



Dairy Farmers of America

April 18, 2016

John Suther, Hearing Officer
Members of the Hearing Panel
California Department of Food and Agriculture
1220 N Street
Sacramento, CA 95814

Re: Post-Hearing Brief for the April 11, 2016 Class 4b Hearing

Dear Members of the Hearing Panel:

There are three points Dairy Farmers of America, Inc. (DFA) would like to address in this brief. The first two are in further answer to the question what facts should the Hearing Panel take into consideration when reviewing the appropriate level to set the whey contribution "scale". Also, we will make some additional comments on the specifics of the Dairy Institute proposal itself.

In response to a question asked by the Hearing Panel on considerations for reviewing the proposed changes to the whey scale, we made several suggestions at the Hearing that included:

- 1) The Hearing Panel has the obligation to review not only the testimony in light of the number of plants that might be impacted but also the volume of product impacted. Based on the table - **Pounds of Milk Processed into Cheese** provided by the Department, eight plants in the two largest volume size categories produced 83% of all cheese in the state. That statistic should logically carry over to the amount of whey produced. According to the table, six of the eight have some level of whey processing. The remaining 51 plants process 17 percent of the cheese and accordingly the remainder of the whey production in some form. There is some obligation by CDFA to give weight to the volumes of product instead of only focusing on the number of plants. The larger plants are also the plants with tremendous scale advantage in their operational costs including whey processing.
- 2) The Department's milk production cost studies that show sizable negative margins for each quarter of 2015 and based on all testimony at the hearing will continue into 2016 – and likely for most of the year. Providing additional revenue via the whey scale is the only way this hearing can impact producer revenues.
- 3) A review of manufacturing costs using well accepted data and metrics indicate that when the costs of manufacturing is reviewed in California at the regional/metropolitan level, the specific geographies where much of the dairy manufacturing takes place, is very competitive with manufacturing in other similar dairy manufacturing regions in the United States.

More Cooperative.

We would like to point out two more data points for consideration.

1) Total cheese production in California based on United States Department of Agriculture/National Agricultural Statistical Service data (USDA/NASS) indicates that since January 2007 – the point that the whey contribution process was first modified and continuing to February 2016, total cheese production in California has steadily increased growing at a Compound Annual Growth Rate of 0.8%. Chart 1 indicates that the growth rate has been on a slow but steady increase. It does follow the normal seasonal milk production curve but when converted to a twelve month moving average clearly trends up.

The Class 4b price formula has been modified 4 times since 2007 (flat 25 cents, scale 1 – top 65 cents, scale 2 – top 75 cents and the current temporary scale) with an increase at each change and all the while, cheese production has continued to increase. As noted by Dairy Institute (DI) much of the state's cheese production is owned by private firms who purchase milk from third parties, and they have the ability to decrease milk purchases if they desire. It doesn't appear that they have chosen to do so. Chart 1 and the data it displays is attached to this brief.

2) There was an implication that milk production increases in the state no matter the plant capacity available to process it. Table A-1 of the Dairy Institute's testimony – **California Milk Production and Estimated Willing Plant Capacity, January 2006 – August 2015** has been used to support this assertion at several hearings.

Admittedly, due to the seasonality of milk production, the timing of each year's flush and lowest milk supply season and the cost of carrying excess balancing capacity there are times when milk production fills and exceeds willing capacity if available capacity is near the level of milk production. But there are also times when milk production exceeds capacity deliberately as a buyer and seller plan for increased capacity to be built. This case has not been considered in the assertion that milk production expansion has been irresponsible.

New plant construction as well as significant capacity expansions can take well over a year (and many times more) to complete and the buyer wants milk for the plant once it is available to operate. The concept of building significant supply capacity **AFTER** a new plant or new capacity is completed simply does not happen. Supply contracts that accompany new plant construction/expansion carry responsibility to have milk available at the initial operation and to grow supply into the plant over time. DFA has faced this process several times in the last decade in California and in other regions of the U.S.

In the case of Dairy Institute Table A-1 it is notable that the first significant "capacity less than production" occurred in the middle to late 2007 – only a few months ahead of the first expansion phase of California Dairies' Visalia plant. Clearly a certain amount of that expansion was due to planning for the new significantly large capacity plant.

The second significant "capacity less than production" period occurred in the middle of 2008. Notably the Leprino Lemoore – West plant's last expansion began to receive milk into the expanded capacity in Q4 2009. Phase II of the CDI/Visalia plant also began operation in Q4 2009. There were ongoing plans to "increase milk supplies" for those plants. The milk price collapse in 2009 makes that difficult to

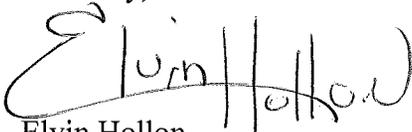
visually understand this process from the data available. The remaining points in 2012, 2013, 2014 and 2015, noticeable but smaller, would be generally marked by that years flush milk production period. It seems that the claim that milk supply increases are generally not related to the desire for additional milk supply from buyers is not well founded.

3) Finally, we want to again emphasize that regardless of whether or not it is good policy for the whey scale to be set by a relationship to whey or to WPC there is a lack of data to support a change.

- If freight allowance is somehow included in the computation, there seems to be no way that the distance that liquid whey is hauled can be equitably determined. Consider that at the 2015 hearing, the DI testimony concluded (unsubstantiated in any reasonable way) that the transport offset should be 100 miles. In the current (2016) hearing, the same testimony now states that 50 miles is the appropriate distance to be included in the proposed formula. There was no response at all to the observation that where the largest amount of whey is processed (likely at least half of the processed volume) the distance would be only a few feet. Clearly an inclusion for transport cost in the formula would be a tremendous windfall for those processors.
- There is no valid cost data for conversion costs. Also no valid way they should (or could) be measured to determine what they might be.
- There is little information available on the price of the finished product since there is no clear data on the final form that liquid WPC is ultimately marketed. A return by the liquid whey processor based on a high percentage protein final product would have a different cost to produce and different revenue from the sale than the same calculation for a lower percentage protein whey product.
- Based on the CDFA **Pounds of Milk Processed into Cheese** table even this calculation process would not result in any difference in the whey return for 38 of the 59 plants reported.

We appreciate the opportunity to file a post-hearing brief on behalf of DFA's member-owners.

Sincerely,

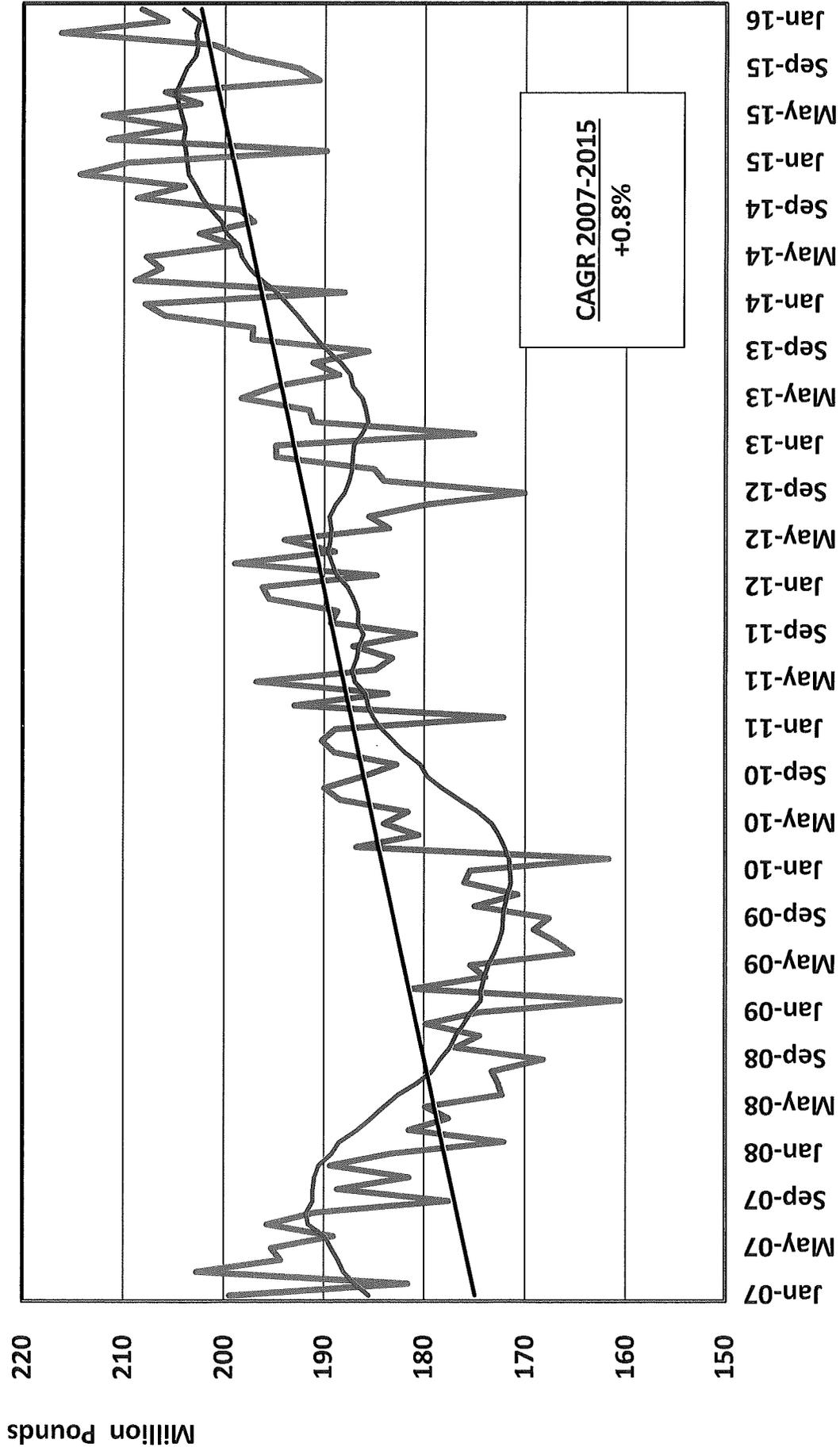
A handwritten signature in black ink, appearing to read "Elvin Hollon". The signature is written in a cursive style with a large initial "E" and a long horizontal stroke.

Elvin Hollon

Vice President Economic Analysis/Fluid Marketing

Chart 1

Total Cheese Production California by Month January 2007 - February 2015



Data - USDA / NASS