



March 15, 2012

Karen Ross, Secretary
California Department of Food and Agriculture
1220 N Street
Sacramento, California 95814

Dear Secretary Ross:

On behalf of the member companies of Dairy Institute, I am writing to request that the Department of Food and Agriculture deny the March 2, 2012 petition received from Western United Dairymen and the petition from John Moons, *et al.*, also known as the "Coalition" petition. The Department's August 22, 2011 decision (effective September 1, 2011) made significant changes in the Class 4b whey factor. It acknowledged the need to balance minimum producer prices with the wide range of cheese manufacturing, whey usage and disposal in California.

As proposed, both the Coalition and Western United petitions would result in a massive increase in regulated price at a time when milk production is growing rapidly and there is a shortage of plant capacity in the state to handle it. There are shipments of milk leaving California to find a home in other states and we are hearing that milk has been offered to calf ranches as feed. Raising the regulated milk price at this time will result in more milk being produced, not less, and will make an already difficult marketing situation more onerous. At the same time, the economic factors challenging California cheese manufacturers have not abated since the June 2011 hearing. Smaller to mid-size plants have seen their margins erode as their milk prices rose sharply after the hearing decision took effect. At least one small cheese plant has exited the business as a direct result of the higher milk costs incurred because of the last hearing decision. Even larger plants have noted in their reports to shareholders that the decision created a "regulatory challenge" to their operations.

At the same time we understand that the Department was attempting to balance the needs of the industry by increasing the price formula contribution associated with whey and increasing the Class 4b minimum price. Moreover, we acknowledged the importance of such a balance last spring when proposing a sliding scale contribution from whey. But a critical part of our and our members' testimony was that this approach be carefully measured to maintain diversity among cheese manufacturing and not jeopardize plant capacity or investment in California. Calling another hearing so soon after the most recent decision was implemented would be unwise. It would undermine business confidence in our state's industry and would jeopardize plant capacity at a time when milk production is increasing. It would increase regulatory uncertainty and evidence a lack of policy consistency that is crucial for attracting new plant investment.

While we understand producers' desire for higher prices, we believe that increasing the Class 4b price, as proposed by both Western United and the Coalition, would be detrimental to the industry. Production of cheese in California is still below the high reached in 2007, and more importantly, there is a very evident lack of new cheese plants being built in the state. At the same time, California milk production, which in 2011 eclipsed the previous record milk production seen in 2008, is growing in excess of 6% to start 2012. At the June hearing, both cooperative and proprietary manufacturers testified to concerns about a lack of adequate manufacturing capacity in the state. Those concerns are now being proven correct.

The notion that California dairymen are entitled to minimum price levels that are equal to those in federal orders was disputed by evidence entered into the record at the most recent hearing, and this evidence was noted in the hearing panel's report. California's minimum prices must be market-clearing, whereas the federal order pooling rules allow for milk to be sold to manufacturers at prices that are sometimes significantly below the minimum regulated price so that their market clears. The bottom line is that California prices for manufacturing milk classes must balance milk production and plant capacity *in California* and not be set at levels that arbitrarily reference regulated milk prices in other parts of the country with different supply and demand dynamics.

Given that neither the current nor the previous Class 4b formula has resulted in a rush of new cheese plant investment, it seems clear that the raising the regulated price as the petitioners proposed would not only forestall any new plant investment, but also would put existing cheese plant capacity at risk. The very worst policy choice when the state has already run out of room to process milk. We respectively request that the Western United and Coalition petitions be denied.

Sincerely,



Rachel Kaldor
Executive Director

Cc Sandra Schubert, Undersecretary
Kevin Masuhara, Director, Marketing Division
Candace Gates, Chief, Dairy Marketing Branch