the grim reality being experienced by dairy farmers and confirm just how bad things have been this year for dairy families in this state. The evidence points to the urgent need for CDFA to act to increase producer prices to provide much-needed relief to dairy producers across the state.

Although CDFA data is not currently available on the number of dairies that remain in California, it is widely estimated that more than 100 dairies will close their doors in 2012, a greater loss than occurred in the devastating year that was 2009. Many of the dairies that have closed their doors in 2012 have been in operation for generations. The impact of the closure of a dairy operation has a ripple effect on the local, regional and state economy and the social fabric of these affected communities.

I just had an opportunity to speak with a dairy producer out in the hall and he emphasized, and I hear this repeatedly, how difficult it is when you can't pay your bills and you can't -- you don't know how you're going to be able to survive in this climate, it's just incredibly difficult.

The situation facing dairy families in this state is dire and our organization has joined with other dairy producer organizations to call for reforms to our state dairy pricing system so that prices paid to producers are more equitable compared to prices paid in federal order states. Despite the unprecedented unity among the dairy producers on the need for reform, particularly of our 4b or cheese price, CDFA has failed to act to increase dairy producer prices so that they are in reasonable and sound economic relationship with prices paid in other states. Dairy producers are repeatedly told that if only they could get together and agree on the reforms necessary to improve our system, lawmakers would respond. The lack of response from the Department, despite the unified call for reform, has caused our members to look toward joining the Federal Milk Marketing Order System in order to receive a price for their milk that is in line with prices paid in the rest of the country.

For the hearing today CDC is calling for CDFA to increase the prices paid on all classes of milk so that they are comparable to prices paid in the federal orders. We believe this should be a permanent change; however, for the purposes of this hearing we are calling for this change over the next six months. We testify today in support of an upward price adjustment that would increase Classes 1, 2 and 3 by $0.40 per hundredweight, Class 4a by $0.30 per hundredweight and Class 4b by $1.90 per hundredweight. We calculated the upward adjustments based upon the average difference between the California price for each of these classes of milk and the equivalent federal order class prices on average over the most recent 24 month period. And there we have listed how it would break out on a fat and solids-not-fat basis.

The last cost data from CDFA indicates that the cost of producing milk is currently $18.46 per hundredweight and the cost including management and return on investment is $19.94 per hundredweight. On Attachment 1 titled North Valley Cost Survey - Percent of Dairies with a Net Loss, which we consider to be representative of the situation facing producers in the state, we have included a graph that shows at current prices paid and current production costs, 80 percent of dairies in the state are operating at a net loss. In order to keep 50 percent of producers at break-even levels we estimate the overbase price must be no less than 87 percent of cost of production. The graph indicates that in the first quarter of 2012 approximately 80 percent of dairies were operating at a loss. And that percentage increased to 90 percent in the second quarter and stands today at 80 percent. The comparable period in terms of dairies operating at a loss was the fourth quarter of 2008 until the third quarter of 2009 and that period was a catastrophe for dairy families in our state. This year has been even more difficult because many of the dairies that remain in operation exhausted their equity during the crisis of 2009.

In contrast to the bleak economic situation facing California dairy producers, others in the dairy food chain are enjoying considerable profits. According to third quarter reports, Kraft Foods posted a net income of approximately $470 million, amounting to a 13 percent increase over the previous quarter. Dean Foods reported a third quarter 2012 net income of $36 million, and that company's earnings increased by approximately 83 percent compared to the year-ago earnings. This James Leprino, Chairman of Leprino Foods, was ranked Number 170 on Forbes' list of richest people in America with a net worth of $2.6 billion. We don't begrudge the ability of others in the dairy sector to be profitable, however, dairy producers deserve to profit as well given the fact that the milk they produce is the foundation upon which the entire dairy sector is built.

Record feed prices caused by the usage of more than 40 percent of the corn crop in ethanol production and the historic drought that is being compared to the Dust Bowl have led to an incredible rise in input costs that is pushing dairies across the state near the brink of ruin. The fact that California prices lag behind prices paid in the rest of the country is worsening the crisis for dairy families in our state. CDFA can provide some relief by restoring equity in our dairy pricing system so that prices paid to California producers are aligned with prices paid in the Federal Order system. Adoption of our proposal would achieve this objective by increasing the overbase price by approximately $1 per hundredweight. However, the increase we are calling for today would not bridge the gap between the cost of producing milk and producer income. According to the Statewide Cost Comparison Summary, third quarter income was $16.75 per hundredweight. Given the $19.94 per hundredweight cost to produce milk, including return on investment and management, dairy producers in this state are losing over $3.19 per hundredweight, and that amount has only increased since then. Our proposal would not bridge the gap between the cost to produce milk and producer income, but it would be an indication that CDFA is responding to the crisis at hand to prevent additional closures of dairies in the state.

Conclusion.

We urge CDFA to increase the prices paid on Classes 1, 2 and 3 by $0.40 per hundredweight, on Class 4a by $0.30 per hundredweight and Class 4b by $1.90 per hundredweight. The upward adjustment we have called for today will bring California class prices in line with Federal Order prices. Adoption of the producer price increases that we have called for today will provide much-needed relief to dairy producers across the state who continue to struggle to remain in operation under incredibly difficult circumstances.

The California Dairy Campaign would like to thank the Department for the opportunity to present our testimony today. We would also like to request the opportunity to submit a post-hearing brief. We look forward to working with CDFA to improve the outlook for California dairy producers now and in the future.

(Applause.)

HEARING OFFICER ROWDEN: First of all, your request for a post-hearing brief is denied. We are not accepting post-hearing briefs on this hearing.

MS. McBRIDE: Oh, okay.

HEARING OFFICER ROWDEN: Questions from the Panel?

MR. EASTMAN: I have a couple of questions.

On page two where you list the actual per pound increases to the components. I know you've kind of written in -- you wrote in a number.

MS. McBRIDE: Yes.

MR. EASTMAN: I assume the number that you want is the one that you wrote in.

MS. McBRIDE: Correct.

MR. EASTMAN: For the 4a fat and solids-not-fat, the $.0246?

MS. McBRIDE: Yes.

MR. EASTMAN: Okay. Then with regards to the method that you arrived at your proposed increases. It looked like you compared the alignment of California class prices with Federal Order prices.

MS. McBRIDE: Um-hmm.

MR. EASTMAN: And in terms of where your proposed increases will go. Do you have a sense of, will that bring the alignment to the exact number? Meaning that there would be zero difference during the course of the six months when your proposed changes would be in effect or does it leave something on the bottom or something above? Where exactly does the alignment go based on your proposal?

MS. McBRIDE: You're asking me to predict prices for the next six months?

MR. EASTMAN: No, what I'm saying is, it appears that you looked at the alignment of California class prices and Federal Order prices over the last 24 month period.

MS. McBRIDE: Correct.

MR. EASTMAN: And so there was some sort of on average, some number difference, right?

MS. McBRIDE: Right.

MR. EASTMAN: So how does that, where does that difference go to, if you were to look at whatever that is, based on the 24 month average and what your increase would do, your proposed increase. Where does the alignment go to at that point?

MS. McBRIDE: Well again we are just using the average over the last 24 months. And because it's a six month period we just think it would bring our prices again closer to what is being received in the Federal Order prices. I can't predict what prices will be moving forward. But we wanted to look back and see that our current system, which we repeatedly expressed to the Department, is not in alignment with the prices received in the Federal Order, which is creating tremendous stress and financial difficulty here in California. So we're just going to add that chunk that we've seen over the last two years, which has been very evident and obvious, and move forward with that additional increase.

MR. EASTMAN: Okay. Those are my questions.

HEARING OFFICER ROWDEN: Thank you very much. The testimony for California Dairy Campaign will be Exhibit 47.

(Exhibit 47 was received into evidence.)

HEARING OFFICER ROWDEN: Next I'd like to invite up the representative from Farmdale Creamery.

For the record please state your name and spell your last name.

MR. HOFFERBER: My name is Scott Hofferber, spelled H-O-F-F-E-R-B-E-R.

HEARING OFFICER ROWDEN: Again, for the record, you are representing?

MR. HOFFERBER: Farmdale Creamery.

Whereupon,

SCOTT HOFFERBER

Was duly sworn.

HEARING OFFICER ROWDEN: Please proceed.

MR. HOFFERBER: Good morning, Hearing Officer and members of the Hearing Panel. I am Scott Hofferber, the Controller at Farmdale Creamery, and I am here at the direction and on the authority of our Board of Directors. Farmdale is a third-generational family-owned and operated dairy processing facility in Southern California. With about 80 employees, Farmdale is processing an average 24.2 million pounds of milk and cream per month, about 100 loads a week, into cheese, sour cream and buttermilk. And we are grateful for this opportunity to provide Farmdale's perspective on the matters before the Panel.

Orderly Marketing.

Regulatory stability is a necessary component to planning and executing a growth strategy in manufacturing industries where large capital investment and long-term physical plant assets are required. Farmdale has relied heavily on the fundamental precept in the Marketing and

Stabilization Plan that "orderly marketing" would rule the process. Our reliance on that precept led us to undertake a substantial investment and improvement to our facilities earlier this year. However, the current climate of continual petition, along with other recent legal and legislative actions, are undermining that stability and creating a very negative environment that may lead to a disastrous outcome for our substantial investment and inhibit the future of other processing growth.

While there are tremendous opportunities for growth and prosperity domestically and abroad, discord within the producer community abounds and is fueling counter-productivity, while stifling constructive debate within the industry. No affirmative progress toward reforming some of the most pressing internal industry issues appears to be forthcoming. The good and hopeful effort of the Dairy Future Task Force has been threatened because of this discord. We are now here to testify to how best to address "The Crisis."

Perspective is everything. Farmdale's cheese business was "in crisis" back in '07 under the variable whey factor in place at that time. Through a hearing and with the cooperation of our customers and our suppliers, we created a way to continue to serve the industry and provide a conduit for milk to clear the market. And when I say "suppliers" in there I am including the producer community in a very large part in our favorable outcome in that situation. Today, our industry is going through a difficult transition. It has been stated repeatedly in the press, in recent meetings and at the last couple of hearings that feed costs are putting certain California producers into an unsustainable business state. No argument. Although McKinsey's 2006 study didn't anticipate the current drought and feed supply constraints, it did warn us that such a stressor on the California dairy farming business model would likely trigger the effects we are experiencing now.

And I'm going to go off the page for a second. We've heard Attorney Riley Walter comments inserted into testimony early today. Along with those comments he presents a number of factors that go into creating the environments of bankruptcy for his clients. And I would encourage, if the entire article isn't included in the testimony where he was originally referenced, get your hands on that and read all of the business model issues that he cites as part of that destructive forces in these bankruptcy situations.

The Relief Effort.

We believe in a free market economy and also believe there is enough latitude in the current construct of the Marketing and Stabilization Plan to allow for temporary relief to come from direct dealings among arms-length parties through communication and negotiation. We are seeing that in action right now.

Earlier in testimony it was discussed with respect to excluding 4a from any kind of adjustment, that the significant investment in 4a plants garners particular protection from whatever we're dealing with here. And I would submit that there's a lot of have and have-not elements to this entire matrix that this panel has to deal with. There's lots of have and have-not constraints within the producer community itself. There was the discussion earlier about smaller cheese plants having or having not the ability to process whey. The have or have-not thing is rampant in this entire discussion. And that solution as far as work -- well, I'll continue.

To state the obvious, Farmdale needs a milk supply. We are hopeful that our producer partners already have and will continue to change their dairy farming models to allow for continued, mutually beneficial business ventures, as we have enjoyed since 1979 in Southern California. Some sort of reasonable short-term blanket relief appears inevitable at this point. And by "reasonable" we mean something that doesn't kill the patient with the treatment. The discussion around which of the utilization classes have the greatest margins, and thus the ability to suffer the added expense of a relief pricing scheme, is beyond the scope of this hearing.

Whatever methodology or magnitude of relief results from this hearing, Farmdale supports:

No change to the pricing formulas. A recent trip, by me, to the local grocery store revealed that store-labeled, "Real California" sealed, in-state jack and cheddar cheeses were being sold at the very same price as identically graded, famous name branded out-of-state cheese. This is what we're competing with.

If there is a temporary price adjustment enacted then it should include all classes of milk. Since feed costs seem to be the primary problem, and since the cows eat the same thing regardless of how their milk is utilized, for the most part, all milk users should participate.

And thirdly, no more than three months for any emergency relief program.

And this testimony is respectfully submitted. Farmdale Creamery.

HEARING OFFICER ROWDEN: Panel?

MR. EASTMAN: I have a couple of questions. Earlier there was testimony on behalf of the major, a couple of the major cooperatives in the state that handle a lot of the milk supply, that state that it appears the milk supply in a certain extent has been, maybe not compromised but there's some nervousness by some manufacturers according to their testimony, with regard to being able to maintain their milk supply. Do you feel any nervousness about the future supply of your milk supply?

MR. HOFFERBER: Southern California is extremely challenged in that the Chino Preserve is disappearing at an alarming rate. So we are nervous about the future, a couple of years out kind of a future. But in terms of current operations and current availability for us, we are running what we can sell at this point.

MR. EASTMAN: Would you state then, you are receiving the exact amount of milk to meet your needs then? So there hasn't really been a change over the last six months or so?

MR. HOFFERBER: We have had great cooperation from our supplier in both directions as the markets dictated our ability to move the product through.

MR. EASTMAN: So does Farmdale currently pay premiums to get milk?

MR. HOFFERBER: Yes.

MR. EASTMAN: Over the last five to six months, since last summer, has Farmdale paid any increased premiums above what they normally pay to procure milk?

MR. HOFFERBER: No.

MR. EASTMAN: Your milk supplier, have they reached out to you to discuss or negotiate the premium structure in lieu of what's happening?

MR. HOFFERBER: Yes.

MR. EASTMAN: Have those negotiations started?

MR. HOFFERBER: The extent of those negotiations really would remain proprietary. But I will say that we have sat down in a face-to-face meeting with our supplier and discussed the overall situation and we understand each other at this point.

MR. EASTMAN: Okay. In the past has that type of discussion occurred with regards to renegotiating premiums? Is this an unusual circumstance or does it happen regularly?

MR. HOFFERBER: Yeah, no, no, this is an unusual circumstance. Typically the contract would run whatever it would run, a year or two or whatever the length of any particular contract would be. And maybe four to five months prior to the renewal of that contract we would be sitting down with the suppliers and saying, they would be coming to us and saying, this is what we think we need to do, and we would say, this is what we think we need to have. And we would come to a number under typical, you know, arms-length negotiations. But this particular one is outside that scope.

MR. EASTMAN: So it's sort of midstream. It's in the middle of your current --

MR. HOFFERBER: That's correct.

MR. EASTMAN: Do you feel that you have an advantage because you do have some sort of long-term milk supply contract? That you sort of have a leverage there in negotiating additional premiums.

MR. HOFFERBER: It's an element -- yeah, it's an element of regulatory stability for us in terms of making our investment. You know, I'll give it credit for that. As an advantage in the marketplace, it is what it is, you know, we suffer or take advantage of however those things work out. Currently we're still making commodity cheddar cheeses and are subject to the CME market and whether or not we can cover our costs with our customer base.

MR. EASTMAN: So it doesn't seem that you're really competing for milk against other manufacturers.

MR. HOFFERBER: We have not had to reach out. To my knowledge, and I am not in the direct line for that. But as I understand it we are running, we are currently able to run what we can sell.

MR. EASTMAN: Got you.

MR. HOFFERBER: And we haven't had to, you know, go looking around at this point.

MR. EASTMAN: And then the other -- obviously this happens fast. I know you mentioned some methodology that you would support if there's going to be some sort of change or temporary price relief. Do you support any other proposals? Do you support the Dairy Institute proposal? Because I know you're a member.

MR. HOFFERBER: Well our primary, our primary offering is just make no change at all and let's continue to have these negotiations and work this thing out, you know. The problem that comes in there is what we've seen in the have and have-not argument, is how does the pool get the benefit when we're having these vertical conversations. And that's a rub I just, I can't approach. I mean, that's -- we're going to leave that up to you guys in terms of a methodology.

MR. EASTMAN: Okay. Those are my questions.

MS. GATES: Just one quick question on your substantial investment that you have engaged in. Is that fully realized yet? Is that on-line?

MR. HOFFERBER: Absolutely not. We're in some permitting delays at this point in time with that project. We're still within the parameters that we discussed with our financiers but, you know, we continue and see a completion to that project.

MS. GATES: On the same time line that you --

MR. HOFFERBER: Yeah.

MS. GATES: Pretty close?

MR. HOFFERBER: In my grand time line, not the --

MS. GATES: Exactly.
MR. HOFFERBER: -- engineer's original idea.
MS. GATES: Okay, thank you.
HEARING OFFICER ROWDEN: All right, thank you very much.
MR. HOFFERBER: Yes.
HEARING OFFICER ROWDEN: And the Farmdale Creamery testimony will be Exhibit 48.
(Exhibit 48 was received into evidence.)
HEARING OFFICER ROWDEN: Next I would like to invite up the representative from Land O'Lakes.
For the record, please state your name and spell your last name.
MR. WEGNER: Tom Wegner, W-E-G-N-E-R.
HEARING OFFICER ROWDEN: Again, please state who you are representing.
MR. WEGNER: I am representing Land O'Lakes.
Whereupon,
TOM WEGNER
Was duly sworn.
HEARING OFFICER ROWDEN: Please.
MR. WEGNER: Mr. Hearing Officer and Members of the Panel.
My name is Tom Wegner. I am here to testify on behalf of Land O'Lakes. My business address is 4001

Lexington Avenue North, Arden Hills, Minnesota. My current title is Director of Economics and Dairy Policy. Land O'Lakes thanks the Department for calling this hearing on its own motion to consider temporary amendments to the Marketing Plans. 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 co-op with 3,000 dairy farmer member-owners. Land O'Lakes has a national membership base, whose members are pooled on the California State Program and five different Federal Orders. Land O'Lakes members own and operate several cheese, butter-powder and value-added plants in the Upper Midwest, East and California. Currently, our 240 California member-owners supply us with over 15 million pounds of milk per day that are primarily processed at our Tulare and Orland plants.

Land O'Lakes proposes that all classes of milk be increased for a period of no less than six months to provide much needed financial support to California's dairy farm families who have experienced ever-narrowing margins over the past 12 months. Land O'Lakes agrees that current market conditions support an adjustment to the California class prices of milk.

Specifically, Land O'Lakes proposes the following increases in the class prices:

Increase the Class 1 price approximately $0.40 per hundredweight by raising the Class 1 milkfat price by $0.004 per pound; the Class 1 solids-not-fat price by $0.034 per pound; and the Class 1 milk fluid carrier by $0.001 per pound.

Increase the Class 2 and 3 prices approximately $0.45 per hundredweight by raising the Class 2 and 3 milkfat and milk solids-not-fat by $.036 per pound.

Increase the Class 4a price approximately $0.10 per hundredweight by raising the Class 4a milkfat and milk solids-not-fat by $0.0082 per pound.

And increase the 4b price approximately $1.65 per hundredweight by raising the Class 4b milkfat price by $0.0082 per pound; and the Class 4b milk solids-not-fat by $0.1864 per pound.

We are assuming that the Department would implement the temporary increases for six months beginning on Feb. 1, 2013. With that assumption in mind the specific proposal is as follows:

I'm not going to read that direct citation, you can have that for your record.

Land O'Lakes proposes a temporary $0.40 increase in Class 1 prices. In 2012, California's Class 1 prices averaged $1.62 less than in 2011 and are projected to continue to move lower in 2013. We already know that the California Class 1 prices for January will decrease by $2.84 from the December prices. We also know that the Federal Order Class I price for January will decrease by $2.42 lower than December for January 2013. So raising the Class 1 price by $0.40 per hundredweight represents a modest increase compared to this $2.84 decrease. If the typical seasonal pattern of Class 1 prices prevails in early 2013, the cost to California's fluid processors will continue to drop as we move into the second quarter of 2013. Additional, the Southern California Class 1 price has averaged $0.48 less than the Arizona Federal Order Class I price for the 12 months of 2012, providing room for this modest increase in Class 1 prices.

Land O'Lakes proposes a temporary $0.45 increase in Classes 2 and 3. Both of these prices have averaged over $3 less in 2012 compared through 2011. Through November 2012, the California Class 2 price has averaged $0.51 less than the Federal Order Class II price. Over the same 11 month period the California Class 3 prices averaged $0.80 less than the Federal Order Class II price. These price differences appear to provide adequate room for Class 2 and 3 processors to accommodate a modest increase of $0.45.

Land O'Lakes proposes a temporary $0.10 increase in the Class 4a price to recognize the Secretary's interest in having all classes of milk contribute to a lift in prices paid to California's dairy farmers. We propose this increase despite the fact that the current California manufacturing allowances remain below the 2011 average manufacturing costs reported by the Department. The butter manufacturing allowance is $0.014 below the 2011 average manufacturing cost and the nonfat dry milk manufacturing allowance is $0.0179 cents below the 2011 average manufacturing cost. Additionally, since September 1, 2011, when the Department last amended the Class 4a formula, the Federal Order Class IV price has exceeded the Class 4a price by an average of roughly $0.33.

By contrast, over the same 15 months, the Federal Order Class III has exceeded the Class 4b price by an average of $2.07 per hundredweight. Year-to-date in 2012, the discount on 4b has averaged $1.87 per month. Even after the most recent change made by the CDFA in September of this year, the Federal Order Class III price has averaged $1.65 more than the 4b price.

Additionally, the current California cheese make allowance comes within one-half cent of approximating the 2011 average manufacturing cost reported by the Department for cheddar cheese. As you are well aware, California's cheese plants, large and small, have benefited from the whey factor adopted by the Department in 2007 and modified slightly in 2011 and again in 2012. It is important to note that the monthly Western dry whey price series used by the Department in the whey portion of the Class 4b formula has continued to exhibit significant market strength in 2012.

Equally important, many dairy market analysts are projecting that whey prices will remain at levels of $0.55 to $0.65 in 2013, which will continue to ensure that the large California cheese plants will return significant margins on their processed whey operations. In light of these market factors and the administrative price constraints, Land O'Lakes proposes a temporary increase of $1.65 in the Class 4b price.

Applying the class utilizations of the California state milk order from 2012 year to date, we estimate that our proposal would result in an increase of roughly $0.82 on the overbase price for six months. Land O'Lakes suggests that adding $0.82 to overbase prices for six months would have a significant, positive financial impact on California's dairy farmer families. This would also send an important message to California dairy farmers that the CDFA Secretary understands the seriousness of the financial pressure that California dairy farmers have been under in 2012 and will likely to continue to be under in 2013.

Next, let me offer some observations about the market factors that support the temporary price increase.

These factors include the trends in milk production, farm milk prices, milk production costs and market projections for 2013.

California's milk production has slowed markedly from the growth rate experienced in the first half of 2012. since June 2012 when milk production posted a year on year increase of +0.4 percent, California's milk production has contracted for four straight months, posting decreases of -1.0 percent, -5.6 percent, -3.9 percent and -3.5 percent in July, August, September and October, respectively. The slowdown continued in November as California's milk production decreased by 2.3 percent, representing a daily milk production decrease of 2.6 million pounds or 50 fewer loads of milk per day in California during November 2012 compared to November 2011.

In addition to the production dampening impact of the high temperatures of August, two production factors drove these decreases-5,000 fewer cows since July 2012 in California; and more importantly, a drastic decrease in milk per cow on California dairy farms. Typically, we observe continual improvements in milk per cow as dairy farmers adopt more efficient production methods. In recent months, however, California's milk per cow has posted decreases of -1.8 percent, -6.3 percent, -4.0 percent, -3.6 percent and -2.4 percent, representing decreases for five straight months from July through November.

By comparison, Land O'Lakes member milk production has decreased even more than the state. Land O'Lakes milk production has decreased by -1.8 through November 2012, compared to the same 11 month period in 2011. In some periods since April 2012 our daily milk volumes decreased by over one million pounds compared to 2011's levels. Admittedly, the heat of August negatively impacted our members' milk production as well, but the combination of decreasing milk prices and increasing production costs have put many of our dairy farmers under extreme pressure as our margins have narrowed to unprofitable levels.

Forty-three dairy farmer members of Land O'Lakes have discontinued milking in 2012, in large part due to the financial distress. And as you know, Land O'Lakes took a significant step in early 2012 by offering our dairy members an option designed to help them avoid additional financial consequences. We are fully aware that some of our members are currently operating under negative margins and have been in frequent negotiations with their lenders. This temporary price increase comes at a very critical point for some of our dairy members.

By any price measure, California's dairy farmers have received far less for their milk in 2012 than they received in 2011. California's overbase price through

October 2012 has averaged $2.48 per hundredweight less than the average overbase price for the same ten month period in 2011.

California mailbox prices have followed a similar path downward. The California mailbox price has averaged $3.11 per hundredweight less in 2012 compared to the same eight month period, January through August, in 2011. For a dairy farm with 1,000 averaging 70 pounds of milk per day, this decrease of $3.11 represents a decrease of $529,000 in revenue compared to the revenue from milk sales for the same eight months in 2011. This huge revenue reduction in and of itself has had a severe financial impact on California's dairy farmers. But this, combined with a significant increase in production costs, has put dairy farmers in a price-cost squeeze similar to the catastrophic financial conditions they experienced in 2009.

The biggest factor driving up production costs has been rising feed prices. The drought in the Corn Belt has had a devastating impact on California producers, especially those who cannot grow their own crops and instead rely on purchased feeds. Corn prices have directly reflected the drought when they rose to all-time highs of $8 in August. More specifically, corn prices in Iowa increased by $1.05 per bushel from August 2011 to August 2012, as reported by USDA's National Ag. Statistics Service. The NASS reported corn price of $7.89 per bushel in August 2012 represents a 15 percent increase over 2011 levels. This translates directly into higher feed costs for those dairies that rely on purchased feeds. Our Land O'Lakes milk production specialists estimate that for every $1 increase in corn a California dairy farmer's feed costs increase by roughly $0.30 per hundredweight, depending on their rations. Some dairy farmers may have changed their rations in an attempt to minimize the impact of rising feed costs; our milk production specialists suspect that this change may have been one of the factors that led to the decreases in milk per cow.

The management strategy of purchasing or even renting additional land to better control feed cost has been and will continue to be an expensive option for California dairymen. Farmers who grow crops like almonds, walnuts and pistachios can typically outbid dairy farmers, making it very difficult for dairy farmers to purchase or rent additional land to grow their own feed.

During the first quarter of 2012, the Department has estimated the statewide total cost of milk production at $16.63 per hundredweight, representing an increase of $1.48 per hundredweight over costs from the first quarter of 2012. During the second quarter of 2012, the Department estimated that the statewide cost of production had risen to $16.84

per hundredweight, representing an increase of $0.21 over costs from the first quarter of 2012. And earlier this week the Department released the production cost estimates for the third quarter of 2012; the Department estimated that the cost of production had increased to $18.62 per hundredweight, representing an increase of $1.62 per hundredweight from the second quarter, nearly a 10 percent increase in cost from the production cost estimated in the second quarter.

Accordingly, feed costs in the third quarter of 2012 averaged 11 percent more than in the second quarter of 2012. Historically, feed costs make up approximately 60 percent of total production costs on dairy farms, the Department's data from the Statewide Cost Comparison Summary confirms this. In the third quarter of 2012 feed costs represented 65.3 percent of total costs.

Income over feed costs has narrowed considerably over the past 12 months. Compared to the third quarter of 2011, the Department's estimates show that the income over feed costs have fallen to $4.66 per hundredweight in the third quarter of 2012, a level considered to be catastrophically low by the National Producers Federation in their development of the proposed dairy margin insurance program included in the Dairy Security Act adapted (sic) by the US Senate.

One year earlier the statewide average income over feed was $9.12 per hundredweight. In 12 months the statewide average income over feed fell by $4.46, representing a decrease of 49 percent from the level experienced in the third quarter of 2011. Few businesses could withstand this kind of drastic loss of income and be expected to continue, much less expand their business.

The Department reported that the statewide blend price for the first quarter of 2012 was $15.93; this price was $0.70 below the statewide total cost of production of $16.63. In the second quarter the Department reported that the statewide blend price was $14.62; this price was $2.22 per hundredweight below the statewide total cost of production of $16.84. And in the third quarter the Department reported that the statewide blend price was $16.49; this price was $1.97 per hundredweight below the statewide cost of production of $18.46. Clearly, the financial condition of California's dairy farmers calls for this emergency action by the CDFA.

Projections for feed costs in 2013 do not look to offer much relief. USDA has estimated corn to average $7.40 per bushel and soybeans to average $14.55 in the coming year. Corn futures have been trading slightly lower but still well above $6 for December of 2013 and soybeans have been trading in the $13 and above range. Unless current drought conditions improve in the US Corn Belt, feed prices look to stay at levels that will continue to challenge California's dairy farmers and especially challenge those who rely on purchased feeds.

We again want to thank the Secretary of Agriculture and the Department for calling an emergency hearing on their own motion. There is no question that emergency conditions exist in the California dairy industry and this temporary increase in the prices of milk in all classes will have a positive financial impact on California's dairy farmers at a time when they need it the most.

HEARING OFFICER ROWDEN: Questions from the Panel?

MR. EASTMAN: When reviewing your proposed changes I noticed that it looks like one of the factors that you used, the methodology that you used to come up with a magnitude of your proposed price increases has to do with alignment with Federal Order class prices. And it appears that for the most part -- or it appears that your proposed changes in the class prices actually leave some sort of competitive advantage for California manufacturers, based on the average comparison there. Was that done on purpose? Is there some sort of competitive advantage that you think is necessary for California manufacturers?

MR. WEGNER: Well, our stake is certainly in the

4a side. And like I said in my testimony, the increase in 4a was an acknowledgement that the Secretary was looking for a class price increase in all five of the classes here so that's where the $0.10 probably came from, Hyrum. Regarding 1, 2 and 3, we definitely thought that that would still allow some piece of competitive positioning for those three classes and in 4b there was still a little bit as well. We felt that $0.82 was a fair number to return to our producers in this condition and adjust it accordingly from there.

MR. EASTMAN: So based on your proposed increase it appears that your proposed 4b price won't affect over the long-term your operation of the Land O'Lakes cheese plant that is still here in California.

MR. WEGNER: Oh, that's not true. It will definitely impact the financial situation of the Orland cheese plant and we are looking at that as something that we need to address in light of what our producers need.

MR. EASTMAN: Okay.

MR. WEGNER: And just to be clear, six months at $1.65 will impact Orland's financial picture.

MR. EASTMAN: Okay. I think I have another question but I'm missing it here, I need to look for a second.

MS. GATES: Mr. Wegner, on page five you talked about, I guess it's the bottom of four and into five, the decrease in production that happened in Land O'Lakes. In your numbers there does that include the 17 that were kind of part of the incentives that you guys put together to kind of get your base programs where it needed to be? Is that included in that?

MR. WEGNER: In the number that says it's 1.8 percent less?

MS. GATES: Yes.

MR. WEGNER: Yes.

MS. GATES: Okay.

MR. WEGNER: And we realized, just if I may follow up, that that decrease, even controlling for the 17 members, is far greater. I mean, it's far greater than the 17 members' decrease, if you understand my point.

MS. GATES: Um-hmm.

MR. WEGNER: Okay.

MS. GATES: When you were referring to production per cow being down on page four. I think you talked about it a little bit later. Were you attributing most of that to different management practices based on changing feed rations, that kind of thing, to bring that down?

MR. WEGNER: Well, I mean, certainly the heat had an impact on it, I am not denying that fact. But certainly trying to escape feed costs by either cutting back on feed or substituting other feeds that are less, let's say productive for the dairy cow, can have impacts. So I would say -- what percent. I'd say the majority of it had to do with rationing.

MS. GATES: Okay. I think I've asked the other co-ops and I'll ask Land O'Lakes also. When it comes to -- back in 2009 we saw retains distributed out through the year as opposed to just waiting until the end of the year. And seeing as Land O'Lakes does have a cheese operation, was that returned back to your producers during that time?

MR. WEGNER: I'm not quite sure what you mean by "the cheese operation." I'm not sure I understand the question beyond that. I understand the question about did we pay out monies in 2009 in addition to what we typically pay out, I suppose, or usually pay out, but I don't understand why you bring up the cheese operation.

MS. GATES: Because I was looking at your testimony to the cheese industry saying how much they benefitted from the whey factor and different things so I just attributed that back to Land O'Lakes too since they have a cheese operation.

MR. WEGNER: It's a rather small cheese plant compared to our volume of milk. But laying that aside for a moment, we did not pay any additional monies out. We feel that the patronage earning that we pay out during the year -- typically when we pay it out, not over the year -- and the competitive premiums we pay were adequate.

MS. GATES: Okay, thank you.

HEARING OFFICER ROWDEN: Thank you very much. The testimony from Land O'Lakes will be Exhibit 49.

(Exhibit 49 was received into evidence.)

HEARING OFFICER ROWDEN: Next I'd like to call up the representative from R. Doornenbal Ranches.

Please state your name and spell your last name.

MR. DOORNENBAL: My name is Rien Doornenbal, the last name is spelled D-O-O-R-N-E-N-B-A-L.

HEARING OFFICER ROWDEN: And you are representing, again, for the record?

MR. DOORNENBAL: I am representing R. Doornenbal Ranches.

Whereupon,

RIEN DOORNENBAL

Was duly sworn.

HEARING OFFICER ROWDEN: Okay, please.

MR. DOORNENBAL: On June the 1st when I sat in this probably exact same chair I was asked to state my name, which I did in the same manner, the same way as I did now. I was asked to state who I was representing and it was slightly different, I told you I was representing R. Doornenbal Dairy; today I represent R. Doornenbal Ranches. Now that's significant and I'll get to that later in my testimony.

I belong to California Dairies, Incorporated. Half of our milk production goes to California Dairies, Incorporated, the other half of our milk production goes to Dairy Farmers of America. We operate three dairy farms, although basically operate as one unit. They are not extremely antiquated but neither are they modern by any stretch of the imagination. I am also a board member of Western United Dairymen. And I want to make it very plain that I do not represent any of the organizations that I belong to, I am speaking here only on my own behalf and for my neighbors and friends in the Escalon area who I am feeling very responsible to.

One thing that's happened since I sat in this chair last time is that I am not a rich man. But I will tell you that I have -- that my equity is about a half a million dollars less than the last time I sat in this chair.

Yesterday I visited with -- my banker came and we signed new loan documents. His name is Fred, he might even be here, I don't know, I haven't seen him yet. But he may, sometimes he comes to these hearings. And so we went and we signed the different lines of credit. And there was only one line of credit that had some room on it. And I said, Fred, there's only one line and it's close to full. What do we do when that fills up and I'm still not cash flowing? He told me, then you're out of money. I said, what? He says, you're out of money then. Basically, I'd be out of business.

I suppose that I should be overjoyed at testifying at this hearing. I'm not. At best I'm ambivalent about this hearing. Definitely I could use the help. Any money that could be added to my milk check would definitely help. But I think that we all know that the big elephant in the room is 4b pricing.

And to stay in the spirit of this hearing, I believe I propose that we increase the price of 4b by $1.75 per hundred pounds. This still puts 4b at about $0.55 below the Federal Order Class III price.

I personally think that an adjustment to the whey factor would probably be better. Maybe even to recognize that in this state there are a variety of different types of whey and from my understanding very little of it is the actual dry whey.

But I don't think that is in the scope of what the Department has proposed. If I understand correctly the Department has asked participants in the industry to look at an exact dollar amount increase in the different classes and so that's why I am stating $1.75 and not proposing some type of formula.

I would like to ask the Department some questions to help me understand milk pricing. I just turned 62. I have been milking cows since I was a kid. I have been in the dairy business since 1975.

Here is my first question: Given the fact that all dairymen are producing under some type of a contract, and those who process the milk are under no obligation to accept more milk than the contracted amount, why is the Department so concerned about processing capacity within the state whenever producers request an increase in the regulated price? It's not a rhetorical question, I would really like a better understanding of that.

I have a friend of mine, his name is Joey Ratto. Joey grows tomatoes. Joey has got tomato juice running in his veins. He loves growing tomatoes. And he grows a lot of tomatoes and he has contracts for his tomatoes. And he is not always able to predict and control the weather and control how many tomatoes are ripe during a certain time. So what happens to his extra tomatoes that are over and above the contracted amount? That is Joey's problem. It's no one's problem but Joey's problem.

If we produce more milk as individual dairymen than what our contracts allow us to produce or our bases are set, that is our own individual problem. And I really think I am going to put it as bluntly as I can because I've stated this -- this is the third time that I've stated this at this panel. I really think that the Department is taking on a responsibility when it comes to plant capacity that they have no business taking on their shoulders.

Much testimony has been given today and at other hearings concerning the difference between the Federal Order Class III and California 4b. Data shows that from 2003 through 2009 the difference between Federal Order Class III and California 4b averaged less than a $0.50 difference, with 4b always being lower. During the last three years the difference has grown to average more than $1.50. So from 2003 through 2009 the difference was less that $0.50, the last three years it's more than $1.50. My question to the Panel and to the Department is, is the Department concerned about that or not? I would like to know. Is the Department concerned?

Another question I have is from page 23 of the Hearing Panel report based on the public hearing held on May 31 and June 1, 2012 which addressed the 4b price formula. And I have the report here and I'm looking at page 23. And I really need some help to understand this. And I will read as follows:

"An analysis of the correlation between the Class 4b and Class III prices shows that the current Class 4b price is highly positively correlated and moves closely with the current

Class III price. A positive correlation implies that as one price moves up or down, the other price moves in the same direction. Although the spread between the two prices has grown in recent years, the correlation has remained relatively consistent, indicating that the two prices continue to maintain a reasonable and sound economic relationship."

So what I am gathering from this is that the Department is concerned about maintaining a reasonable and sound relationship between 4b and Class III. But what I am also gathering from this is that the relationship, the most important part of the relationship is that the two prices track each other and that it doesn't make any difference at all how much difference there is between the 4b price and the Class III price. That is how I am understanding it. If I am not understanding it correctly I would really like to be educated.

A few points I would like the Panel to consider. During times such as this as today when the cost of production is more than revenues, individual producers have one of two choices, get out of the business completely or produce as much milk on a per cow basis as possible. Most attempts to reduce inputs on dairy farms during times of low milk prices succeed in lowering milk production, however, the net effect to the individual dairymen generally is to lose even more money.

You know, when I was a kid in the dairy business, my dad was in the dairy business. And even in the '70s times would get rough and you'd say, you know, you would say, man, I am just not going to buy that extra load of grain this month. And you'd just hope that the cows wouldn't go down in production too much and that you could decrease your inputs more than you would lose on the revenue side. We were never really sure how it all worked out.

But in recent years we have all had to get more sophisticated. Well, I would say 90 percent of the dairymen in this room work with nutritionists, we work with other kinds of consultants. We even have folks come into the state from other states that educate us or help us to manage our dairies.

And I remember distinctly going to a meeting and Dr. Hutchins from Wisconsin was there. It was very enlightening because this was in 2009 when things were really, really rough as well. And he had a PowerPoint presentation with a spreadsheet and he went through one by one by one of the different options that dairymen might choose to try to lower costs and perhaps lower some revenue but still capture -- at the end of the day be in a better position. And one by one, everything he showed us. You could cut back on your hoof trimming, you could cut back on your level of feeding concentrates and all of the things that we normally do to take care of our cows.

And all you do is lose more money. That's all you do. There is no way for us to reduce our expenses more than the revenue that we would lose. And I could share more of that topic with you in a different venue.

So, you know, when you -- my point is, when you see that the individual dairyman and the production per cow doesn't go down, it doesn't mean that they are doing it because they're making money, no, it's preservation is all it is.

We hear a lot about the high feed costs in California. And high feed costs affect all dairy farmers across the United States. I have a very good friend, very good dairymen, he's in Northwest Iowa. Huge corn growing area. He's got a very modern 4,000 cow dairy; does an excellent job. But his model is that he dairies and he purchases the feed. The feed cost portion of his business is eating him up. He's in Northwest Iowa, he is in the middle of the corn, because that corn farmer next to him that he hopes to buy the corn salvage from has got two options, he can sell it to my friend Harvey or he can run the combine through it. So high feed costs affect all of the dairymen in the United States.

And the only -- the best thing -- the best position to be in is if you're a dairymen now and you're also doing a large amount of farming. And if you are doing a large amount of farming and you have land that has been paid for that you don't owe a lot of money on, there's some cash flow there that can go to help fund the losses on the dairies.

Our problem in California is that for the most part we in California, we keep talking about the high feed costs. But here in California we're operating with a lower milk price than the rest of the country. The testimony from California Dairy Campaign quotes a recent *Hoards Dairyman* article that bears this out.

Some of this milk price problem that we experience here in California could be rectified with an increase in the 4b price and I believe there is some sound economic for that, that the Department could justify that increase and still allow a reasonable profit for the state's cheese makers.

Eric Erba gave some excellent testimony to the Panel's questions concerning dairymen going out of business and what happens to the cows in the facilities. We are not by any stretch of the imagination seeing a normal kind of consolidation. And that's coming from a guy, right here, that would rather be at home on my dairy wearing rubber boots with my dog Rusty following me around. Unfortunately, I need to be here to do what little I can to encourage the Department to carry out part of its mandate, and that is, to align the 4b price more closely to Federal Order Class III. And I am not only here for own sake but also for my friends and neighbors.

And let me give you a little, just a little picture of what's going on in Escalon, okay. This little flyer here, the red flyer, I'll tell you what the yellow paper is later. The red flyer is a flyer I received in my mail. I can't tell you when it was dated but it was two weeks ago. And I'm looking at -- oh, my friend Carl is -- I can't believe it, my friend Carl is selling out. You know, what is going on, my friend Carl, I couldn't believe it. So I called another friend who also knows Carl and he says, oh, Carl has been talking to me for a couple of months already because he's looking at making a change.

Well what Carl decided -- he wasn't broke. The bank didn't, the bank didn't sell him out. If he would have kept going indefinitely this way he would have but the bank didn't sell him out. This is what Carl said: I have decided to exit the dairy business because -- and you'll learn more about him, his family has been in it for 70 years. "I have decided to exit the dairy business because I want to make a decision before someone makes a decision for me, i.e., the bank." So that's just one little story of what you see going on.

I think what we heard earlier as far as dairymen exiting the dairy business where those dairymen who had no choice but the bank came in and forced them out. We've heard those stories. What you are not hearing about are the people like Carl. What you are not hearing about is another friend that I'm thinking of, and I can't his name because it wouldn't be fair, who had some different options and said, you know, why would I stick with the cows, it looks like a loser to me over the last four or five years.

HEARING OFFICER ROWDEN: You have a little less than a minute left.

MR. DOORNENBAL: Okay. I'd like to tell you how, and I may take just another minute if you would because I'm almost finished. R. Doornenbal Ranches and how it came about. The hard part of leaving the dairy industry or the dairy business is who to become once you are not milking cows, okay. What do I morph into? What do I change to? I'm a dairyman. So that's the hardest part.

We also farm. We farm roughage for our cows, we're in the beef cattle business, we grow some almonds as well as walnuts, although dairying is by and far the most significant portion of our business.

Right now my farming operation is subsidizing my dairy operation. How long do I continue? And I'm just bringing this up because I'm just one guy amongst hundreds, okay. How long do I continue? The hard part has been done, I no longer see myself as a dairyman. I am now a rancher or a farmer or an agri-businessman. Do I continue to produce milk? Unfortunately, much of that decision is in the hands of CDFA. CDFA needs to act to bring 4b in alignment with Class III.

(Applause.)

HEARING OFFICER ROWDEN: Panel?

MR. EASTMAN: I have a couple of questions. You mentioned at the beginning of your testimony that you changed from being a representative of your dairy to being one with the name of Ranches at the end. So does that mean that since about last summer is that when you started to diversify into a couple of the things that you mentioned like the beef and the almonds?

MR. DOORNENBAL: No, I have always been somewhat diversified but not in a serious way. But -- for example, I had an opportunity to buy a small almond orchard as well as walnuts. One of the reasons I took that opportunity was to learn about that business in case I ever had to reinvent myself, so to speak. But not with, not with the intention, at least at that time not with any intention of getting out of the dairy business.

MR. EASTMAN: About how long ago was that?

MR. DOORNENBAL: That's four years ago.

MR. EASTMAN: Four years ago. Do you foresee that for California dairymen and dairywomen, or even those in the whole western region of the United States, what you read is the western style dairy where you purchase a lot of feed concentrates, et cetera. Do you think in general that in order to get through the volatility that is always there in the industry that there's going to have to be measures like that taken by a majority of dairies in order to survive the ups and downs going into the future?

MR. DOORNENBAL: Well it's certainly not a bad strategy. But if the dairy itself -- and I would say that -- I would guess that 90 percent of the dairymen that are in this room keep separate records of the dairy's income and expenses and also separate records on the farming. And so when you see that the farming operation continually subsidizes the dairy it doesn't take long and the decision makes itself.

MR. EASTMAN: ObviouslY I know you can't speak for all dairymen. I know that you mentioned your friend that's in what, Northern Iowa. That friend of yours, does he do any farming, has he tried to diversify into anything else?

MR. DOORNENBAL: No, he does -- no, he does no farming at all, he does no farming at all. But I take issue with those folks who blame the dairymen that don't farm who feel like they -- people that are in positions such as yours perhaps who might take a position that people should be farming if they are dairying. And I really don't believe that is correct because you cannot, you cannot have one business that constantly subsidizes another business. They are two separate businesses, they are two separate types of businesses.

MR. EASTMAN: Actually, I'm sorry, I was going to mention one other thing. I know you had some serious questions that you wanted answers to. The purpose of the hearing is just to receive information. But once the hearing is all said and done, if you would like to have a conversation I'm willing to have a conversation with you. Once the hearing process is completed, which would be the end of January when more open discussions can be made, if you're interested.

MR. DOORNENBAL: Thank you very much, I would definitely be interested, yes. Thank you.

HEARING OFFICER ROWDEN: Thank you very much.

Next I would like to invite up the representative for the Milk Producers Council.

Please state your name and spell your last name.

MR. VANDENHEUVEL: My name is Rob Vandenheuvel, V-A-N-D-E-N-H-E-U-V-E-L.

HEARING OFFICER ROWDEN: And again, who do you represent?

MR. VANDENHEUVEL: Milk Producers Council.

Whereupon,

ROB VANDENHEUVEL

Was duly sworn.

HEARING OFFICER ROWDEN: Please.

MR. VANDENHEUVEL: Mr. Hearing Officer and Members of the Panel, my name is Rob Vandenheuvel and I am the General Manager of Milk Producers Council. MPC is a nonprofit trade association with office locations in Ontario, Bakersfield and Turlock, California. We represent a voluntary membership of dairy families throughout Southern and Central California. My testimony today is based on positions adopted by the MPC Board of Directors.

On a recently created page of CDFA's website, the role of CDFA in pricing milk is stated as such:

> "CDFA is the regulatory agency charged with balancing the needs of dairy farmers producing milk on the farm, manufacturers taking milk from the farm and converting it into dairy products, and consumers looking for a reliable supply of reasonably priced products."

It has been abundantly clear that the needs of manufacturers have certainly been a priority of CDFA over the years. Some examples include:

An end-product pricing structure that largely mitigates the market risk for our manufacturers, through the use of regulated make allowances in our formula,

A dry whey factor, as we heard about in numerous testimony here, that is significantly limited when compared to the benchmark pricing formula in the Federal Order system,

An f.o.b. adjustment in our Class 4a and 4b formulas to account for location challenges associated with being on the West Coast,

A transportation subsidy program, funded by dairy farmers, to ensure that Class 1 plants have an adequate supply of milk, and

A pooling plan that just fundamentally allows processors of all classes of milk to equally compete for a milk supply, regardless of how their individual class compares to the rest of the classes.

All these items are aimed at providing opportunities for our dairy product manufacturers to: (1) secure an adequate supply of milk; and (2) have a reasonable opportunity for a return on their investment.

What has been missing is the other side of the coin, the balance; the balance of also looking at the economic needs of California's dairy families. While our manufacturers have been able to enjoy some of the structural advantages listed above, our state's dairy families have been financially massacred in recent years. To amplify this point we need to go no further than CDFA's own data on the cost of producing milk versus the combined income from all five classes of milk, which consequently is one of the outlined considerations specifically mentioned in the California Food and Ag Code. The table and chart there on page two shows the average statewide cost of production as calculated by CDFA's cost of production unit, compared to the statewide blend price. And you can see there, there's three columns, the statewide cost of production, the statewide blend price and the difference, along with an illustration there showing the last -- from 2006 to 2012.

As CDFA's data demonstrates, California's dairy families were subjected to financial losses in five out of the past seven years. To put these figures in perspective, a 1,000 cow dairy producing 65 pounds of milk per cow per day, about the average operation here in California, would reasonably assume to have lost, according to CDFA's own economic data, a combined $2,135,523 during that seven year period. That's over $2100 per cow in losses accumulated over that period of time according to that data. Testimony at today's hearing will undoubtedly and has uncovered the reality behind these financial estimates; massive debt accumulation, dispersal sales and bankruptcies.

California's dairy families are hopeful that today's hearing marks a change of course and the beginning of a real balance amongst industry participants.

A Strong Case for Increasing the Regulated Minimum Price.

We are in the midst of killing the dairy producer sector in California. Month after month our dairy farmers are selling their milk at prices well below the cost of producing that milk. Some on the processing side of our industry have hinted that dairy farmers and their cooperatives ought to just negotiate better prices for their milk. What that statement ignores is the fact that our dairy farmers and their marketing cooperatives often sell their milk supplies under long-term contracts for economic stability. We heard about that earlier today. These contracts are typically, if not exclusively, pegged to the regulated prices announced by CDFA. Modest service premiums are often attached, mostly to compensate for balancing costs and encourage higher quality standards.

Why have dairy farmers and their co-ops contracted milk using regulated prices as the benchmark? Well it makes perfect sense when you look at CDFA's responsibilities as outlined in the California Food and Ag Code, the law of the land here.

This is one of the things in the Food and Ag Code: A goal of the regulations is to enable the dairy industry, with the aid of the state, to develop and maintain satisfactory market conditions ... and bring about and maintain a reasonable amount of stability and prosperity in the production of market milk. And that's 61805(d).

We've talked about the reasonable and sound economic relationship with around the country, it's been mentioned before.

And the third bullet there, rather than read it because it's legal lingo, basically that CDFA needs to consider the cost of producing milk, including reasonable return on investment and management as compared to what the average prices being paid for that milk are.

Dairies and their co-ops rely on CDFA to follow the Food and Ag Code when they establish contracts to sell milk to their manufacturers. We rely on the fact that one of the stated goals of CDFA is to "bring about and maintain a reasonable amount of stability and prosperity in the production of market milk." We rely on the fact that prices must be competitive with what comparable milk is worth in other parts of the country. We rely on the fact that CDFA must consider producers' cost of production, including a return on investment and cost management when establishing prices.

Why would sellers of raw milk in California agree to long-term contractual relationship fundamentally based on CDFA-announced minimum prices if they thought those prices would result in on-the-farm losses in five of the past seven years? Why would we lock ourselves into contracts pegged to CDFA-announced prices if we knew those prices would be systematically discounted below prices paid for comparable milk around the country? It's simple, we wouldn't.

Processors (sic) desperately need, and the California Food and Ag Code allows, for CDFA to make a meaningful upward adjustment to minimum prices, even if only for the short time period being allowed by the call of this hearing.

The Milk Producers Council's Board of Directors has had the opportunity to review the proposal put forth by Western United Dairymen and we strongly support it. The proposal, if implemented, would result in much-needed additional market revenue being paid to our state's dairy farmers.

Restoring Fairness and Equity in the System.

The issues before us are not new. The dairy producer community has been extremely vocal and active in the past two years, pointing out the desperate need for an increase in the pay price for milk, particularly with respect to the Class 4b price. While producers have been fighting for their financial lives, we have seen a specific line of rhetoric emerge from the state's cheese manufacturers. Their basic argument is that the minimum prices are fine where they are, some have even proposed in past hearings to lower them, and premiums should be the only tool we use to increase our pay price for milk. Here's a few examples of those quotes:

From the testimony of Hilmar Cheese, May 31, 2012.

"Hilmar Cheese Company supports a low regulated minimum price that allows the market to efficiently set high market-driven prices."

From the testimony of BESTWHEY, LLC:

"Cooperatives should use milk premiums over minimum pricing as a way to improve producers' income based on the supply and demand of milk in a working market."

A letter from Farmdale Creamery in March:

"Why don't these producers merely go to their customers and raise their price?"

And finally, testimony from the Dairy Institute of California in 2011:

"The role of regulated prices should be to undergird the market, providing some stability yet leaving room for market forces to work."

Even CDFA has referenced this line of thinking in recent months. From a press release in October:

"Additionally, some milk buyers have announced they will add a whey revenue-sharing premium for their milk producers immediately, equating to an increase of over 50 cents per hundredweight. So we are seeing some positive activity in the milk market driven by changes in supply and demand."

To those that don't fully understand how milk is marketed in California, this rhetoric sounds pretty logical. Why should we worry about minimum prices? They're just minimums. Why not just focus on generating higher premiums? One of the reasons that logic fails the smell test was discussed earlier in this testimony, the issue of long-term contracts. But beyond that, there is another reason why proper minimum prices are needed.

One of the Secretary's considerations specifically spelled out in the Food and Ag Code is the reasonableness and soundness of the relationship between the various classes, it's a paraphrase from Section 62062(c). That consideration was also specifically included in the official notice for today's hearing. Why is that in there? The reason is simple. While today's hearing is specifically on the five minimum prices established each month, we need to remember that these minimum prices do not exist in a vacuum.

California operates under a pooling plan that pools the revenue from the sale of milk in each of the five classes. One of the fundamental tenets of that pooling structure is that each of the five classes must make a fair and equitable contribution to the pool.

We recognize that this does not mean all five class prices must be equal. But the Secretary is nonetheless tasked with maintaining a fair and reasonable relationship between the classes. Let me specifically look right now at the relationship over the past several years between our two main manufacturing classes, Class 4a and 4b.

Over the past three years, since January 2010, the Class 4b price has averaged $14.88 per hundredweight, while the Class 4a price, butter/powder, has averaged $16.33 per hundredweight, an average difference of $1.45 per hundredweight. At the same time, the overbase price, which is ultimately the price that plants are obligated to pay their milk suppliers, has averaged $15.57 per hundredweight. What this means is that since January 2010, in order to be able to pay their producers the blended overbase price, our cheese plants have collectively received almost $344,700,000 out of the California pool. At the same time, our butter/ powder plants have had to not only pay their milk suppliers the blended overbase price, but on top of that they have collectively contributed more than 283,200,000 pounds (sic) into the California pool.

What does this mean? Through the California regulated pooling system, our butter/powder plants have been heavily subsidizing the cheese plants over the last three years. Without our pooling system, how much milk would our cheese manufacturers have been able to purchase in 2011 at the Class 4b price, which was $2.45 below the Class 4a price last year. Instead, those cheese plants were able to compete for milk on an equal playing field with the butter/powder plants, since hundreds of millions of dollars were taken from the butter/powder plants and given to the cheese plants.

It's frankly dishonest for our cheese manufacturers to lecture dairy farmers and their cooperatives about going to the marketplace for additional revenue, while the regulated system has overseen the transfer of $344,500,000 in pool revenues that they did not earn in order to pay the market price for the milk that they do need. This is why Milk Producers Council believes that the Western United Dairymen proposal, which includes a significant increase in the Class 4b price while proposing no increase in the Class 4a price, is an appropriate adjustment for CDFA to make. It's about justice and fairness; something the Secretary is sworn to uphold.

In conclusion, there is ample evidence that dairy farmers are in desperate need of a meaningful increase in the price they are paid for their milk. We've also demonstrated that a significant adjustment to the Class 4b price is in the interest of fairness and justice. CDFA and Secretary Ross are empowered by California law to make these adjustments, and we along with our fellow trade associations, marketing cooperatives and the roughly 1,600 individual dairies that are left in California, are hopeful that Secretary Ross will heed our requests.

That concludes my testimony.

(Applause.)

HEARING OFFICER ROWDEN: Panel?

MR. EASTMAN: Apparently I get to go first no matter what. On your testimony you mention -- it looks like on page two and page three you talk about how with regards to milk pricing, a big component of that is the role that the Department plays in setting a minimum regulated price. do you feel that producer organizations or cooperatives that handle a large portion of producer milk have no role to play with regards to the marketing of their milk with the prices that are negotiated? Or would they have a role as well?

MR. VANDENHEUVEL: Well of course they have a role. My point was looking -- we can only deal with the here and now. And so the here and now is we are engaged in these long-term contracts, some of which may expire at some short period of time, others that are going longer. And the question being, how did you get into this mess? Those particular paragraphs were explaining why it made perfect sense to enter into contracts that were pegged to the regulated minimum prices.

Obviously if over the long-term we are going to see regulated prices that are discounted significantly below what we can afford to sell the milk for, we are going to have to change our behavior. But in explaining why would dairy farmers enter into a long-term contract fundamentally based on the Class 1, 2, 3, 4a or 4b prices, the reason that I was pointing to is some of the responsibilities that are outlined for CDFA and why it would be reasonable for our industry to believe that those minimum prices will take into account our costs, will take into account reasonable relationships around the country.

MR. EASTMAN: So would that mean that in the future you believe that maybe the nature of supply contracts should change or the manner in which those are negotiated should change going into the future or do you see this only as a temporary sort of circumstance of current present conditions or do you view going into the future that that would have to change at some point?

MR. VANDENHEUVEL: Well, I come from a trade association which doesn't market milk so my thoughts are purely academic as opposed to, you know, on the ground at the cooperatives, it would be a better question for them. But when you look at, you know, a lot of how our future is, is going to depend on what's going on now. What is the regulated price going forward? And we're going to have to respond to that.

I think the testimony later on talks about why it's fundamentally unsound for a pooling system to have one class that we believe is deeply discounted while the other classes are paying a fair and equitable contribution. So I wouldn't say we ought to just throw in the towel and say, set the regulated minimums wherever they want and let the co-ops contract that milk. I was merely trying to explain why we are in the position we are today, not tell the co-ops how to set their contracts in years to come.

MR. EASTMAN: With regards to pooling. Obviously if class prices are set at different levels and you have a pooling which then blends the revenues from all the classes into a pool price, ultimately there's going to be some classes of milk, some manufacturers that would be paying into the pool because their class price is higher than the pool price and others that wouldn't.

How would that argument -- I know you make an argument amongst 4a and 4b manufacturers. I suppose there could be some people in the room that are representing Class

1 or Class 2 or Class 3 manufacturers that might be ones that also pay in the pool. Wouldn't they have the same argument that, hey, you know what, maybe it should go the other way around. Maybe my price should be one of the ones that are under the pool price, so to speak. Why would only those two prices come into consideration when we have three others that pay into the pool or participate in the pool as well?

MR. VANDENHEUVEL: Well, when you look at the California pool, 75 percent of the milk is covered by Class 4a and 4b, so those are the two primary manufacturing classes. I realize that historically markets shift and sometimes the opposite is true. My point was to demonstrate what, quite frankly, is the hypocrisy of telling dairy farmers to go to the marketplace, rely on premiums, and don't keep tapping the government well, go to the marketplace, while at the same time that government well is providing those processors with $344 million in subsidies to pay for milk that they need from revenue that they did not earn. So it was to demonstrate that intellectual dishonesty as opposed to make a policy statement about the future of, you know. Is 4a always going to be contributing? Actually over the past five months it has reversed. I'm looking at a more macro scale over the last three years.

MR. EASTMAN: So your argument necessarily isn't one that -- I guess it' more theoretical in the sense that --

MR. VANDENHEUVEL: Well, it's not theoretical, it's real. We've heard more of it today, rely on premiums. Well premiums don't go in the pool, they don't go through the pool. So you've got plants that have been collecting hundreds of millions of dollars from the pool, and then when milk gets short they publicly provide some premiums, we read about it in a press release from CDFA a couple of months ago, and are heralded somehow as the heroes, when they have been extracting millions of dollars from the pool previously.

And so my point was to point out the double standard. Rely on the regulations to provide us with the subsidy to allow us to pay for our milk. But when it comes to raising the regulated minimum price, those dairymen really shouldn't be going after the regulated system, they should go to the marketplace.

MR. EASTMAN: So do you feel that it's more a question of from a systemic or structural standpoint there is no way to get at those premiums? You're not opposed to the idea, you just don't think it's possible to get it, or you're just opposed to that concept all together?

MR. VANDENHEUVEL: I'm opposed to double standards, that's what I was talking about.

MR. EASTMAN: Okay.

HEARING OFFICER ROWDEN: Thank you very much. The testimony of the Milk Producers Council will be Exhibit 50.

(Exhibit 50 was received into evidence.)

HEARING OFFICER ROWDEN: The representative from Leprino Foods, please.

Please state your name and spell your last name.

MS. TAYLOR: My name is Sue Taylor, the last name is T-A-Y-L-O-R.

HEARING OFFICER ROWDEN: And for the record, you're representing?

MS. TAYLOR: Leprino Foods Company.

Whereupon,

SUE TAYLOR

Was duly sworn.

HEARING OFFICER ROWDEN: Please proceed.

MS. TAYLOR: I am Sue Taylor, Vice President of Dairy Policy and Procurement for Leprino Foods Company. Leprino operates ten mozzarella plants in the United States. Three of these are located in California, two in Lemoore and one in Tracy. We also process our whey into sweet whey or whey protein concentrate and lactose. All whey from our California plants is processed into protein concentrates and lactose.

Dairymen must be profitable over the long term to remain viable. But regulated minimum milk prices are only one of several factors that drive the level of net returns and should not be viewed as the sole solution to farm financial stress. The national supply and demand balance that drives the finished product values that determine the overall market value of milk through the regulated price. Additionally, local supply and demand balance impacts market premiums that are paid in excess of the regulated minimums. It is therefore important to recognize that a change in the regulated minimum milk price formula is not the sole source of relief for dairy farm profitability issues.

At the June 1st hearing I acknowledged that dairy producers in California, like many dairy producers in areas dominated by a purchased feed dairy model, were under financial stress after experiencing significant losses in 2009, followed by a couple of recovery years prior to what has become a negative cash flow period for many throughout this year. Producers across the country experienced similar patterns of stress and profitability at varying levels over the last several years. This stress and the associated contraction in milk supply and dairy product production nationally resulted in an increase of $0.635 per pound cheese from bottom to peak, $0.633 per pound butter, and $0.488 per pound nonfat from their lows earlier in the year based upon the weekly quotes. Consequently, Class 4a prices were $5.10 per hundredweight higher in November than in June and Class 4b prices peaked at $6.01 per hundredweight above their February low in October, before receding to $5.06 above the low in November. Blending the effects of all of the class price movements, the November overbase price for producers at $18.49, was $4.84 above the May price and slightly above the Q3 CDFA estimate of cost of production.

In addition to the milk price increases that have resulted from rising commodity prices, we have also responded to the dairy producer stress with increased premiums above the regulated price. Isolating out the protein premiums that we pay that change from month to month depending upon milk composition, the value we paid for milk in excess of the minimum regulated price in November was more than 2.5 times the level that we were paying in the spring. In short, we stepped forward with higher premiums out of concern for our milk suppliers and in the interest of ensuring that we continue to the be able to operate our California facilities efficiently. I cannot speak to other manufacturers' actions regarding over-order premiums, but it is logical to expect that competitive issues will drive other manufacturers to similarly increase payments as milk shifts to higher paying markets.

We appreciate the Department's interest in evaluating the health of the dairy production sector and the potential need for emergency price relief through the regulated system. However, we believe that the marketplace is the better venue for such price relieve and we have acted accordingly. To the extent that the Department adopts an elevated emergency price through this hearing, it simply diverts money that we are already paying into the pool, and depending upon the -- that should be instead of "into the pool," "to our suppliers." And depending upon the construct of the regulated relief and the dilution as the money is washed through the pool, reduces the milk price to our suppliers. That is a counterproductive effect. Therefore, to the extent that the Department determines that regulated price relief is warranted, we urge the Department to apply it across all manufacturing classes as proposed by Dairy Institute. Additionally, we urge the Department to apply it over a maximum of a three month time frame to minimize the disruption to marketplace responses that have already developed.

MR. EASTMAN: So it appears your position here is that there shouldn't be a change, but if there were to be a change you would suggest the Dairy Institute proposal; is that correct?

MS. TAYLOR: Correct.

MR. EASTMAN: Now the question I have is, as a purchaser of milk, as a manufacturer in the state, I know that Leprino had announced that they were going to be paying premiums. Was there a nervousness or worry about the future of your supply of milk, is that what prompted that?

MS. TAYLOR: Yeah, it was really seeing what happened to milk production in August, in recognizing that it was due to a combination of heat stress and financial stress. And we decided that in the interest of our long-term operations in California and the viability of the supply to keep them efficient we would step forward and increase our premiums.

MR. EASTMAN: Did you get a sense that you had to compete with other manufacturers to make sure that you maintained your milk supply or do you not -- do you have any sense of any competition like that happening currently in the marketplace?

MS. TAYLOR: At the time I believe we led the market. We do have competitive conditions. We are one of those manufacturers probably referenced by other witnesses that has a long-term supply agreement, we do have one. It is indexed to regulated prices but there are competitive conditions clauses, as I suspect there would be in most long-term arrangements, so that if there are players in the marketplace that adjust their premiums up our suppliers have the right to approach us and say, you are not being competitive. Our sense in August was that that had not happened. We were looking more at the overall production sector health and production trend and decided to move forward under our own motion to some extent to move forward with a higher price.

MR. EASTMAN: So do you expect then that going into the future over the next few months, going into the spring flush period of our production cycle, that that same -- you are going to be following the same sort of path with regards to how you are going to pay those premiums or do you think that once the spring flush starts that the conditions are going to change?

MS. TAYLOR: Our intent is to continue to maintain the program that we've put into place, ultimately it will depend upon competitive pressures. And if in fact on the flip side, on the unfinished product side, we become uncompetitive, then we'll have to reevaluate. But our intent is to make this a long-term change in our milk pricing program.

MR. EASTMAN: In your view, obviously as a cheese maker your class of milk, 4b along with 4a, is one of the manufacturing classes. Typically those tend to be the classes that seem to suffer the brunt of any sort of milk price decrease. You would think that based on our classified pricing structure the higher value classes, the 1, 2 and 3 that carry the higher prices, would tend to get the milk that they would need and then 4a and 4b manufacturers would sort of be stuck with what's left over. Do you find that to be an accurate statement?

MS. TAYLOR: Yes, I think that's a fair statement.

HEARING OFFICER ROWDEN: All right, thank you very much. The testimony from Leprino Foods will be Exhibit 51.

(Exhibit 51 was received into evidence.)

Next up I'd like the representative of Hilmar Cheese Company.

Could you please state your name and spell your last name.

MR. AHLEM: My name is David Ahlem, the last name is A-H-L-E-M.

HEARING OFFICER ROWDEN: And you are representing?

MR. AHLEM: Hilmar Cheese Company.

Whereupon,

DAVID AHLEM

Was duly sworn.

HEARING OFFICER ROWDEN: Please.

MR. AHLEM: Before I start I must note, I must collect a little credit. And for those of you familiar with that process, to get to follow Sue Taylor, that doesn't happen very often.

(Laughter.)

MR. AHLEM: Something must be different today than in most hearings I've been to. I didn't think that would happen at this point in my career.

My name is David Ahlem. I am the Vice President of Dairy Procurement and Policy for Hilmar Cheese Company. Hilmar Cheese Company is a cheese and whey products manufacturer with locations in California and Texas. In California, Hilmar Cheese Company processes over 12 million pounds of milk per day, more than ten percent of the milk produced in California, and purchases from over 200 dairies. Finished products are sold to over 50 countries around the globe.

Hilmar Cheese Company was formed in 1984 by a group of innovative, market-oriented Jersey 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.

I am here today to represent Hilmar Cheese Company and our dairy producer owners. Hilmar Cheese Company supports a low, regulated minimum price that allows the markets to efficiently set high market-driven prices. While we are supportive of the spirit of the Dairy Institute of California's proposal, we don't believe price increases should come through increases in the regulated price. Increases should come through the marketplace.

The Situation.

High feed prices, which are a direct result of intrusive federal policy to promote ethanol production, have dramatically changed the competitive position of producers throughout the Western United States. Those who have the ability to grow their own feed are in a much better financial position than those who purchase outside feedstuffs. The purchased feed model that was once integral to California's success is now a detriment to some and the industry is undergoing a painful adjustment to this change and we continue to see consolidation.

I think that's illustrated by somewhat stable cow numbers as well. And I would also just note when I say "Western United States." We see the same trend at our facility in Texas as well. We have lost dairy producers, actually probably twice as many cows on equivalent terms, on a smaller plant out in that region than we have in California.

Hilmar Cheese Company Supports High Market-Driven Prices.

Our company was Founded to pay more for milk. The dairymen who established this company sought to get more value out of milk and pay high market-driven prices to its suppliers. Hilmar Cheese Company continues to invest and innovate, and is a leader in returning value to dairymen in California.

California producers should continue to ask why they receive less revenue for their milk than many of their domestic and global peers. Why do producers in regions with no minimum regulated prices get more for milk, for example Idaho and New Zealand? In the end it has nothing to do with regulated prices and everything to do with supply and demand conditions and competition for milk. This is especially apparent in regions like Idaho that have no minimum prices. Market demand and competition drive value, not regulated prices.

Increases in the regulatory price will not generate more revenue for the industry. The Secretary cannot wave a magic wand and pull more revenue out of the sky. Unless driven by market fundamentals, regulated price increases are artificial and the benefits to producers will be short lived. In the end, these changes via price regulation are simply about income/revenue redistribution.

Our industry must shift our focus from debating about how the pie is sliced to what we must do to grow the revenue pie for all. We must embrace market-oriented policy that allows us to grow the value of milk for dairy producers and processors.

Market Can Respond; Minimums are Minimums, Not Maximums.

Minimum prices are just that, minimums. Nothing precludes processors from paying more and nothing prevents milk sellers from asking for more from buyers. Many California processors pay premiums to producers above the 4b price. Hilmar Cheese Company is one such example of a processor who pays market-driven premiums for milk. Since its inception, Hilmar Cheese Company has consistently paid premiums to its producers well above the 4b price.

As market conditions change, the marketplace can and will respond. Hilmar Cheese Company has already responded to concerns about the supply situation going forward. In October, we made significant proactive increases in our pay prices above and beyond the premiums that we have paid for years. And I say "proactive" because in general today looking at kind of our intake, our intake is flat to slightly above last year levels, although we did see some drop offs in the summer months in a dramatic shift from the spring. But we anticipate going forward that if things continue, that was necessary to be a leading competitor and a leading buyer of milk out there in the marketplace.

Furthermore, California cooperatives that control 80 to 85 percent of the milk in California have the ability to increase the price for milk to all of their customers tomorrow. Instead of going to the marketplace and asking their customers, processors, for a higher price, many of the cooperatives have chosen to delegate this responsibility to the Department of Food and Agriculture. This is not the intended function of the regulatory system. The regulated price should be a market clearing price, not a market making price. If allowed to function, the marketplace will drive premiums and establish value for milk above and beyond the regulated price, which often occurs today.

Increases in the Minimum Price Do Not Benefit All Producers.

Any increase in the minimum 4b price will take money away from those premium-earning producers who supply Hilmar Cheese Company. Any increase in the regulated price will not aid our producers, it will simply erode their mailbox pay prices as premiums get redistributed to others via the pool.

In the first 11 months of this year, nearly $6 million of Hilmar Cheese Company premiums were redistributed through the pool as a result of the last two 4b hearings. This means that our producers took home $6 million less than they would have if there had been no change in the 4b price. This is not $6 million that Hilmar Cheese Company had to dig deeper into our pockets and come up with, as some presume, but this money we already paid out for milk. Increases in the 4b price simply redirected milk value that was already established in the marketplace away from our producers who were supplying our facility. When the minimum 4b price increases, our premium-earning producers lose. Those who invest, innovate and perform, lose, and those who haven't invested are not required to compete.

The Big Question: Will We Pursue Regulated Solutions, or Market Solutions?

Trade organizations and cooperatives in California have been trained by our state pricing system to look for artificial ways to inflate prices. Their efforts have resulted in several milk pricing hearings over the years, with a recent emphasis on the whey factor portion of the 4b formula.

Lately, tactics have included unsuccessful litigious attempts to force the CDFA to increase the whey factor in the 4b formula and the introduction of an Assembly bill that attempts to bypass the CDFA and legislate a minimum price for one class of milk. These are all varying forms of "regulated solutions." None of these efforts contribute to increasing the market value of milk or dairy finished products. Increasing the regulatory price does not create more revenue or increase the value of milk.

As long as we continue down the track of pursuing regulatory solutions, California producers will continue to see margins erode relative to our global competitors. We will simply continue the pattern of redistributing revenue via the pool, which reduces competition for milk and shields processors from risk. We need to move toward a system that forces all market participants to compete for milk and create value. This is the only way to grow the value of milk long-term.

If we really want to grow the value of milk in California we must pursue market-based solutions. Regulatory solutions are unsustainable and will only yield more of the same poor results for producers.

Our out-of-state competitors have the ability to choose whether or not to participate in the regulated system. This is not an option in California. Minimum price increases puts California cheese processors at a disadvantage to our primary competitors in unregulated markets, both domestically and abroad.

Outside of California, most cheese and whey processors operate, or have the option to operate, outside of the confines of federal and state price controls. In these unregulated markets, our competitors are not obligated to pay minimum prices or pay for milk according to regulated end-product pricing formulas. If the Secretary increases the regulated minimum price above the market price to pursue parity with another region, we run the risk of being uncompetitive in the marketplace we currently compete. If we become uncompetitive, California will lose business to its competitors out of state who are not subject to the same constraints. The outcome will be processing facilities will move to other states, causing a further reduction in the demand for California milk.

Regulatory Uncertainty Impedes Investment.

In the past ten years we have had 26 milk pricing hearings in California, not including today's. Each of these changes significantly impacted margins and the returns for processors and producers. This frequently changing regulatory environment creates uncertainty and discourages long-term, capital-intensive investments. As some in the industry have recently noted, processing capacity, or the lack thereof, is a key issue in California. What they fail to recognize is that an uncertain regulatory environment, one with frequent hearings and legislative efforts to regulate price, do nothing to create capacity in the state. They only serve to be extremely effective deterrents to new investment. We will not incent new capacity in California as long as we continually return to Sacramento to look for regulatory price enhancements.

In this environment, is it any surprise that new investment in California has been scarce? Even if the appropriate market signals existed today, any potential investor would have put their plans on hold while they waited for the outcome of this hearing. This does not benefit a state that desperately needs additional plant capacity to create more competition for milk.

This regulatory uncertainty paralyzes the industry and increases the risk of new investment. Continuing instability will drive investment to other regions. It's time we introduce some stability into our pricing environment and allow market signals to drive investment decisions.

The Real Solution: Real Reform.

As a producer-owned entity, we believe the California dairy industry would be better served to focus on fundamental reform that moves us towards growing the value of milk over time.

As long as we remain entrenched in formula pricing, we will continue to have these contentious debates around value sharing, producers will continue to bear all the market risk, and our industry focus will be on the system and not the customer.

Instead of trying to extract value from the regulatory system, it's time we let market signals reign and turn our focus towards customers, markets and growing the value of milk. Further insulating the industry from market signals will not benefit dairymen. We need to learn to respond to the market signals and develop the skill set necessary to compete in the global marketplace.

Both the McKinsey Report and the Innovation Center's Report on Globalization concluded that there is tremendous opportunity for California and the US in the global marketplace. However, they both suggested that the industry adopt market-oriented policy initiatives and pricing reform. Both warned that failure to do so might compromise our competitive position long-term.

We are now at that critical juncture. We must choose a path. If the California dairy industry is to retain its position of strength, we must make fundamental reform. Simply tweaking the formulas will not alleviate today's challenges, but only continue to place the emphasis on regulatory solutions versus creating valuable milk-based products for customers here and abroad.

On behalf of Hilmar Cheese Company and its producer owners, I urge the state not to increase the minimum price. Further increases in the regulated minimum price are a step in the wrong direction for both processors and producers. Continuing to seek regulatory solutions in the short-term is a long-term choice. As long as we continue to avoid real reform, we will continue to see more of the same poor results. Reform can and will lead to value creation, which will benefit all industry participants over time. Now is the time to embrace a market-oriented approach and work together to capture the opportunity that exists in our global marketplace.

Thank you for your time and consideration. I would be happy to answer any questions you may have.

HEARING OFFICER ROWDEN: Panel?

MR. EASTMAN: I just have a couple of quick questions. I know in the past Hilmar, they have their own direct shippers or producers and then in the past sometimes they have also purchased milk on the spot market basis. Do you still purchase spot market milk?

MR. AHLEM: Very, very little.

MR. EASTMAN: Very little?

MR. AHLEM: Very little.

MR. EASTMAN: Is that just because you have been able to get the type of milk production you need out of your own producers, have you kind of gone towards that direction?

MR. AHLEM: Part of it is that it's wanting to be closer to our milk supply for both milk quality and animal welfare reasons. The other part is just the strategy to make sure that we have secured our supply in the marketplace so we have taken on more control of that.

HEARING OFFICER ROWDEN: Okay, thank you very much.

MR. AHLEM: Thank you.

HEARING OFFICER ROWDEN: The Hilmar testimony is Exhibit 52.

(Exhibit 52 was received into evidence.)

HEARING OFFICER ROWDEN: The next part of the hearing what we like to do is invite those folks that had signed up for three minute presentations. And I will be calling you in the order that you signed up.

Antoinette Duarte. Please state your name and spell your last name for the record.

MS. DUARTE: Antoinette Duarte, D-U-A-R-T-E.

HEARING OFFICER ROWDEN: And today you are representing?

MS. DUARTE: Representing my dairy, my husband and my son, Duarte Dairy, Inc. in Elk Grove, California.

Whereupon,

ANTOINETTE DUARTE

Was duly sworn.

HEARING OFFICER ROWDEN: Please.

MS. DUARTE: Good morning, Hearing Officer.

The Secretary, Madame Secretary Karen Ross and I and 11 other dairymen and women met here about almost ten months to the day. Our message to the Department was that we were losing equity due to the low milk prices, and particular to the 4b. At that time we had the endured economic losses of 2009. I call it the earthquake of the dairy producers.

Little did we know at that meeting we would be paying for high feed and high fuel prices at the highest level due to the drought in the Midwest. This I labeled, the tsunami, because we producers are and had been receiving $2 per hundredweight less than anyone in the surrounding states, and this has caused a collapse or a wipe-out to the dairy producers of California. All of the costs that are obtained from the dairymen that are on the cost production program don't lie. This Department sees and reviews them month after month.

We will not know what will happen this coming fall of 2013 with the corn crops. The hay prices have gone through the roof and the creditors are at bay.

Generations of dairies have gone out of business and will never return. The losses are tremendous, not only financially but the health and the mental well-being of the families that own the dairies. I doubt that my son will ever see the loans paid off that we have had to borrow to stay in business. There is not much equity left.

This business is not only our business but is our livelihood. We have four employees. They and their families are an extension of our family; we all work together. They are concerned also, not only for their job but they see the tremendous amount of stress on my son's and my face each and every day. We try to be optimistic because it helps us through the day and it helps our employees.

It is ironic because when things come up to one's attention at a time is when you need it. I did not know what to say today, for I have said it many times to you, the Secretary and the Department, not only at presses, through the TV and through the newspaper but at both rallies. But just this Wednesday night we were watching America's Heartland. The interview was focused on a gentleman who makes cheese here in California and he is a very prominent cheese maker. He mentioned time and time and time again how the feed costs have taken a hit on his bottom line and that he also had hoped he could see his son and grandson carry on the business, but he was in doubt. Large and small dairies are being affected.

My husband suffered a stroke two and a half years ago due to the stress. I do not want to see anyone else go through the same thing. It has been very difficult to see that his independence was taken away and his love for the dairymen. Just like the gentleman who spoke earlier and said that his friend had tomato juice running through his veins, we have milk running through our veins, the commitment we have to our cows.

This Department has an obligation to follow the law as we are to be paid relatively a price for our high quality milk as the surrounding states. I support the California Dairy Campaign proposal. And with all due respect, this Department has been sleeping at the wheel way too long. It is time that we are recognized for the hard work, the sacrifices and investments that we have put into our dairies for years. And I thank you for the opportunity.

(Applause.)

HEARING OFFICER ROWDEN: Thank you very much.

Loren Lopes. And you're signed up on two lists. Do you want the short list or do you want the long list? Would you rather talk long or short?

MR. LOPES: I'll talk short.

HEARING OFFICER ROWDEN: Okay.

MR. LOPES: I need five minutes, though.

HEARING OFFICER ROWDEN: That's fine. Okay, please state your name and spell your last name.

MR. LOPES: My name is Loren Lopes, L-O-P-E-S.

HEARING OFFICER ROWDEN: And today you are representing?

MR. LOPES: Dairy producer, myself and my dairy.

Whereupon,

LOREN LOPES

Was duly sworn.

HEARING OFFICER ROWDEN: Okay. Please.

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

My name is Loren Lopes from Turlock, California.

I have been in the dairy business since 1968, just as pooling was adopted.

I have been an activist for fair dairy prices that will allow the average producer to receive the cost of production and return on investment for their milk. I have been on the California cost study for over 20 years. I have served on national dairy policy committees with the National Family Farm Coalition, National Farmers Union, and most recent the Progressive Agriculture Organization to develop a cost-based pricing system, the Federal Milk Marketing Improvement Act of 2012. This proposal was supported by 65 percent of the dairy producers in a poll by *Progressive Dairyman* magazine.

The Young Act was adopted in 1935 because of producer pricing inequities in the 1930s. The Gonsalves Milk Pooling Act was adopted in 1969 because of the inequities of the pricing system through the 1950s and early 1960s. Desperate prices among producers in the same region were a source of frustration and led to disorderly marketing practices, much as it is today. Most contracts were subject to cancellation by either party upon 30 day notice. In 1969 pooling was adopted and the quota system to address the Class 1 market share. Prior to pooling the majority of producers could not cover their cost of production with the pricing system they had then. There were a few select producers that held Class 1 contracts that received a much higher price than the majority. When the majority of producers can no longer afford to supply the market, the pricing system must change or the industry will vanish. This is much like what we are experiencing today with the majority of producers underwater between the cost of producing and the price of milk.

Pooling was adopted to achieve a more equitable blend price so that the majority of producers could receive a fair break-even price and supply the markets. In the early years we had a support price that was based on parity and was set for five years at a time through the farm bill. This was the foundation or the floor price for the manufactured milk prices. The support price, along with cost of production and consumer net spendable earnings, was a part of a formula to set the Class 1 price. The parity prices were not get-rich prices by any means compared to the cost of production, however, they kept the majority of producers at break-even and the Class 1 market achieved the profitability. During this period, producers' efficiency was maximized and resulted in lower cost of production. Since that time the support price was decoupled from parity and then decoupled from the minimum price and now only serves as a floor for the basic commodity price of cheese powder and butter if sold to the Commodity Credit

Corporation. The decoupling from the minimum price has caused increased volatility and instability in the markets with lower producer profitability at a steady trend since 1990. The majority of growth in California came from tax code money, sometimes referred to as "Chino money." This put increased pressure on prices and made it difficult for producers that were just trying to make a living from just milking cows.

Prior to 1983 there was a single Class 4 price in California. With continued production growth and the need to produce more cheese the 4b pricing formula evolved through several hearings from 1983 to 1996. In 2007 a whey value was included. The 4b price formula is a very lucrative formula designed to keep the cheese processors competitive with the rest of the country. The California dairy producers have vested in the cheese processing through this formula by accepting a lower price than the Federal Order cheese milk price. The California 4b price formula has guaranteed cheese processors tremendous profitability. The profitability of the California dairy producers has continued to deteriorate and many good dairy producers have left the business through attrition because of the current end-product pricing system. There have been several hearing petitions asking CDFA to have the cheese processors vest back the in-California producers. They have refused the idea up to now. They are buying milk 10 percent below the Federal Order price and that is their focus, not producer sustainability.

From 1969 to 2009 the California pricing system is back to where it was 40 years ago with prices far below the cost of production for a continued period of time. 2009 to 2012 is the financial clinch pen for the majority of California dairy producers. Feed costs have had the biggest effect on cost because of the ethanol mandate and now the drought. The export market and globalization has been exaggerated as a cure-all for California producers. There is nothing wrong with exploring emerging markets if they are profitable for all stakeholders, including the producers. Alfalfa hay is being exported every day to China, Japan and the Middle East for developing those countries' dairy production to supply their needs. This is done by guaranteed lines of credit by those governments and ours.

The California third quarter cost comparison summary is showing an average of $18.46 a hundredweight for total costs and $19.94 with return on investment and return on management. The third quarter average mailbox price was $17.39. This was an average loss of $2.55 a hundredweight figuring return on investment and return for management.

The California September mailbox price reported by *Hoards Dairyman* was $17.36 a hundredweight.

The Wisconsin mailbox price for September by the same magazine was $20.48. This is $3.12 a hundredweight above the California September mailbox price of $17.36. This shows that there is room for an increase in the manufactured price of milk and California would still be competitive with other states.

The majority of California dairy producers will need $2 a hundredweight emergency price increase to survive the next six months. If this is not achieved more producers will be forced to exit the dairy business, and more jobs lost.

This is the time for the processing sector and the producer sector to come together for the purpose of saving the California dairy industry so both are profitable. It is the responsibility of the Secretary of Agriculture through CDFA to facilitate this task and to be fair to the producers in this very critical time.

The current end product pricing system, either in California or in the Federal Orders and the deregulated areas that mimic the two, are fundamentally flawed. Without a price floor there is no incentive for the process or the processing cooperative to raise milk prices through marketing because that will negatively affect their raw product costs and profits. So they rely on the producer to make up the margins, as they say. There is even a proposal in the farm bill for the government and the dairy producer to finance margin loss insurance. The producers' margins have been exhausted so there is no margin for the processing cost through increased make allowances. So then they go to hauling charges assessments and other disorderly marketing schemes to get the margin. With a cost-based pricing system the milk price is stable and the producer covers his or her cost and more of the marketing premiums stay with the processors or cooperative.

This must change because the system is railroading way too many people, way too many producers out of business. This financial environment is discouraging a majority of young farmers from the business and we are losing that talent. The system doesn't allow the new producer to build equity and doesn't allow the old producer to maintain equity.

I am not only here for myself but I am here for the future dairy producers, including my son and my grandchildren and their love for cows and tractors. We need to make an effort to correct these producer inequities as those did before us with the Young Act in '35 and the Gonsalves Milk Pooling Act in 1969. History will tell us that dairy cannot function without the sanction of government regulation because we have a perishable product that is produced by a living organism every 12 hours and that makes a producer vulnerable to establishing a fair price for his or her labor.

Please take this very seriously in your decision-making process to build confidence back into the California dairy industry and related support businesses.

And I'd like to say one more thing before I thank you for being able to testify. I also thank Secretary Ross for giving us access and meeting with the dairymen as much as she has. She inherited this wreck. Governor Brown has always stood up for the underdog and we are they now. So I thank her also and thank the Department for this opportunity to testify. There has been a great train robbery here, you know, out there. And I am not against anybody being profitable but this is way out of hand on who has got the money and who is losing the money and this has to be brought back into balance. So that's my testimony for today, thank you.

(Applause.)

HEARING OFFICER ROWDEN: Thank you very much. Mr. Lopes' testimony will be Exhibit 53.

(Exhibit 53 was received into evidence.)

HEARING OFFICER ROWDEN: Barbara Martin.

MS. MARTIN: Good morning.

HEARING OFFICER ROWDEN: Please state your name and spell your last name for the record.

MS. MARTIN: Barbara Martin, M-A-R-T-I-N.

HEARING OFFICER ROWDEN: And you are representing today?

MS. MARTIN: I am representing Tony Martin Dairy, which has 1,000 cows and employs 10 people. I am also representing Dairy Goddess Farmstead Cheese and Milk, which employs one full-time employee and five part-time. I am also representing my new entity, which is Dairy Goddess Pork, which is the way I manage my whey factor, making it profitable for my business.

Whereupon,

BARBARA MARTIN

Was duly sworn.

HEARING OFFICER ROWDEN: Please.

MS. MARTIN: I am here today urging you to increase the pay price that dairy farmers receive. We have been receiving nearly $2 less per hundredweight than the rest of the United States for far too long. Along with that, we have the highest costs and the highest regulations, as well as providing the highest quality of milk.

Three hundred dairy families are gone, along with another 100 this year. We have been pleading and petitioning for a year, all to be denied and delayed. All the while many dairy families have lost or are losing their generational farms and culling generational herds.

We hear from processors that we need to become more efficient. I can guarantee you this. The dairy farmers that are still in business today have become efficient, or else they would not be in business with the prices that we have been receiving, which is $2 less than the rest of the country. I would hope that our government would become as efficient as dairy farmers. We would not be on the fiscal cliff that we are standing on right now.

Have any of you ever seen a dairy farmer walk around his dairy after his cows have left for slaughter? It is heartbreaking and it is a memory that I will never forget and I pray that no more dairy families have to take that walk.

Those of us still here are fighting for our lives. Yet as we fight for our lives our main concern is to feed and care for our cows. Everything we do revolves around our animals. That is a pressure you'll probably never understand. Getting the cows fed and feeling relieved. Only then to have the burden of figuring out how you're going to cover your other bills, like payroll, electricity, fuel, insurance, environmental regulation fees. And God help us if we have a blown tire or a pump goes out. I do not wish the stress and pressure on any of you, though I would like for each of you to walk in my shoes for one day.

We dairy families rallied on the Capitol steps in

September aid October, only to be treated as a minor nuisance. It was disheartening for so many. But I am extremely proud that finally California dairy farmers and three of our major co-ops stood together as one.

I am disappointed in the actions of Secretary Ross and the CDFA. I would never expect for you to work as you do and not receive a fair wage. Yet you have sat back and watched the demise of so many dairy families, knowing that we were receiving so much less than the rest of the nation. Shame on you CDFA. Shame on you for waiting so long and hoping it would fix itself. It has done so in the past but it is not going to do so now. Shame on you for not appreciating California dairy families and all that we have contributed to California.

In March of this year was the first I had heard of the forming of a task force to fix our industry for the long term, one that I believe needs to happen. I pray for its success. But as predicted, it did not start off to be very fruitful. The one plus I see from their meeting is that Secretary Ross could see for herself the true line in the sand between the producers and the processors.

There is a dark, sinister cloud that looms in our industry. I hope that we can work to change our system for a healthy dairy industry in the future and to rid the dark forces that shadow it.

Here we are at year's end asking yet again to be given some type of relief as a result of this hearing. I urge you to act swiftly. We are hanging on by a thread and for too many it's too late.

I'd like to thank you for giving me the opportunity to speak here at the hearing. I hope you can appreciate the difficulty of this early morning meeting on the Friday before Christmas and the difficulty it is for the other producers to make it here. But I would like to thank you for having the meeting before the holiday and request your swift action, thank you.

(Applause.)

HEARING OFFICER ROWDEN: Thank you very much.

Linda Lopes. Please state your name and spell your last name.

MS. LOPES: Linda Lopes, L-O-P-E-S.

HEARING OFFICER ROWDEN: And state who you are representing.

MS. LOPES: California Dairy Women and myself.

Whereupon,

LINDA LOPES

Was duly sworn.

HEARING OFFICER ROWDEN: Okay. Please.

MS. LOPES: Mr. Hearing Officer and Members of the Hearing Panel:

I am Linda Lopes, President of the California Dairy Women Association and also a dairy producer for 45 years, from Turlock, California.

CDWA represents 180 dairy producers from Sonoma to Tehachapi. The CDWA is a unique group. We do not claim to be experts in milk pricing formulas. Most of our members are in charge of the financial business of the dairy operation. This job is getting very difficult. We have become experts in balancing the checkbook and knowledgeable in the business' income and expenses. We know that we are not covering our cost of production. We also do the shopping and are aware of the retail prices for dairy products. We know that we are not receiving our fair share of the market price.

This hearing was called to consider whether market conditions support short term price adjustments to all classes of milk. The cost of production figures calculated by CDFA for the third quarter of 2012 show it at $18.46. The average mailbox price was $17.03. At today's prices, per every 500 cows, we are losing $22,000 a month, $264,000 a year. We are all eating up equity. Equity that took years for us to build. With today's increased costs we need between $18.00 and $20.00 to catch up.

On a personal note, I have been on the cost study for over 20 years. I have been wondering if it is a waste of time because you see that we have been losing thousands of dollars and you are not doing anything to correct the situation.

We are experiencing many increased costs. As you are aware, our feed costs have increased dramatically. Environmental regulations have also increased our costs. We cannot pass these increases on to anyone. We are at the end of the line. It is not right that CDFA covers the costs of the processing side of the dairy industry but not the producer side. You might say that we must keep the processors in business to process the milk. CDFA makes the statement that there is always an adequate supply of milk. Someone will always produce the milk for less. Let us turn the table and compare it to your jobs. The State of California is in need of money. They cut your salaries by 30 percent. They tell you to survive on your equity. The Governor says he can hire someone else to do your jobs for less money. How would you like it?

The California dairy business is at this very moment disintegrating before our own eyes. I hear from many distressed dairy wives who say they cannot take this constant pressure much longer. Some of them couldn't even afford the fuel to come here today. They are looking for a ray of hope to keep their business. Thousands of cows have been sold for beef. It was not their fault, it was yours.

If we do not start covering our costs many more cows will be slaughtered. You now have a choice as to whether you will take steps to salvage it or to drive the final nail in the dairy industry's coffin. The dairy industry is not an "it" but rather a living thing composed of living animals that once dead cannot be resurrected.

California milk producers are number one nationally for production and quality. We have invested millions of dollars in our businesses to do this. Many other support businesses both small and large depend on the dairy industry to survive in their business also.

You are the ones in power in the State of California who can appeal on behalf of our industry and make the necessary changes that are needed at the state.

I know you are very knowledgeable on the dairy situation. I just feel that it is a shame that the number one dairy state for production is the lowest priced dairy state. California milk producers need an emergency price relief. I leave this problem in your very capable hands and I thank you for your time.

I'd like to add a couple of things. I would be in support of the CDC proposal.

And number two, it was brought up that dairymen that are farming make more money. Well farming more acres is advantageous but farming is not cheap. All our inputs were up.

And third, premiums that were paid out to the producers did not cover our losses, not even the ones paid by the cheese plants. And some of these processing plants have been able to go out and purchase these dairymen that have went out of business, their properties, because they have made all the money and the dairymen have lost all the money. So that's all I have to say and thank you for your time.

(Applause.)

HEARING OFFICER ROWDEN: Thank you very much.

We have two more witnesses signed up so we are going to work this thing through. So the next one up is the Marquez Brothers International representative.

One more time, if you wish to speak make sure you're signed up.

Please state your name and spell your last name.

MR. MALDONADO: Jose T. Maldonado, my last name is M-A-L-D-O-N-A-D-O.

HEARING OFFICER ROWDEN: Again, for the record, you are representing?

MR. MALDONADO: Marquez Brothers International.

Whereupon,

JOSE T. MALDONADO

Was duly sworn.

HEARING OFFICER ROWDEN: Please go ahead.

MR. MALDONADO: Thank you. Mr. Hearing Officer and Members of the Hearing Panel:

Good afternoon. My name is Jose T. Maldonado, I represent Marquez Brothers International based in Hanford, California. I have worked for Marquez Brothers for over 15 years.

Marquez Brothers International is disappointed a hearing has been called again to modify the milk price formulas. At the same time we understand and we are concerned by the very challenging situation facing many California farmers right now and that this hearing has been called on an emergency basis to assist the farmers. We would also like to point out that the last two hearings have resulted in price increases which have presented challenges to our company, specifically the limit on the value MBI can derive from the cheese and the byproducts side of our business. The frequency of these hearings are causing us great concern and hindering our ability to plan for growth. Marquez Brothers' position is to support a no change on milk price formulas. We respectfully request that no changes are made to the milk formulas. Dairymen are caught in a food price crunch right now, but that is a national problem, not just California, and raising the milk price will do little to help farmers with that and will put plants like ours at risk and thereby remove markets from California farmers' milk.

Marquez Brothers International, Inc.'s primary business focus is the manufacturing and distribution of Hispanic cheese products. Since the foundation of Marquez Brothers in 1981, we have grown our business as demand for our cheese products has expanded. Our particular cheese market demand is highly price sensitive and very competitive. We are in the business of manufacturing Hispanic-style cheeses such as Queso Fresco cheese, creams and drinkable style yogurts. The manufacturing of these specialty cheese products are highly labor-intensive, lacking the economies of scale compared to large cheddar cheese automated plants that produce 40 pound blocks.

It is important also to touch upon the whey factor in the Class 4b price, only because it has been an issue that has been the center of attention in the last several hearings and it will certainly be brought up today, like it has. Marquez Brothers reluctantly invested in a whey processing facility in 2004 in order to reduce the cost of disposing of whey. This investment cost was more than any other investment Marquez Brothers had ever made. The investment decision was driven primarily by the rising environmental concerns with the whey disposal and the cost of the whey disposal, not the projected financial return.

Furthermore, Marquez Brothers is primarily in the cheese business and investing in a whey plant was a necessary but unwanted investment decision outside of our core competencies.

With respect to making whey processing investments within the industry, it is generally acknowledged that a plant must produce at least 1.2 million pounds of whey per day in order to reach the economies of scale necessary for a whey plant investment to break even. Adoption of any 4b milk price, or changes in the 4b milk price, will result in not only small/medium size cheese manufacturers not able to recoup their investment but the extinction of California's small and medium size manufacturers.

The last two hearings have resulted in price increases which have presented challenges to small and mid-sized cheese manufacturing companies, specifically the limit on the value such as the byproducts, which is the whey in this case.

As you can see here on this graph, we had input of 12.3 total solids that comes in from the -- the solids we receive.

And we -- the output is -- that goes into the cheese is approximately 5.9 percent of the total solids going to the cheese and 6.4 percent going to the whey.

Adding those two together adds up to what we received in input from milk, 12.3.

So Graph 1 depicts that 48 percent of the total solids from the milk go into our cheese and 52 percent of our total solids go into the whey.

Of those 52 percent solids that are in the whey, 5.11 percent of that goes into the whey cream. Which in our operation we have very little -- we can't really do too much with the whey cream. We can't put it back in our product so we sometimes have to dispose of that or feed it back to the animals for feed.

WPC 80 percent represents 9.45 percent of those solids and then the Permeate/Lactose represents 85.44 percent.

It is well known that in cheese making, if one starts with approximately 100 pounds of milk you will get more or less 10 pounds of cheese and 90 pounds of whey, with a solids content of 6.4 percent before whey cream separation. Of the solids in the original milk, which is approximately 12.3 percent, roughly 48 percent of the solids end up in the cheese and 52 percent the whey, which permeate and lactose is about 85 percent of the whey solids. Basically this is recapping what I just discussed so I'm going to jump down to the last point here.

In California, out of the 57 plants that make cheese, only 11 plants have some sort of whey concentration facilities, if you see Exhibit A. Of the 11 plants that process whey, less than a handful dry permeate and lactose.

So going back to what we were discussing, we don't really -- at Marquez Brothers we don't have the capacity to dry permeate. And so that is one portion, that's an area that I think that's misunderstood a lot of the whey -- for those that manufacture whey. The WPC 80 percent, you need to have the economies of scale to actually get into and invest an additional $35 million to dry the permeate. We don't have that kind of money to invest. I don't think we could find a bank that would probably lend us that kind of money to invest. Because, first of all, that particular commodity is very volatile. It changes very -- it's not a stable commodity price.

To capture the maximum value of the whey stream it is important to have the ability to take it all the way to a dry state. Unfortunately, the installation of the whey evaporators and dryers is an extremely capital-intensive operation and subject to large economies of scale. Small and medium size cheese companies like MBI don't dry permeate/lactose fraction and don't have the ability to fund a $35 million permeate drying facility so we will be unable to capture revenues to keep up with the rising milk costs, specifically in the 4b whey component formula. We don't recoup the full value of the whey. And also finding experienced people to run this complicated equipment is no small task.

Whey evaporation and drying is governed by huge economies of scale and small- and medium-sized plants don't individually have enough whey volume to justify the expenditures. Sales and marketing expertise is critical to economic success and most small and medium cheese companies don't currently have this expertise in-house. In time when additional plant capacity is needed, the state's regulated milk pricing formula applicable to cheese plants will discourage investment in new cheese plants and WPC plants and will make it difficult for some plants to continue operations. MBI currently sells its permeate after operating costs at around .02 cents per pound of solids, versus the current price of lactose average of most at .77 cents per pound, a 97 percent price difference. So we are not recouping the -- two percent of the permeate, lactose.

According to the milk pooling data table prepared by CDFA on Exhibit A:

Thirty-three plants representing approximately, about 58 percent of the total plants producing cheese in California are processing less than 664,000 pounds of liquid whey per day, assuming 17.7 million average milk pounds per month. These cheese factories are too small to dry whey, or process whey to get whey proteins, they lose money every month on this portion of the Class 4b milk price.

Six plants representing approximately 10.5 percent of the total 57 plants producing cheese in California are processing less than 1.19 million pounds of liquid whey per day.

In other words, 49 plants, representing approximately 86 percent, approximately 86 percent of the total 57 total plants producing cheese in California are either not processing or processing less than the break even point.

Although all 57 plants would be severely financially impacted by the increase in the milk price, 33 cheese processing plants will never recover their investment and 6 other plants will break even, taking them decades to recover or see a return, if they were to build a whey plant. These plants are financially burdened when the whey market price increases dramatically or reaches certain thresholds.

Even for companies like ours that have some when processing capabilities, growth in cheese manufacturing and distribution will be severely restricted should we experience further losses in our whey business. Our experience has been that during the three to four years of our whey operations we did not see any net profits.

Cheese whey disposal has always been a burden and an environmental problem, costing Marquez about $1.5 million per year to dispose of with zero revenue value and no milk allowance in the 4b price to recover whey disposal costs over the years. I repeat, there is no real recognition for our whey disposal cost losses in the milk pricing formula.

Historically, whey powder values compared with whey protein concentrate values were similar when calculated on a price per pound of protein basis. This led us to a decision in 2004 to finance a whey protein plant only. The decision was driven by two key factors:

That the environmental problem associated with whey disposal would be alleviated and Marquez Brothers could focus more on their cheese business.

The pricing history in 2003 indicated that the revenue stream from the WPC-80 only would be similar to a whole whey powder plant and therefore justified as building a WPC-80 only plant, while disposing of the concentrated permeate as animal feed.

A I mentioned earlier, Marquez Brothers International's primary focus is on cheese manufacturing and distribution. Prior to construction of the whey plant our cost to dispose of the whey component for the years 2000 to 2005 was approximately $7.5 million, or $1.5 million per year. The whey protein plant was completed in August 2005, for an investment amount of approximately $20 million. Despite our multimillion dollar investment to alleviate the environmental problems associated with they whey, we have not seen a return on the investment. Our total loss incurred from August 2005 to 2007 mainly due to the whey component is approximately $7 million. To date, we have not yet recovered from these losses and we are years away from ROI. Why? We simply do not have enough volume.

As a result of having the whey plant, we have seen an increase in our hydraulic BOD and EC loads. This has led us to make another multimillion investment in a waste water pre-treatment plant with an operating cost of approximately $200,000 a month.

Cheese pricing at the consumer level has become much more difficult to price out to our customers because we can no longer gauge ourselves based on the CME cheddar cheese prices. The whey component distorts our margins and pricing mechanisms. The whey component factor in the 4b formula significantly increases the price of our number one raw material, which is milk, and whey prices have no correlation to the CME cheddar cheese price. However, the cheddar cheese price has a direct correlation to our cost per pound of milk and cheese. We are in the cheese business, not the whey business, and our milk cost should be based on the cheese only.

In the Federal Order, the entire value of dry whey, minus the make allowance, could potentially be generated from the liquid whey produced from cheese production is captured in the Class III milk price. In effect this means that a cheese maker is paying his producers for the value of the whey that could potentially be generated from their milk, whether or not the cheese maker extracted the value from the whey.

The producer expresses a lack of correlation of the California 4b price with the Federal Order Class III prices. This comparison is not valid. According to an article written in the *Cheese Reporter* by John Umhoefer on January 6, 2012, "If dry whey in November was worth $2.57 per hundredweight for a dairyman, where does a small cheese plant find that money?" I provided that article in Exhibit B as well.

He performed a study in Wisconsin where he determined "That income is far below the Class III value of $2.57 per hundredweight for other solids." He further states that the "plants always earn less for their wet, unprocessed whey than they have to pay out to their farms in the other solids price." The article continues to say that "one third of Wisconsin's cheese plants are swimming in red ink on the other solids price." He also states that "The only realistic hope for changing this nine-year-old mistake is recognition of this problem in the 2012 US farm bill."

Given the fact that the last two hearings have resulted in price increases which have presented challenges to our company, we support a no change in the Class 4b formula. Leaving 4b prices as is will provide margins for the cheese makers to invest in new technology to keep the plants operating, to invest funds in research and development that will lead to innovation, new products and expanded markets for cheese and milk. It will also incentivize the processor community to grow by allowing the majority of the returns to be realized by those taking the risk of the investment and increase milk processing capacity in cheese plants in a time when there is excess milk.\

In conclusion:

Changing the 4b price specifically adjusting the whey component pricing will discourage cheese plant investment and place near-term plant capacity at risk, at a time when plant capacity growth is essential to the continued health of both producers and processors. Milk producers are not contributing to the investments required to process the whey and alleviate the environmental problems associated with the whey. We want to see no change in the 4b milk price formulas unless the milk producer is prepared to contribute to capital investments required to handle the whey. We take all the risk processing the whey, producers don't. We make the capital investments in whey manufacturing facilities, producers don't. We take all the losses in the weak markets, producers don't.

In your role as regulators and policy administrators from the California Department of Food and Ag we are asking you for your assistance to leave the 4b price formulas as they are. It is not sustainable to keep adjusting the 4b milk prices and to suffer further financial losses. California cheese plants are still struggling to adapt to the changes implemented in 2011 and 2012, which to date has added $0.50 per hundredweight to the cost of milk. Compounding our problems due to the whey component in the Class 4b milk formula, we are confronting ever-higher energy, labor, resin, petroleum-based packaging materials and worker compensation costs to operate in California, which has made it much more difficult to be competitive.

Given the serious threat that continuation of the current pricing formula poses to California poses to California dairy farmers and cheese makers, a regulated system needs to have stability. Revisiting a topic that has been discussed at length numerous times over the past decade is not productive. CDFA must protect the dairy industry, and the continued modification of the 4b price is a recipe for catastrophic disaster by threatening the ability for cheese manufacturers of all sizes to continue in the dairy business. Investments will be limited, innovation will be hindered and buyers on the global scale will not view

California companies as reliable suppliers.

If an emergency price relief is passed it must be modest and of short duration.

Thank you for the opportunity to be here today.

HEARING OFFICER ROWDEN: Questions?

MS. GATES: Just one quick question.

MR. MALDONADO: Yes.

MS. GATES: Short-term duration, can you put a number to that?

MR. MALDONADO: Short-term duration?

MS. GATES: Yes.

MR. MALDONADO: I think that somebody had suggested three months.

MS. GATES: Okay, thanks.

HEARING OFFICER ROWDEN: Thank you very much.

MR. MALDONADO: Thank you.

HEARING OFFICER ROWDEN: The testimony from Marquez Brothers International will be Exhibit 55.

Also, just in case I didn't get Exhibit 54, that was from the California Dairy Women Association.

(Exhibits 54 and 55 were received into evidence.)

HEARING OFFICER ROWDEN: Okay, last on our witness list is J & D Star Dairy.

MR. VANDEN HEUVEL: Geoffrey Vanden Heuvel.

HEARING OFFICER ROWDEN: Please sit down. And make sure your mic is on.

MR. VANDEN HEUVEL: Geoffrey Vanden Heuvel. The first name G-E-O-F-F-R-E-Y, the last name, V-A-N-D-E-N, capital H-E-U-V as in Victor-E-L.

HEARING OFFICER ROWDEN: Okay. The firm again, who you are representing?

MR. VANDEN HEUVEL: I'm representing myself and my dairy.

Whereupon,

GEOFFREY VANDEN HEUVEL

Was duly sworn.

HEARING OFFICER ROWDEN: Okay. Please.

MR. VANDEN HEUVEL: I do not have a prepared statement. I am on the board of the Milk Producers Council and have served there for many years as well as many other boards. I have been involved in the dairy industry for my whole career. I started in 1979 in the dairy business. I'm a city kid. I wasn't raised on a dairy but I had the opportunity to go into the dairy business and have enjoyed it very much, the career, the people, the work, it's a wonderful, it's a wonderful life.

The California dairy industry in 1979 when I started was about half the size of Wisconsin's dairy industry. They were about 24 or 25 billion pounds of milk per year of production and we were about 12 or 11. And we built this industry through the '70s, the '80s and into the '90s, basically on a cheap feed model. Corn was $2 a bushel, they couldn't afford to grow it for $2 a bushel but they got a government check that helped keep the corn farmers alive. We bought their cheap corn and we made milk with it. And because of the weather and the innovation and capital and all the things that we have going for us in California we were able to rapidly expand and we built a tremendous industry.

We needed markets for that milk and we came up with a pretty good strategy for that too, we just discounted it. And we could go grab markets from other people by selling our milk cheap to our processors. And we trained our processors that they could buy all the milk they wanted it and buy it at a discount. It worked pretty well.

We heard a lot of screaming when we would listen from the Upper Midwest because their dairy industry really stagnated and they went through a horrible transition. In about 20 years they lost a lot of dairy families and farms in the Upper Midwest because they really couldn't compete with us.

But the worm has turned and the days of cheap feed are over. We are very frustrated. I think that those of us who, because we don't think it was a fair fight, ethanol policy, the renewable fuel standard, has great increases in the regulated demand for corn. To a point where I think the numbers I've seen is that over 40 percent of this past year's corn crop is dedicated to ethanol.

So then you just throw a little market restriction from the drought on top of it and you take the price of corn to the stratosphere. And of course that sets the price -- you know, corn competes with soybeans for acres and soybeans set protein markets and corn sets energy markets so the price of feed just skyrockets.

And what we are discovering in the marketplace is that we cannot get milk prices high enough to cover those feed costs, we just can't. We just witnessed the latest round of it here in the last few months, you know. As soon as we get that milk price up to 20 bucks or so there is just a resistance in the marketplace and it just will not sustain that.

So the question for California is, you know, what do we do? You know, the Department's regulated system, you know, the discounts are still there, and in fact they have been exacerbated on the 4b side.

And I guess, you know, what's the market telling us? As a dairy farmer I'm sitting here trying to interpret, what is the market telling me? It's basically telling me, I need to get out of business. We need to reduce the supply of milk in California because we are not competitive. And I guess the -- I'm willing to accept that, my free market side. My emotional side deals with it in a different way but my objective side says, okay.

Is it really fair to sacrifice a big chunk of the California dairy industry when the state is the one legislating a discount of this magnitude?

When I look at my balance sheet, in my experience over the last four or five years, if I was getting something close to, within 30 or 40 cents of the Federal Order prices, I have a chance to make it. But I haven't received that.

And I really think that you're really looking at the tip of an iceberg. We didn't hear a lot from dairy farmers today. And I've got to tell you, I'm torn about being too personal about this. But, you know, Rien was up here and he talked about signing loan documents. He's a lucky one, he actually signed loan documents. He got a renewal of his loan.

There's a lot of us whose loans have expired. We're basically -- we've got -- we're in limbo land with our banks. They'd like to liquidate us, they'd like to get paid back, but frankly, you know. Right now we just had two dispersals in Chino, we sold 9,100 cows in the last six days in Chino at auction. One of them I believe was pretty close to a distress-type situation, the other one was not. This family has other wealth, other assets, they were not broke, but they made a decision that it just didn't look like a wise thing to continue to be invested in California.

But that's going on all over the place. I've got relatives whose milk check on the first of December was taken by the bank, which forced them into bankruptcy. That's a very typical thing that's playing out.

If you're sitting there looking at the milk supply you don't really see it yet. By the time this whole thing will play itself out, and it will play itself out, okay. The market will correct. We will find an appropriate part -- at some point in time we'll write the history of what happened in California.

But what's in front of you today? You hold in your hand the livelihoods of thousands of people. Not just dairy farmers. I have 13 employees. All of my people -- the hoof trimmers, the soap people, the grain dealers, the hay dealers. The amount of employment and the number of families that are impacted by the decisions you make today.

And I'll tell you what we need. I mean, in terms of what we need right now, we need a little hope. And the Department has been, you know, I don't know how to say this without sounding bad but you guys have been so stubborn in your refusal to listen to the producers. And I think some of it is that, you know, we have said wolf before and then we come back and produce a lot of milk and so there is a belief that really the California dairy farmer will produce milk no matter what you pay him. So you can discount what they say.

This time is different. And what's fundamentally different is the attitude of the banking industry. We are out of equity and they are getting -- they are already executing plans to liquidate. It just takes time. They don't want all these cows rushing to the border at the same time because it's too disruptive so they're trying to find it in as organized a fashion.

But we need a little hope. And I guess the question for the Department is, are you going to give us some? Are you going to give us ten cents for the next three months, is that what you're going to do? That's a statement, we are not very valuable, you're on your own. And you know what, eventually we will --

You know, I'm hearing the major cooperatives are absolutely -- I think it was absolutely reasonable for them to have set up long-term arrangements, some of these arrangements run for many, many years. Relationships between a national dairy cooperative and a national mozzarella cheese maker that spans the country, that operates for years. These are long relationships.

When you look at the responsibility of the Department to set minimum prices, all of the right language is in there. Is the Department no longer going to recognize that language? That's really the question. It was very interesting to hear Mr. Eastman's question about, should the co-ops develop different contractual relationships? Well, is the Department no longer going to enforce the law? By your actions, you're not. By your actions you think market clearing and protecting processors is more important than protecting producers. There is no way we can avoid that conclusion. If that is in fact the case then we do need to construct our contracts differently and we are.

You know, these small cheese plants, they can make a heck of an argument, as the prior witness did. He's going to pay more for his milk, I can guarantee you. The question is, how many exited producers are going to -- how many casualties are there going to be between now and then?

And what you can impact today by your decision over the next six weeks as you contemplate this is, how much of this industry can we still salvage? We've lost a lot, we're going to lose a lot more no matter what you do. But that doesn't mean that your efforts aren't valuable. You will save some by what you do. And I plead for you to do the most that you can. Give us a chance, that's what we need. That's my testimony.

(Applause.)

HEARING OFFICER ROWDEN: Thank you very much.

One more time, is there anyone else that wishes to speak?

(No response.)

HEARING OFFICER ROWDEN: I want to thank you all for the conduct that was had at this hearing; it met the gravity of the subject.

This hearing is closed.

(Thereupon, the public hearing was closed at 12:45 p.m.)

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CERTIFICATE OF REPORTER

I, JOHN COTA, an Electronic Reporter, 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 it was thereafter transcribed.

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 27th day of December, 2012.

JOHN COTA

CERTIFICATE OF TRANSCRIBER

I certify that the foregoing is a correct transcript, to the best of my ability, from the electronic sound recording of the proceedings in the above-entitled matter.

December 27, 2012

RAMONA COTA, CERT**478