

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

MONDAY, MAY 20, 2013

8:00 A.M.

A P P E A R A N C E SC DFA Panel

John Suther, Hearing Officer  
Senior Special Investigator

Candace Gates, Branch Chief  
Dairy Marketing Branch

Hyrum Eastman, Dairy Economic Advisor  
Division of Marketing Services

Kevin Masuhara, Director  
Division of Marketing Services

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

Erica Sanko, Agricultural Economist  
Dairy Marketing Branch

Karen Dapper  
Dairy Marketing Branch

Also Present

Joe E. Paris  
Joseph Gallo Farms

Michael Marsh  
Western United Dairyemen

Gary Stueve  
Dairy Farmers of America

Greg Dryer  
Saputo Cheese USA Inc.

Eric Erba, PhD  
California Dairies, Inc.

William Schiek, PhD  
Dairy Institute of California

Renee Peets  
Kraft Foods

Scott Hofferber  
Farmdale Creamery, Inc.

Thomas Wegner  
Land O'Lakes, Inc.

Lynne McBride  
California Dairy Campaign

Rob Vandenheuvel  
Milk Producers Council

David Ahlem  
Hilmar Cheese Company, Inc.

Emily Rooney  
Agricultural Council of California

Tom Barcellos  
T-Bar Dairy

John Clement  
Los Altos Foods

Sue Taylor  
Leprino Foods Company

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P R O C E E D I N G S

8:03 a.m.

1  
2  
3 HEARING OFFICER SUTHER: Good morning, folks. May  
4 I have your attention, please.

5 Before we start this hearing I'd like to go over a  
6 few important details that will help ensure that this  
7 hearing will be as productive as possible.

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

10 Second, anyone planning to testify in the hearing  
11 must sign in in the back of the room with Karen.

12 Third, each person has one opportunity to come  
13 forward and provide testimony for up to 20 minutes. There  
14 will be no post-hearing brief filing period for this  
15 hearing. Witnesses will be called in the order that they  
16 sign up. The time clock is on my right and has been  
17 established to assist you when testifying. You will be  
18 testifying from the chair with the microphone on the left at  
19 the end of the table there.

20 And fourth, if you want to submit an exhibit,  
21 please bring it up to me before you testify.

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

1 hearing the testimony.

2           The restrooms are outside of this room. Make a  
3 left and then they will be right on your right.

4           We will probably break for lunch around noon if we  
5 need to. And in case of emergency please exit out of the  
6 front doors.

7           This hearing will now come to order. The  
8 California Department of Food and Agriculture has called  
9 this public hearing at the Department's Auditorium, 1220 N  
10 Street, Sacramento, California, on this day, Monday, May  
11 20th, 2013, beginning at 8:00 a.m.

12           My name is John Suther. I am a Senior Special  
13 Investigator for the Department. I have been designated as  
14 the Hearing Officer for today's proceedings. I have no  
15 personal interest in the outcome of this hearing and I will  
16 not be personally involved in any decisions that may result  
17 from this hearing.

18           The Secretary has called this hearing on her own  
19 motion to consider the proposed temporary amendments to the  
20 Class 1, 2, 3, 4a and 4b prices. Specific aspects of the  
21 pricing formulas such as FOB, adjusters, make-allowances,  
22 yield factors or whey factors are not included in the scope  
23 of this hearing.

24           Specific proposals need to adhere to the scope of  
25 the hearing and may only increase or decrease the per pound

1 component prices of Class 1, 2, 3, 4a and 4b prices by a  
2 specific amount for a temporary period.

3 All parties wishing to submit information germane  
4 to the call of the hearing must submit eight copies of the  
5 information either here at the hearing or via email to  
6 dairy@cdfa.ca.gov or faxed to 916-900-5341 by the close of  
7 the hearing. Any information submitted after the close of  
8 the hearing will not be included in the record for  
9 consideration by the hearing panel.

10 Testimony will begin with a representative of the  
11 Department who will introduce the Department's exhibits.  
12 The audience may ask questions of the Department's  
13 representative only as it relates to the exhibits. This is  
14 the only witness that may be questioned by those other than  
15 the panel members.

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

20 Questioning of witnesses other than the Department  
21 representative by anyone other than the members of the panel  
22 is not permitted.

23 The hearing panel has been selected by the  
24 Department to hear testimony, receive evidence, question  
25 witnesses and make recommendations to the Secretary. This



1 HEARING OFFICER SUTHER: You may proceed.

2 MS. SANKO: Mr. Hearing Officer, my name is Erica  
3 Sanko. I am an agricultural economist with the Dairy  
4 Marketing Branch of the California Department of Food and  
5 Ag. My purpose here this morning is to introduce the  
6 Department's Composite Hearing Exhibits numbered 1 through  
7 34. Relative to these exhibits, previous issues of Exhibits  
8 4 through 34 are also hereby entered by reference.

9 The exhibits entered here today have been  
10 available for review at the offices of the Dairy Marketing  
11 Branch since the close of business on May 13th, 2013.

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

15 I ask at this time that the composite exhibits be  
16 received.

17 HEARING OFFICER SUTHER: Thank you, Ms. Sanko.

18 Are there any questions of the Department's  
19 witness regarding the Department's exhibits?

20 (Exhibits 1-34 were received into evidence.)

21 Do you have anything else to add?

22 MS. SANKO: I am also entering the following  
23 correspondence. A letter from Dairy Goddess/Farmstead  
24 Cheese dated May 13, 2013 and signed by Barbara Martin as  
25 Exhibit 36.

1 HEARING OFFICER SUTHER: Are there any more  
2 questions for the witness?

3 Okay. Could you please bring those up.

4 (Exhibit 36 was received into evidence.)

5 HEARING OFFICER SUTHER: I will now call the next  
6 witness to testify, based on the order that they have signed  
7 in. Joe Paris.

8 Mr. Paris, please state your full name, spell your  
9 last name and state your affiliation for the record, please.

10 MR. PARIS: My name is Joe, middle initial E,  
11 Paris, P-A-R-I-S.

12 Whereupon,

13 JOE E. PARIS

14 Was duly sworn.

15 HEARING OFFICER SUTHER: Do you have a witness  
16 statement or other things you would like to enter? You  
17 brought those already up here?

18 MR. PARIS: Yes.

19 HEARING OFFICER SUTHER: Okay. Are you testifying  
20 on behalf of an organization or individually?

21 MR. PARIS: I'm testifying on behalf of Joseph  
22 Gallo Farms.

23 HEARING OFFICER SUTHER: And your exhibit will be  
24 number 37, for the record.

25 (Exhibit 37 was received into evidence.)

1 HEARING OFFICER SUTHER: You can proceed.

2 MR. PARIS: Mr. Hearing Officer and Panel, Joseph  
3 Gallo Farms would like to thank the Secretary of Agriculture  
4 Karen Ross for the call of this hearing and allowing us to  
5 testify before this panel.

6 My name is Joe E. Paris. I am a -- the statement  
7 was prepared in consultation with Michael D. Gallo, CEO of  
8 Joseph Gallo Farms and is given with his approval.

9 My name is Joe E. Paris. I am a dairy consultant  
10 here on behalf of Joseph Gallo Farms. Joseph Gallo Farms,  
11 also known as Gallo Farms, is located at 10561 West Highway  
12 140, Atwater, California, 95301. Gallo Farms is a third  
13 generation dairy that is currently milking 10,000 cows. We  
14 also buy milk from two local milk cooperatives. In addition  
15 we have a cheese plant on our farm that makes cheddars,  
16 Monterey Jacks, Mozzarella, Muenster and Pasta Filata. Most  
17 of our cheese is sold under the Joseph Farms Cheese label.  
18 Gallo Farms processes over 45 million pounds of milk monthly  
19 in our cheese plant. We also employ 400 people in the  
20 cheese plants and the dairy farms.

21 Gallo Farms is here to support a continuance of  
22 the temporary class price increases that were in effect from  
23 February 1, 2013 through may 31, 2013 in their present form.

24 We are not in support of any changes in the level of  
25 increases, up or down, from where they are today in the

1 temporary class prices. We request that these temporary  
2 price increases remain in place until the Dairy Task Force  
3 has concluded their report and their recommended decisions  
4 have been placed into effect. At that time the temporary  
5 prices should be eliminated.

6 And that is the end of my statement.

7 HEARING OFFICER SUTHER: Are there any questions  
8 from the panel?

9 Thank you, Mr. Paris. Mr. Marsh.

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

12 MR. MARSH: Michael Marsh, M-A-R-S-H. I'm with  
13 Western United Dairymen.

14 Whereupon,

15 MICHAEL MARSH

16 Was duly sworn.

17 HEARING OFFICER SUTHER: And we have your -- you  
18 will be Exhibit number 38.

19 (Exhibit 38 was received into evidence.)

20 MR. MARSH: Thank you.

21 HEARING OFFICER SUTHER: You may proceed.

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

24 My name is Michael Marsh. I am the Chief  
25 Executive Officer of Western United Dairymen. Our

1 association is the largest dairy producer trade association  
2 in California, representing approximately 900 of the state's  
3 dairy families. We are a grassroots organization  
4 headquartered in Modesto, California. An elected board of  
5 directors governs our policy. The board of directors  
6 approved the position we will present here today at a  
7 special board conference call held on May 9th, 2013.

8           We would like to thank Secretary Ross for the call  
9 of this hearing. Western United has advocated for price  
10 relief at the last emergency hearing on December 20th, 2012  
11 and continues to believe that price relief is necessary.  
12 Dairy families in the state have struggled in 2012,  
13 especially in the second half of the year. 2013 certainly  
14 has not been easier, with months of milk prices remaining  
15 under the cost of production. While we appreciate the  
16 Secretary's goal of finding a long-term solution, we need  
17 dairy families to make it through these difficult financial  
18 times.

19           To expand on this issue, Western United Dairymen  
20 respectfully submits a proposal to consider amendments to  
21 the Stabilization and Marketing Plans for the Northern and  
22 Southern California Marketing Areas. Specifically, Western  
23 United Dairymen proposes a temporary price increase on the  
24 Class 4b formula, for Class 4b milk solids-not-fat, \$0.138  
25 per pound. The appropriate changes to the Plans are

1 presented in Appendix A.

2 Arriving at this position was a lengthy process  
3 that did not begin with this petition. With the fixed whey  
4 factor implemented on December 1, 2007, it was only a matter  
5 of time before prices would fall significantly out of  
6 alignment with federal order pricing. The issue became  
7 particularly apparent in 2011 as the value of dry whey  
8 started to rise. The producer community, concerned with the  
9 inequity, overwhelmingly supported change.

10 Agreeing the issue should be revisited, the  
11 Department called for a hearing on June 30, 2011. Support  
12 from dairy producer organizations and cooperatives was  
13 unparalleled - all sought changes that would bring the  
14 California 4b price in closer alignment with federal order  
15 prices. Western United Dairymen specifically submitted an  
16 alternative proposal requesting changes that would have  
17 allowed the whey value in California to track very closely  
18 to the whey value generated with the Federal Class III  
19 formula. As a result of the hearing, the Department decided  
20 to implement changes, eliminating the fixed whey factor and  
21 replacing it with a sliding scale.

22 The changes resulting from the June 30, 2011  
23 hearing and implemented on September 1, 2011 were an  
24 improvement for producers; the whey value was now allowed to  
25 fluctuate a bit. However, while Western United Dairymen

1 appreciated the modification, we believed it still fell  
2 short of a fair method to determine the whey value in the  
3 Class 4b formula. Hence, we again submitted a petition to  
4 the Department on December 2, 2011. And un the petition,  
5 Western United proposed modifying the current sliding scale  
6 in the 4b formula to allow the whey factor to more closely  
7 reflect the whey value generated by the current Class III  
8 formula. Essentially, just allowing it to work with the  
9 marketplace and allowing it to be a market-based approach  
10 rather than what we have here today. At the time, the  
11 difference between California's whey value and the federal  
12 order since the new sliding scale's implementation averaged  
13 a staggering \$1.75/cwt. California dairy families clearly  
14 needed a better way -- means to capture whey value.  
15 Unfortunately, the Department decided not to act on the  
16 matter and denied the hearing request of our association.

17           After the Department's denial, the issue remained  
18 and producer discontent intensified. Our board discussed  
19 asking for reconsideration or immediately filing another  
20 petition. We stressed the imperative of resolving this  
21 issue sooner rather than later and impressed upon the  
22 Secretary that waiting until after cost studies were  
23 completed in September 2012 would not work. Our board was  
24 not going to give up lost producer revenue and decided to  
25 petition again. Industry-wide support on the producer side

1 was evident. Lengthy discussions took place and each  
2 organization agreed on the requested changes that were  
3 argued for at the May 31-June 1, 2012 hearing. The  
4 Secretary agreed to raise the top end of the whey scale by  
5 an unfortunately very small 10 cents.

6           Following ever-increasing producer discontent,  
7 Western United decided to petition the Department again in  
8 August 2012. The objective, once again, was to bring the  
9 whey value in the Class 4b formula more in line with the  
10 whey value generated in the Class III formula. That  
11 petition also included a dry whey credit concept. The  
12 Department denied the petition on the grounds that the  
13 Secretary lacked the authority to implement such a credit.  
14 Ironically, in this absurd response to our petition, the  
15 Secretary was indicating that somehow her discretion was  
16 narrow in this regard, contrary to the argument the Attorney  
17 General would make in litigation against the Secretary in  
18 December 2012. Apparently, the Secretary seeks to have it  
19 both ways. Heads the cheese makers win, tails the farmers  
20 lose.

21           This brought Dr. Richard Pan to introduce a bill  
22 in the California legislature in December 2012. The  
23 producer community has rallied behind this bill and fought  
24 for its passage since. The price relief needed from a fair  
25 adjustment to the Class 4b formula is crucial to the

1 producer community. While we appreciate the Secretary's  
2 willingness to quickly by calling this emergency hearing, we  
3 continue to believe relief needs to come from the  
4 significant discrepancy that exists in the pricing of whey  
5 in the 4b formula.

6           Given current conditions in the industry, the  
7 years ahead will undeniably be more challenging for  
8 California dairy families. Economic and regulatory  
9 pressures are escalating in the state. Current and proposed  
10 environmental regulations have led and will continue to lead  
11 to added costs, something farmers in no other state have to  
12 deal with. Aside from this regulatory burden, costs of  
13 production on the dairy have increased significantly. The  
14 Secretary, with the appointment of the task force,  
15 understands the challenges ahead and the need for a long-  
16 term solution. In the meantime, dairy producers are facing  
17 tough economic times. If the producer is to make it through  
18 these difficult times, price relief is needed.

19           To understand why dairy families are in such a  
20 precarious situation, a little historical perspective is  
21 helpful. As everyone well remembers, producer milk prices  
22 fell significantly through most of 2009, posting an overbase  
23 price of only \$9.60/cwt. in July 2009, compared to  
24 \$17.35/cwt. the prior July. For the second half of 2009,  
25 prices slowly increased to \$14.47/cwt. by the end of the

1 year. However, prices dropped again to the \$12-\$13/cwt.  
2 range for the first part of 2010. With a statewide average  
3 cost of production of \$15.02/cwt. for the first quarter of  
4 2010, the financial situation for dairy producers was  
5 unbearable. After prices softened through the first half of  
6 the year they showed signs of improvement by the end of the  
7 summer when the August 2010 overbase price reached  
8 \$14.84/cwt. The overbase price made it all the way to  
9 \$15.94/cwt. in October. With the statewide average cost of  
10 production of \$15.13/cwt. for the third quarter of 2010,  
11 some producers were likely experiencing positive margins for  
12 a short period of time.

13           While milk prices were improving, the cost of  
14 production was also increasing. Improving dairy prices is  
15 good news, but it will take a prolonged period of improved  
16 margins for dairy producers to recover the immense losses  
17 and eroded equity that arose from the economic disaster of  
18 2008-2010. Revenues per cow in 2010 did not come close to  
19 the losses per cow incurred in 2008-2009. 2011 was an  
20 improvement but 2012 has proved to be financially  
21 challenging for many dairymen. After all the aforementioned  
22 losses, another downturn proved unbearable for many.

23           According to CDFA data, 105 dairies went out of  
24 business in 2012 alone. Just in our association membership,  
25 six additional dairy sellouts occurred in the first three

1 months of this year. In addition to these disturbing  
2 figures, reports of family dairies having filed for  
3 bankruptcy in the last 12 months are abundant.  
4 Conversations with dairy producers seeking bankruptcy  
5 protection revealed that attorneys have had a hard time  
6 keeping up with the demand from dairy producers.

7           The number of dairy farms in distress is not  
8 surprising if you take a look at financial data compiled by  
9 the accounting firm Frazer LLP. According to their latest  
10 available data, for the first half of 2012 dairies in  
11 Southern California, Kern County and the San Joaquin Valley  
12 have lost a significant amount of money with average net  
13 incomes of  $-\$2.24/\text{cwt}$ . for Southern California,  $-\$0.92$  for  
14 Kern County and  $-\$1.75$  for dairies in the San Joaquin  
15 Valley, respectively.

16           A comparison of California overbase prices to the  
17 average cost of production in California since 2001 reveals  
18 the challenge faced by producers. Production costs were on  
19 a steady upward trend until the beginning of 2009. At the  
20 same time, prices were not only volatile, but far below  
21 costs in many months. The difference between the cost of  
22 production and overbase price in 2009 is striking evidence  
23 of the catastrophe that occurred for dairy families. And  
24 please see Table 1.

25           A disturbing fact about this displayed picture is

1 the trend that stands out. Clearly, margins have been  
2 deteriorating. We have shown this chart -- we showed this  
3 chart at the December 20, 2012 hearing, and unfortunately  
4 the picture has not improved since the data was released for  
5 the fourth quarter of 2012.

6           A minimal softening in feed costs had been a  
7 notable mover in the reduction in cost of production  
8 observed from the first quarter of 2009 to early 2010.  
9 According to CDFA data, feed costs rose from just over 51%  
10 of the total cost of production in 2003 to 60% of total  
11 costs by the third quarter of 2008. Feed costs dropped to  
12 an average of 56.5% of the cost of production for the second  
13 quarter of 2010; lower, but still historically high. The  
14 slow decline in feed costs was short lived, since fall of  
15 2010, feed prices have skyrocketed and reached a record high  
16 in the third quarter of 2012 at \$12.09/cwt. This caused a  
17 record high cost of production of \$19.94/cwt. These records  
18 were soon broken with the fourth quarter 2012 data, with  
19 feed costs at \$12.24/cwt. and cost of production above  
20 \$20/cwt. Figure 2 shows the dramatic increase in feed costs  
21 experienced at the dairy.

22           In 2011, estimates from USDA reported the corn  
23 ending stocks-to-use ratio at its lowest level since '95-96.  
24 This outlook has led to dramatic increases in feed prices,  
25 further eroding already tight margins. The issue remained

1 throughout the year as feed costs represented an ever-  
2 increasing share of total cost of production, 63.9%, 64.7%  
3 and 65.3% for the second, third and fourth quarter  
4 respectively. In 2012, that percentage reached 65.4% in the  
5 third quarter and a record 66% in the fourth quarter. The  
6 significant declines in overbase prices combined with steady  
7 record high feed prices struck California dairy families in  
8 a way no one could see coming. The drought that plagued  
9 most of the US last summer, creating a never before seen  
10 feed price escalation, is a rather unusual situation. And  
11 unfortunately, we could not get the Governor of the state of  
12 California to assist us when we petitioned US EPA for  
13 relief.

14           While the latest USDA report came out somewhat  
15 bearish for corn prices, the forecast range is \$4.30 to  
16 \$5.10 per bushel for the 2013-14 season, we have to keep in  
17 mind USDA is assuming Mother Nature will cooperate. After  
18 three straight adverse growing seasons, this may be a risky  
19 assumption.

20           We reviewed the cost of production because the  
21 Department must take it into account:

22           "In establishing the prices, the director  
23 shall take into consideration any relevant  
24 economic factors, including, but not limited to,  
25 the following: (a) the reasonableness and economic

1 soundness of market milk for all classes, giving  
2 consideration to the combined income from those  
3 classes prices, in relation to the cost of  
4 producing and marketing market milk for all  
5 purposes, including manufacturing purposes. In  
6 determining the costs, the director shall consider  
7 the cost of management and a reasonable return on  
8 necessary capital investment."

9 From Section 60262 of the Food and Ag Code.

10 At the last two hearings, we testified that while  
11 production was increasing at the time, base programs had  
12 been put in place in the state to take care of potential  
13 plant capacity issues. Keeping a lower milk price in our  
14 state, we argued, would only contribute to the financial  
15 plight of dairy producers and unfortunately this is  
16 precisely what happened.

17 The impact of our proposed change would result in  
18 an approximate \$0.50 increase in the overbase price. While  
19 this is not enough to recoup the immense losses incurred in  
20 the recent past, it will not only help bridge the gap  
21 between cost of production and milk revenues; it will  
22 provide a much-needed closer relationship between Class III  
23 and Class 4b prices.

24 The temporary increase proposed for Class 4b is to  
25 get to what the producer side of the industry has been

1 advocating for almost three years, a fair pool value from  
2 cheese making revenues.

3           The changes resulting from the May 31-June 1  
4 hearing and implemented on August 1, 2012 were a minimal  
5 improvement for producers. The whey value was now allowed  
6 to reach \$0.75 instead of the previous \$0.65. However,  
7 while Western United appreciated the modification, we  
8 believe it still falls well short of a fair value for whey  
9 in the 4b formula. While we understand the Secretary  
10 believes the dry whey issue shouldn't be the only factor to  
11 look at when providing price relief, Western United  
12 continues to believe the whey factor should more closely  
13 reflect the whey value generated by the current Class III  
14 formula. The difference between California's whey value and  
15 federal orders in 2012 averaged an astounding \$1.69/cwt.  
16 California dairy families clearly need a better means to  
17 capture whey value.

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

25           When looking at 2012 data, Federal Class III has

1 averaged \$1.91/cwt. higher than 4b. The deviation between  
2 Class III and 4b prices was caused by several factors.  
3 Notably, formula differences such as different price series,  
4 CME versus NASS, make allowances, yield and formula  
5 construct, all contribute to the divergence. But the whey  
6 value is what creates the most variance between the two  
7 class prices and this is a significant concern to the  
8 members of Western United.

9           According to our analysis, since April 2007, over  
10 80% of the difference between Class 4b and Class III was  
11 attributable to the whey value.

12           More specifically, assuming the current formulas  
13 had been in place since the beginning of the year, the  
14 average difference between the whey value in Class III and  
15 Class 4b would have been \$1.75/cwt. With whey values that  
16 follow market movements in Class III and a sliding scale  
17 value in Class 4b that does not track market values capped  
18 at \$0.75/cwt., such a discrepancy was not unlikely to occur.

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

1 with this idea. Our proposed increase would result in 80%  
2 of the Class III whey value, based on 2012's average  
3 difference.

4           Additionally, we first introduced the concept of a  
5 dry whey credit five years ago to keep in mind the financial  
6 burden small cheese makers could face due to an increase in  
7 whey value. In the past, the Secretary has voiced concerns  
8 for the smaller cheese makers unable to process whey and we  
9 remain cognizant of that. Unfortunately, the scope of this  
10 hearing also prevents us from advocating for such a  
11 proposal. Needless to say, we continue to believe such a  
12 credit would be beneficial for the industry. We strongly  
13 suggest the Secretary immediate call a hearing in regard to  
14 the collection of evidence and data for a program to protect  
15 the growing segment of artisan cheese makers, or at her own  
16 discretion adopt a whey credit program that is non-  
17 discriminatory in nature.

18           The concept of pooling was created to allow  
19 sharing of revenues among producers. This is what has  
20 allowed producers shipping to different plants to get the  
21 same price for the same commodity, regardless of where they  
22 ship their milk. In any given month, depending on where  
23 class prices settle, some plants need to pay more into the  
24 pool than the average overbase price, whereas some other  
25 months they pay less. To give an example, the first month

1 of 2012, a producer shipping to a cheese plant got an  
2 overbase price of \$15.55/cwt. The cheese plant had to  
3 contribute only \$13.42/cwt. to the pool. Without the pool,  
4 the plant would have been required to pay the producer at  
5 least that minimum price of \$13.42/cwt. In 2012, the 4b  
6 price was lower than the overbase price in seven months. By  
7 not including a fair whey value in the 4b formula, Class 4b  
8 plants are not sharing into the pool like the other classes  
9 are. Producers shipping to cheese plants benefit from  
10 higher blended prices from 1, 2, 3 and 4a when the Class 4b  
11 price is lower than the overbase, but the Class 4b plant  
12 does not share the full value of what it processes into the  
13 pool.

14           The Secretary has the legal authority to implement  
15 a temporary price increase according to the following code  
16 sections, Section 61805 as well as Section 61802.

17           This concludes our testimony with one exception.  
18 If you'll turn to the final chart in our testimony, This is  
19 a chart of the whey value in the California formula plotted  
20 against the whey value of the Federal Class III formula.

21 You can see that Secretary Bill Lyons back in 2003 actually  
22 tied the market value for whey to the California 4b formula.

23       And it tracked very closely to that until, unfortunately,  
24 Secretary Kawamura in 2007 disconnected us from the  
25 marketplace. Disconnected the whey value of California's 4b

1 pricing from the market value for whey found outside the  
2 state of California. And if you were to shade in that area  
3 between the disconnected California 4b whey value and the  
4 Federal Class III whey value, that represents a billion  
5 dollars transferred. A billion dollars transferred from the  
6 producers in the state of California to the cheese makers in  
7 the state of California. This is intolerable, it is  
8 unconscionable and it needs to be fixed.

9           This concludes our testimony and I would be happy  
10 to answer any question the panel might have.

11           MR. EASTMAN: I have a couple of questions. So I  
12 just want to make sure I understand your proposal correctly.

13           As a result of the hearing last December, the temporary  
14 price increases from that hearing are going to end in May  
15 and so at that point we go back to the existing formulas.  
16 And so with those expiring then, your proposal is only to  
17 increase the Class 4b price, correct?

18           MR. MARSH: That's exactly correct.

19           MR. EASTMAN: Okay.

20           MR. MARSH: Unfortunately, the Department at the  
21 last emergency hearing put a similar increase on Class 4a.  
22 What that's created within our cooperatives in the state of  
23 California has been an extraordinary situation where,  
24 unfortunately, their prices have actually been -- for 4a has  
25 been higher than the federal Class IV. And that, of course,

1 restricts their ability to sell product into that  
2 marketplace, forcing them to build inventories or else take  
3 a loss on the inventory that they are unable to sell into  
4 the market. That was -- unfortunately, the decision that  
5 came from the Department as a result of the last hearing  
6 was, in my opinion, irresponsible in that respect.

7           And with regard to Class 1, 2 and 3. We feel at  
8 this time that when we look at, when we look at the markets,  
9 Class 1, Class 2, Class 3, Class 4a, those revenues are  
10 essentially pooled. Unfortunately, the only aberration we  
11 have with that fair pooling system is with Class 4b and the  
12 why value associated with Class 4b. That's why we focused  
13 on 4b.

14           MR. EASTMAN: And then I might have skipped this  
15 but is there a certain time frame that you feel that your  
16 proposal should extend through, a certain date or --

17           MR. MARSH: Similar with most other types of  
18 hearings, Mr. Eastman, we would -- we would appreciate this  
19 continuing until the Secretary would call another hearing  
20 and actually implement a change from another hearing  
21 sometime in the future.

22           MR. EASTMAN: And then I have one more question.  
23 I think it's page three of your testimony. You cite cost of  
24 production financial data from Frazer LLP and I noticed  
25 there wasn't anything included in your testimony. Is that

1 public data? Is there someplace where it's easily, readily  
2 obtainable online or something?

3 MR. MARSH: Yes. Would you like us to provide  
4 that to you?

5 MR. EASTMAN: Well, unfortunately we are not --

6 MR. MARSH: Oh, it's past --

7 MR. EASTMAN: There's no post-hearing briefs. But  
8 maybe you can just tell me if you have a sense of where that  
9 could be online.

10 MR. MARSH: It is publicly available but I am not  
11 sure where it is online. My brilliant economist, Mrs. Ac-  
12 Moody would know.

13 MR. EASTMAN: Is she still in the country?

14 MR. MARSH: She is still on vacation.

15 MR. EASTMAN: Those are my questions.

16 MR. MASUHARA: You indicate in your testimony that  
17 a \$0.50 increase to the overbase price would, according to  
18 your analysis, adequately address the producer situation.  
19 Is that a fair statement to make, the \$0.50?

20 MR. MARSH: No. The result of our proposal would  
21 increase the overbase price by about \$0.50 but it does not  
22 resolve the structural inequity that still exists within the  
23 Class 4b formula with regard to the value for whey. And  
24 that's really what needs to be fixed.

25 MR. MASUHARA: So you don't feel \$0.50 is adequate

1 to the overbase price to address the current situation that  
2 producers are experiencing?

3 MR. MARSH: We wouldn't be in this situation,  
4 Mr. Masuhara, if we actually had a 4b formula that tracked  
5 with the marketplace instead of being disconnected from the  
6 marketplace.

7 MR. MASUHARA: The question is, is just to address  
8 the current producer situation, to quantify a level that  
9 your analysis has indicated would address it, partially  
10 address it. So that would be fair to say, it partially  
11 addresses the current situation at \$0.50 to the overbase  
12 price?

13 MR. MARSH: We had proposed an increase to the 4b  
14 price that would result in about a \$0.50 increase in the  
15 overbase price to producers. Unfortunately, the problem  
16 that we've got is a structural deficiency, an inequity  
17 within our 4b formula with regard to the value of whey.  
18 This change and tacking on the surcharge onto 4b does not  
19 address the structural flaw inherent within the present 4b  
20 formula.

21 MR. MASUHARA: So \$0.50 isn't adequate. That's  
22 what I'm trying to get to is, did your analysis come up with  
23 some level? And then if you could describe what that level,  
24 what it can do. Can it partially address the situation  
25 that's going on, is it completely inadequate, is it halfway

1 there or 25 percent of the way there?

2 MR. MARSH: As I indicated within our testimony,  
3 what we tried to do here is to try to take something that  
4 would approximate 80% of the Federal Order whey value being  
5 included in the California 4b formula. We've tried to do  
6 that to the best of our ability, based upon the current  
7 constructs of the 4b formula. Unfortunately, this emergency  
8 hearing will not bring producers the relief they need, which  
9 is actually a revision to the 4b formula, providing them  
10 with a market-based value for whey.

11 MR. MASUHARA: And I realize that we are just  
12 talking assumptions here but you made a statement that, we  
13 don't know what the corn crop is going to do, but the  
14 previous three, if that's any indication, so we can't assume  
15 that the USDA's predictions are going to materialize. So we  
16 are just trying to, I guess, trying to make some assumptions  
17 with a little bit of quantification associated with them.  
18 So I guess that's what my question was trying to flesh out.

19 MR. MARSH: We watch the futures markets with  
20 regard to corn as well. We also watch what USDA has  
21 reported with regard to potential for the corn crop. But  
22 again, we are here at an emergency hearing. We are asking  
23 that a surcharge be adopted for Class 4b. Because all of  
24 the other classes of milk contribute fairly to the pool,  
25 with the exception of 4b. So that's why we are asking for

1 an adjustment to 4b as a result of this hearing.

2 MR. MASUHARA: Okay.

3 HEARING OFFICER SUTHER: Are there any further  
4 questions from the panel?

5 Thank you for your testimony, Mr. Marsh.

6 MR. MARSH: Thank you, Mr. Hearing Officer.

7 HEARING OFFICER SUTHER: Mr. Stueve.

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

10 MR. STUEVE: My name is Gary Stueve, last name S-  
11 T-U-E-V-E. I am here representing Dairy Farmers of America.  
12 Whereupon,

13 GARY STUEVE

14 Was duly sworn.

15 HEARING OFFICER SUTHER: You may proceed.

16 MR. STUEVE: Mr. Hearing Officer and members of  
17 the Hearing Panel.

18 My name is Gary Stueve; I am Vice President of  
19 Operations for the Western Area of Dairy Farmers of America.

20 On May 15, 2013, the DFA Western Area Council, whom I am  
21 representing, approved the position that I will be  
22 presenting today.

23 Dairy Farmers of America is a Capper Volstead milk  
24 marketing cooperative. We are a national cooperative of  
25 more than 15,000 member-owners. We market over 30% of the

1 milk throughout the US and own and operate over 32  
2 processing plants in areas that are regulated under federal  
3 orders, state orders and areas where there are no marketing  
4 orders. Within California approximately 315 farms are  
5 member-owners of DFA and our monthly marketings represent  
6 approximately 20% of the state's milk production.

7           Within California we market milk to 30 buyers in  
8 the state. We are also processors and currently operate two  
9 plants. Our facility in Hughson, California is primarily a  
10 Class 4a facility and our plant at Turlock, California, a  
11 Class 4b facility. Several of our members operate dairies  
12 in California and in states where the Federal Milk Marketing  
13 Order system administers prices. Several of our customers  
14 operate plants in California and in regions of the country  
15 within the Federal Order system. As a cooperative with  
16 members, customers and manufacturing plants operating within  
17 California and also throughout the country, DFA is well  
18 qualified to submit testimony and evidence to the Secretary  
19 on the matters of this proceeding.

20           I want to thank the Department for calling this  
21 hearing in recognition of the needs of our members and the  
22 state's dairy farmers. We also want to thank the State's  
23 Assembly Committee on Agriculture and its Chairperson, Susan  
24 Eggman, for their urging of the Secretary to reconsider this  
25 situation and communicate the legislature's concern about

1 dairy farm families' stressful margin situation. The  
2 legislature, through its hearing process, is well aware of  
3 the current margin situation and the outcome of the December  
4 21, 2012 CDFA hearing. Clearly, the Committee's concerns as  
5 expressed directly to the Secretary via letter, would carry  
6 the expectations that the result from this hearing does not  
7 simply maintain the status quo but provides additional  
8 margin relief to the state's dairy farm businesses.

9 We support the proposal as outlined by Western  
10 United Dairymen. And as I believe will be evidenced by this  
11 hearing, broadly supported by the producer community. We  
12 agree with the calculations presented by the Western United  
13 witness.

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

20 Support for the Proposal.

21 Our position and that of other producer groups is  
22 to focus this hearing request narrowly on the price  
23 misalignment between the CDFA 4b price and the Federal Order  
24 Class III price, which represents the vast majority of  
25 pricing paid by cheese manufacturers throughout the country,

1 including by several processors in California which have  
2 built a growing number of large producing plants within  
3 areas regulated by federal orders. Our position remains  
4 consistent that this relationship is out of line. For  
5 calendar year 2012 the 4b price was \$1.91/cwt. below the  
6 Class III price. For the first four months of 2013 the  
7 difference has narrowed but is still well below the Class  
8 III price by \$1.68/cwt. Based on Class 4b utilization of  
9 approximately 45%, this difference would make an additional  
10 contribution of approximately \$0.75/cwt. on the producer pay  
11 price. Our proposal demonstrate a significant compromise as  
12 it does not reflect a request for the full value of this  
13 difference.

14           There has been much testimony about this issue and  
15 the information that may be important to the Secretary in  
16 reaching her conclusion and perhaps meeting the expectations  
17 of the Legislature. We would make one key point to bolster  
18 our view that dairy farm families in California continue to  
19 experience financial devastation.

20           Farm Margins.

21           Dairy farm margins have been destroyed as  
22 strikingly shown using the CDFA published cost of production  
23 summaries. The quarterly CDFA Statewide Cost Comparison  
24 Summaries, attached to the written testimony and dating back  
25 to the third quarter 2011 and most recently Q4 2012, show

1 computations for total feed costs and income over feed  
2 costs. Adding the two figures should result in total income  
3 to the farm operation. Netting the total income against the  
4 total costs and allowances figures from the summary yields a  
5 dairy farm margin.

6           Reviewing statewide calculations show negative  
7 margins for every quarter in 2012 and the last positive  
8 margin was in Q3 2011. The next five consecutive quarters  
9 showed a statewide negative margin position. The reported  
10 margins were as follows: Q3 2011, \$1.70/cwt., Q4 2011,  
11 -\$0.33/cwt., Q1 2012, -\$1.93/cwt., Q2 2012, -\$3.19/cwt.; and  
12 Q4 2012, -\$0.25/cwt. These are the operations that survived  
13 2009 and therefore represent some of the most efficient of  
14 operators that have already maximized cost reductions and  
15 enhanced business practices. Surely the Secretary, when  
16 viewing her own cost and return data, can clearly see the  
17 situation and offer adjustments that will meaningfully help  
18 the industry deal with the current margin situation.

19           Our contention, which is backed by the  
20 Department's cost comparisons, demonstrates that milk  
21 production growth has been fueled not by positive economics  
22 but through the use of eroding farmer equity which is no  
23 longer capable of subsidizing the industry.

24           Duration.

25           There are currently other dairy industry

1 initiatives attempting to deal with both short-term and  
2 long-term pricing solutions. Our view is this hearing  
3 should yield a result that would provide price relief until  
4 such time as properly beneficial longer term changes in  
5 policies can be initiated.

6 Rationale for Proposal Choices.

7 As stated earlier, we support the details offered  
8 by the Western United Dairymen witness for focusing the  
9 proposal only on Class 4b. Our position of support is based  
10 on the consistent message that the 4b price is not properly  
11 aligned with the nationwide price surface. Our request will  
12 recognize approximately 80% of the value of that difference,  
13 which is a significant compromise on the part of the  
14 California producers who must compete with dairymen across  
15 the US.

16 Proposal.

17 Following the format prescribed in the hearing  
18 notice our proposal for Article III, Section 300, paragraph  
19 H, is as follows:

20 (H) The minimum prices for components used for  
21 Class 1, Class 2, Class 3, Class 4a and Class 4b, as set  
22 forth respectively in Paragraphs (A), (B), (C), (D) and (E)  
23 of this Section, shall be increased by the following  
24 amounts:

25 You can see in my written testimony that I

1 provided that Sections (1), (2), (3) and (4) comprised of  
2 Class 1 milk fat, Class 1 milk solids-not-fat, Class 1 milk  
3 fluid carrier, Class 2 and 3 milk fat and milk solids-not-  
4 fat would represent no increase.

5 Section (5) would be revised to read: "For Class  
6 4b milk solids-not-fat, thirteen and eight tenth cents or  
7 \$0.138 per pound.

8 Impact.

9 Our proposal would have the following impacts:

10 Class 1 prices would not be increased.

11 Class 2 prices would not be increased.

12 Class 3 prices would not be increased.

13 Class 4a prices would not be increased.

14 Class 4b prices would be increased approximately  
15 \$1.20/cwt.

16 The producer price pool impact of these changes  
17 would be an approximate increase of \$0.54 more per cwt.

18 Again, I would like to thank you for the  
19 opportunity to testify today. I would be happy to try to  
20 answer any questions the panel may have.

21 MS. GATES: Mr. Stueve, I have one question. With  
22 your proposal to support all of the increase being on Class  
23 4b how does that impact your 4b plant in your organization?

24 MR. STUEVE: It would impact it the same as it  
25 would any other 4b plant if our proposal went through. We

1 would pay the \$1.20 -- our plant would pay the \$1.20  
2 additional just like any other private plant would so it  
3 would have the added costs.

4           The way we operate our plant, our cheese plant is  
5 part of a division within DFA that includes other cheese  
6 plants across the country so we would price the milk locally  
7 at that, at that higher level. We firmly believe, because  
8 we have done enough work in this, that the plant would  
9 continue to be viable and profitable, even at that level.

10           MS. GATES: Okay, thank you.

11           MR. EASTMAN: I have a couple of questions for  
12 you. On page three you mentioned, you talk about farm  
13 margins for the available data that the Department has  
14 released and at this point the Department only has released  
15 cost data through the fourth quarter of 2012. Do you have  
16 any sense into 2013 based on your experience, what you're  
17 seeing with your members and your cooperative, what sort of  
18 margins they're experiencing or any sort of levels or  
19 numbers at all?

20           MR. STUEVE: Yeah. I don't think I have specific  
21 numbers. I mean, I think it's possible that when we look at  
22 the first quarter that there will be some margin  
23 improvement, given the fact of where milk prices are and  
24 some possible lowering of feed costs. But I don't have any  
25 data that would suggest an exact number but it's possible

1 there was some improvement.

2 MR. EASTMAN: And then you mention that for the --  
3 for your proposal, when it comes to the duration of the  
4 increase on the Class 4b price, it's a little vague in terms  
5 of how long it should go forward. Is there some particular  
6 event that would help define when it would end? I know you  
7 mention the legislation that was heard by the Assembly Ag  
8 Committee. They appear to be looking for short-term  
9 solutions and long-term solutions. So do you feel this as a  
10 short-term solution should extend until the task force  
11 called by the Department is able to gain traction or come up  
12 with some medium- or long-term solutions or is there maybe  
13 some other defining event that would help indicate when your  
14 proposal should end?

15 MR. STUEVE: I don't think there is one specific  
16 defined event. When we talk about different initiatives  
17 that are going on it includes legislation, it includes  
18 suggestions from the Dairy Advisory Committee, the  
19 Secretary's own task force. So I don't think we have a  
20 defined event in mind. The Assembly bill certainly would  
21 provide some relief as well but I don't think we have one  
22 specific event in mind.

23 And I think as Mr. Marsh mentioned, the calling of  
24 hearings, which is something that we see a lot of,  
25 represents an avenue for change down the road as things

1 progress. Whether called by industry or called by the  
2 Secretary.

3 MR. EASTMAN: Got you. If the Secretary,  
4 hypothetically, were to adopt your proposal and supposing  
5 that the California Legislature were to pass some version of  
6 the bill that deals with this topic at hand, when that bill  
7 were to become effect do you think that's when maybe price  
8 relief would end, based on your proposal? Would that be an  
9 acceptable event?

10 MR. STUEVE: I think we'd have to continue to  
11 evaluate it going forward, whether this relief is something  
12 that has some permanence. Whether it came through this  
13 proceeding or through the legislative process I think we  
14 have to continue to evaluate whether that was viable going  
15 forward.

16 MR. EASTMAN: Great. And then when I was looking  
17 at milk production data for the state for 2013, obviously  
18 milk production is down compared to last year where we had a  
19 very strong beginning to the year. But when you compare  
20 milk production this year in 2013 to say, the prior year in  
21 2011, we seem to be above that level up to this point for  
22 the data available. Do you see, are you having any problems  
23 handling your milk supply? Are you having to enforce any  
24 sort of production bases or any sort of production levels by  
25 your members?

1           MR. STUEVE: We have not implemented any  
2 production controls or supply management on our members this  
3 spring. I am not aware if the others have or not, I don't  
4 believe they have, but we have not. I think it's important  
5 to point out too, when we talk about capacity, that to some  
6 degree, as marketers of milk we expect to have challenges in  
7 the springtime. It is probably more pertinent to talk about  
8 capacity and production on a year-round basis. But milk  
9 production is fairly strong. We have not implemented any  
10 supply management options within our program.

11           MR. EASTMAN: Do you have any sense -- obviously  
12 it's impossible to predict the future but do you have any  
13 sense of how milk production is going to go for your  
14 organization here in California as we head into the summer  
15 and then the fall when milk supplies obviously are in their  
16 cyclical low point?

17           MR. STUEVE: Well, I think for us there is no real  
18 way to predict exactly where milk production is going. For  
19 us we think we're peaking right about now. Everybody has a  
20 little bit different peak time. We think we are peaking  
21 right about now. It much depends on the weather as well.  
22 We have had years where -- in fact, I think 2011 was a  
23 summer that really we didn't have much heat until late, late  
24 in the summer; last year we had a hotter summer. So the  
25 weather will play an impact, it's impossible to tell where

1 we're going there.

2 We also, and I can only speak for DFA. We have a  
3 situation where we would like to, if we can, bolster our  
4 milk production somewhat because we have opportunities at  
5 the end of the year, new demand capacity coming on at the  
6 end of the year. So we may be in a little bit different  
7 position than others.

8 MR. EASTMAN: With regards to new demand that you  
9 just mentioned, are you referring to your plant that is  
10 being built in Nevada?

11 MR. STUEVE: Yes, yes.

12 MR. EASTMAN: That's all my questions.

13 MR. MASUHARA: Similar to what I asked of Western  
14 United. The current increase you're asking for, do you feel  
15 that's adequate, do you feel it's inadequate and could you  
16 quantify it at any level?

17 MR. STUEVE: I don't think that we have a specific  
18 number out there that we would define as adequate. But we  
19 would say that the -- and we are estimating ours at around  
20 \$0.54. It does not represent everything that the producers  
21 need or require to be viable going forward. But it's a  
22 start.

23 And I think we mentioned, I think a couple of  
24 times in our testimony, that it does represent a compromise  
25 on our point. I am only asking for 80% really of the

1 federal order whey value, still far behind where producers  
2 are in other parts of the country. So I would say that  
3 \$0.50 is not completely where we need to be by any stretch  
4 but I don't have a defined quantitative number above that.

5 MR. MASUHARA: And similar to that because you're  
6 proposing to take away the increases on 4a that have been in  
7 effect the past few months. For your powder operations or  
8 for your 4a end usage have you been severely impacted on a  
9 competitive basis or has it been a moderate impact? How  
10 would you characterize the past few months?

11 MR. STUEVE: I would say our impact to what you  
12 may hear from some of the large powder producers later. I  
13 don't know what they are going to testify to. But we are  
14 such a small player in 4a. Our plant at Hughson is a drying  
15 plant but it is a very, very small drying plant compared to,  
16 really, any of the large dryers in the state. We have had  
17 an impact that has been minimal only because the size is  
18 minimal.

19 MR. MASUHARA: That's all I have.

20 HEARING OFFICER SUTHER: Any further questions of  
21 Mr. Stueve?

22 Thank you for your testimony, Mr. Stueve.

23 Mr. Dryer, please.

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



1 time for the Secretary's Dairy Future Task Force to develop  
2 a more permanent solution to California's outdated milk  
3 pricing system.

4           Anything beyond six months could not reasonably be  
5 considered "temporary." Farm economics are forecast to  
6 improve markedly this year and it is unlikely the need for  
7 relief be for a higher amount or extend beyond six months.  
8 If conditions change the issue, of course, be revisited in  
9 six months.

10           Clearly, California's existing end pricing system  
11 is no longer sustainable. The Dairy Future Task Force has  
12 been charged with the responsibility to design a system that  
13 allows stakeholders to succeed and take full advantage of  
14 opportunities presented by the burgeoning world market.  
15 Hopefully, the new California system will become the model  
16 on which the federal system is based.

17           California held promise of a nationally and  
18 internationally competitive milk supply from large, modern,  
19 efficient dairy farms. Those advantages still exist today.  
20       Recent economic conditions dating back to 2009 have clearly  
21 shaken California dairy farmers but they are not a result of  
22 the California milk pricing system. If that were true, the  
23 problems would not be manifest in so many other states and  
24 countries. Many states have lost more dairies this year,  
25 not only in numbers but also as a percentage of their total

1 dairy farms. This is a direct result of feed costs reaching  
2 record levels. In spite of difficulties, California  
3 continues to produce a quantity of milk sufficient to  
4 satisfy local demand.

5 The solution to these issues will come from all  
6 the state's stakeholders working together in a constructive  
7 fashion.

8 Endless hearings, legislative efforts and lawsuits  
9 in an attempt to mandate a higher regulated price only  
10 create uncertainty that benefits no one. Attempts at  
11 shifting the burden from one segment of the industry onto a  
12 single class of milk buyers is not only unfair but is not  
13 viable. At the end of the day, the free market will  
14 prevail.

15 Please extend the existing temporary relief for a  
16 period of no more than six months. That concludes my  
17 testimony.

18 MS. GATES: Mr. Dryer, just to clarify for the  
19 record. You would like to extend what is currently in place  
20 right now until the end of the month on all Classes, 1, 2,  
21 3, 4a and 4b correct?

22 MR. DRYER: Yes, exactly as it exists today.

23 MS. GATES: Thank you.

24 MR. EASTMAN: I have a question. How has the  
25 temporary price increases that are currently in place

1 affected your operations in your competitive marketing of  
2 your products?

3 MR. DRYER: You know, we have seen our costs over  
4 the course of the last few years increase about \$0.80/cwt.  
5 Which is small from the perspective of the issues facing the  
6 dairy producers but it's a big burden to a cheese  
7 manufacturer dealing in a very low margin business. So, you  
8 know, in cheese that represents \$0.08 a pound, which is a --  
9 it's a big, it's a big number to us.

10 MR. EASTMAN: So in terms of marketing your cheese  
11 then, is there still a margin available for you to manage  
12 through that as indicated by the fact that you want to  
13 extend the temporary price increases or are you leveraging  
14 your national and international presence to make that work?

15 MR. DRYER: The reason we're supporting it is  
16 because the Dairy Institute, which represents us, in  
17 discussions with the Legislature made the commitment to do  
18 that, so we are willing to stand behind that commitment.

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

21 MR. DRYER: Thank you, sir.

22 HEARING OFFICER SUTHER: Mr. Erba.

23 To clarify for the record, Western United is  
24 Exhibit 38, Mr. Stueve's testimony is Exhibit 39,  
25 Mr. Dryer's testimony is Exhibit 40 and Mr. Erba's testimony

1 will be Exhibit 41.

2 (Exhibits 39-41 were received into evidence.)

3 HEARING OFFICER SUTHER: Please state your full  
4 name, spell your last name and state your affiliation for  
5 the record, please.

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

8 HEARING OFFICER SUTHER: You may proceed.

9 DR. ERBA: Thank you.

10 Mr. Hearing Officer and members of the Panel:

11 Good morning. My name is Eric Erba and I hold the  
12 position of Senior Vice President and Chief Strategy Officer  
13 for California Dairies, Inc., whom I am representing here  
14 today. California Dairies is a full-service milk processing  
15 cooperative owned by 430 producer-members located throughout  
16 the state of California and collectively producing almost 18  
17 billion pounds of milk per year, or 47% of the milk produced  
18 in California. Our producer-members have invested over \$500  
19 million in large processing plants at six locations, which  
20 will produce about 400 million pounds of butter and 800  
21 million pounds of powdered milk products in 2013. On May  
22 15, 2013 the Board of Directors for California Dairies  
23 approved the concepts contained in the testimony that I will  
24 be presenting here today. California Dairies' proposal is  
25 consistent with the guidelines given in the Food and

1 Agricultural Code, Division 21, Part 3, Chapter 2, starting  
2 with Article 1 and including Article 9 that discusses  
3 establishment of minimum prices.

4           We thank the Department for calling this hearing,  
5 this milk pricing hearing and allowing us the opportunity to  
6 present our proposal to change the Class 4b milk pricing  
7 formula. Our proposal will bring equity to the price of  
8 milk used in cheese processing and will also provide  
9 California dairy producers the relief that they need.

10           Several witnesses testified at a hearing held just  
11 five months ago that California dairy families were under a  
12 great deal of financial stress, with some unable to achieve  
13 a margin sufficient enough to remain in business. This  
14 situation has not changed. Feed costs remain high and dairy  
15 farm margins hover near historic lows. What has also not  
16 changed is the disparity between the California Class 4b  
17 price and the federal Class III price. Figure 1 shows the  
18 result of subtracting the Class III from the Class 4b price  
19 over the past five years. For comparison and reference the  
20 market price for dry whey is overlaid on the graph. The  
21 trend is clear enough - since the Department abandoned the  
22 end product pricing approach used to value whey in the Class  
23 4b formula, the difference in the two class pricing series  
24 has grown. The class price difference has averaged  
25 \$1.13/cwt. since January 2007 and has averaged \$1.22/cwt.

1 since December 2007 when the Department instituted a \$0.25  
2 fixed factor in place of the end product pricing formula  
3 used to capture the value of whey in the Class 4b formula.  
4 On the chart the dashed vertical line indicates this data.

5           As might be expected, the financial pressures are  
6 having an effect on milk production. We can verify that  
7 California Dairies has experienced a drop of 5% in member  
8 milk production compared to last year. This is not a huge  
9 surprise after losing 32 dairies in 2012 and hitting our  
10 lowest daily average since 2005, an ignominious benchmark  
11 reached in September of 2012. For a full-service milk  
12 marketing cooperative with customers throughout the world,  
13 these milk production statistics are unnerving. We are  
14 beginning to question how well we will be able to follow our  
15 various milk and dairy product marketing plans if milk  
16 production continues to fall well below our projections.

17           We recognize that attempting to achieve a milk  
18 price high enough to erase the financial losses sustained by  
19 producers as a result of inappropriate whey valuation and  
20 high feed costs is problematic for both producers and  
21 processors in California. We have chosen not to take that  
22 course of action. Instead, we are proposing what we believe  
23 represents a solution to the milk pricing inequity that can  
24 be justified based on milk prices in surrounding states and  
25 the market conditions facing the dairy industry. We also

1 note that our proposal is very closely aligned with AB 31,  
2 the legislation that is being considered that would increase  
3 the whey portion of the Class 4b price to be no less than  
4 80% of the federal milk marketing order value for whey.

5 Proposal from California Dairies:

6 The hearing notice issued May 1st set forth the  
7 guidelines for proposals that will be considered at this  
8 hearing. California Dairies' proposal was designed to  
9 follow the format found in Article III, Section 300,  
10 paragraph (H) of the Stabilization and Marketing Plans for  
11 Market Milk for the Northern California and Southern  
12 California Marketing Areas. The language found in paragraph  
13 (H) shall be replaced in its entirety with the following  
14 language:

15 "The minimum prices for Class 4b milk solids-  
16 not-fat, as set forth in Paragraph (E) of this  
17 Section shall be increased by thirteen and eight-  
18 tenths cents (\$0.138) per pound."

19 As proposed, the projected effect would be to  
20 increase the Class 4b price by about \$1.20/cwt. The  
21 proposal was also projected to increase pool prices by  
22 approximately \$0.52/cwt., if adopted and implemented.

23 The Class 4b component bears the entire milk price  
24 increase for two major reasons. First, a primary objective  
25 was to present a proposal that is consistent with the

1 message that has been brought forward by the introduction  
2 and subsequent discussion of AB 31. That legislation would  
3 increase the whey portion of the Class 4b price to be no  
4 less than 80% of the federal milk marketing order value for  
5 whey, which is approximately \$1.20/cwt.

6           Second, when making class-by-class comparisons of  
7 California milk prices with those in other milk marketing  
8 orders, only one class of milk stands out in the comparison  
9 as not being at all close to its federal counterpart and  
10 that's Class 4b. While California prices do not have to  
11 match milk prices found in other milk marketing orders, the  
12 prices ought to be reasonably close. Allow me to run  
13 through some of the differences.

14           For milk that is used to produce butter and milk  
15 powders, the California price has averaged \$0.27/cwt. less  
16 than the federally announced price since 2011.

17           For milk that is used for fluid purposes, the  
18 Southern California prices averaged \$0.52/cwt. less than the  
19 Arizona Order's announced price and the Northern California  
20 price has averaged \$0.34/cwt. less than the Pacific  
21 Northwest Order's announced price.

22           The Southern California Class 2 price has averaged  
23 \$0.42/cwt. less than the federal Class II price, and the  
24 California Class 3 price has averaged \$0.70/cwt. less than  
25 the federal Class II price.

1           I suggest that for those price comparison, an  
2 acceptable level of price difference between California  
3 prices and federal order prices is demonstrated. However,  
4 when comparing the announced price for milk used to make  
5 cheese, the California Class 4b price has averaged  
6 \$1.96/cwt. less than the federal Class III price for the 27  
7 month comparison period. The reason for the enormous  
8 difference is easily identified. A simple statistical  
9 analysis reveals that almost 80% of the change in the  
10 difference in the two milk price series is explained by the  
11 change in the value of dry whey. This phenomenon is a  
12 function of milk pricing formula construct regarding the  
13 valuation of whey and can be remedied easily by adopting  
14 California Dairies' proposal.

15           I will make one final point in support of  
16 California Dairies' proposal. Recently, California Dairies  
17 received the results of a study that reviewed the potential  
18 impacts of a federal milk marketing order in California.  
19 We, along with Dairy Farmers of America and Land O'Lakes,  
20 co-funded the study conducted by Drs. Mark Stephenson and  
21 Chuck Nicholson. The study identified the large Class 4b-  
22 Class III price spread as being problematic and suggested  
23 that a manufacturing differential on the Class III price  
24 could resolve the problem of higher milk prices while  
25 simultaneously encouraging pool participation by cheese

1 plants. The level of the differential is about \$0.70/cwt.  
2 In other words, the study suggested that the California  
3 price for milk used for cheese ought to be \$0.70/cwt. less  
4 than the federal price. That \$0.70 differential is  
5 approximately the same as what was represented in AB 31 and  
6 is about the same as the \$1.20/cwt. increase in the Class 4b  
7 price that we are proposing today.

8           Concerns About Increasing the Class 4a Price:

9           At the December 2012 hearing, I explained why  
10 increasing the Class 4a price as a means of achieving a  
11 higher price was fraught with problems. And yet, in the  
12 Department's decision, both 4a and Class 4b were increased  
13 by the same amount at \$0.30/cwt. I feel compelled to  
14 reiterate the caution for increasing the Class 4a price and  
15 will provide a numerical example that uses the December 2012  
16 hearing results to underscore the point.

17           Because nearly all butter and powder processing  
18 facilities are owned by producers and not by proprietary  
19 companies, increasing the Class 4a price only functions to  
20 redistribute money from the producers who have made  
21 investments in butter and milk powder processing facilities  
22 to those producers who have not. This is entirely counter  
23 to the concept of increasing milk prices to provide  
24 equitable milk price assistance to all producers. The  
25 higher the increase in the Class 4a milk price the less

1 equitable the milk price assistance becomes. From the  
2 perspective of a CDI member, this caution appeared to be  
3 largely ignored when the Department issued its decision.  
4 Basically, CDI members will net only about \$0.07/cwt. more  
5 in their milk price as a result of the December 2012 milk  
6 price hearing. The reason is that CDI members will have had  
7 to give back about \$0.18/cwt. of the \$0.25/cwt. in the form  
8 of higher prices paid by their cooperative for milk  
9 processed into butter and milk powders. In contrast, a  
10 producer who does not belong to a processing cooperative and  
11 has no investment in processing capacity will receive the  
12 full \$0.25/cwt. price increase.

13 Our Negotiated Offer to Cheese Processors.

14 At some point during the discussions and  
15 negotiations that have taken place over the last three  
16 weeks, there was mention of the benefits of negotiating a  
17 compromise between the producers and processors to be  
18 presented jointly at this hearing. Using information passed  
19 along to us, California Dairies made a good-faith effort  
20 last week to develop a proposal that achieved middle ground  
21 in the discussions, that is to say, one that recognized and  
22 satisfied the positions of both producers and processors but  
23 required concessions from both sides.

24 The proposal had basically two tenets. First, all  
25 of the pool value increase from the December 2012 hearing

1 decision would be borne entirely by Class 4b. This would  
2 mean that the Class 4b price would need to increase by about  
3 \$0.60/cwt. Second, the sliding scale used to value whey in  
4 the Class 4b formula would be restructured to result in a  
5 new ceiling of \$1.00/cwt. contributed to Class 4b,  
6 achievable at current market prices for whey. In  
7 combination, the changes would increase the Class 4b price  
8 by about \$0.80/cwt. and pool prices would increase by about  
9 \$0.35/cwt. Clearly, this proposal represented a significant  
10 concession from the position we have adopted for today's  
11 hearing. The fact that this proposal is not being presented  
12 jointly by producer and processor representatives tells the  
13 story - our proposal to find middle ground was not accepted.  
14 Consequently, California Dairies' proposal is aligned with  
15 the proposals being made today by other producer groups.

16 Some Concluding Remarks.

17 At a time when so many California dairy farmers  
18 are struggling to survive, the widely advertised disparity  
19 between whey valuation in federally regulated milk marketing  
20 orders and in California is difficult to understand and even  
21 more difficult to accept. We are mindful of the industry's  
22 efforts to create a foundation for a stronger and more  
23 viable dairy industry through the work of the Dairy Future  
24 Task Force. Dairy producers and California Dairies  
25 understand their obligation to be engaged in the process.

1 However, dairy producers, including members of California  
2 Dairies, need to survive in the short-term first. Our  
3 proposal mirrors the Class 4b pricing formula adjustment  
4 found in AB 31. We believe our proposal provides a  
5 reasonable and actionable method to achieve milk price  
6 equity and to bridge the financial gap from where California  
7 milk prices are today and where they will need to be in the  
8 future to prevent further attrition on the producer side of  
9 the California dairy industry.

10 Thank you for your attention. I am happy to  
11 answer any questions you might have.

12 MR. EASTMAN: I have a few questions for you,  
13 Dr. Erba. On page four of your testimony you mentioned a  
14 study that was -- that is being conducted by Drs. Stephenson  
15 and Nicholson that is reviewing the California industry.  
16 You make some mention of some of what their thoughts are as  
17 a result of the study. I don't see the study attached to  
18 your testimony; is that study eventually going to become  
19 publicly available? Is that something that is going to be  
20 kept close to the vest or how do you see that?

21 DR. ERBA: That study was co-funded by the three  
22 co-ops. At this point there is no talk of releasing the  
23 results of that study publicly. I've mentioned just one of  
24 the small things that they found from that study. I suspect  
25 that over time we will be able to discuss that more

1 publicly, but for now we are not planning to release that in  
2 any public setting.

3 MR. EASTMAN: Are there any other conclusions that  
4 they made that would be more comprehensive? I guess one of  
5 the concerns I would have is by not seeing any of the  
6 results of what their study shows, you've picked out one  
7 part of it, I am just curious if -- or concerned there could  
8 be other aspects that are -- more conclusions they have  
9 reached that are more comprehensive that kind of point to  
10 the entire industry compared to just one portion of it or  
11 one point that you are making here in your testimony.

12 DR. ERBA: Right. You pointed out that the study  
13 is very comprehensive and obviously this was not the point  
14 of the study. The study was focused on something entirely  
15 different, this was something that came out of the study.  
16 At this point I think I'll just leave the conclusions as  
17 what I've said here in the testimony.

18 MR. EASTMAN: Okay. Obviously last year, I have a  
19 similar question of one I asked the representative from DFA.  
20 Milk production is obviously down this year compared to  
21 last year because last year we had such strong production  
22 during the spring flush, the first half of the year. But it  
23 appears, based on the data available, our milk production  
24 through the first few months of this year actually exceeds  
25 slightly what we were experiencing in 2011. If I remember

1 correctly, you had some concerns back in 2011 with regards  
2 to the amount of milk we were producing. You felt that  
3 although you were able to handle it more or less you felt we  
4 were close to a tipping point or close to having concerns,  
5 you were close to having concerns. How do you view the  
6 current milk supply right now, the way you're handling it?  
7 Are any of your production bases in force, et cetera?

8 DR. ERBA: Our production base never goes out,  
9 it's always in, it's just a matter of are there any  
10 penalties assessed or not; we didn't assess any penalties  
11 this year. As Mr. Stueve said, it's a challenge every year,  
12 every spring, to get through that spring flush period and be  
13 able to handle the milk without having any significant  
14 problems. We were able to do that this year. We have gone  
15 past our peak and are starting to come down, it's through  
16 the good efforts of the folks that we work with.

17 And I want to also recognize the customers that we  
18 have, their ability to run their plants efficiently as well.

19 Without them we would have problems. If they weren't  
20 running well we would necessarily have problems. We did not  
21 have problems this year that would result in penalties. And  
22 that's not to say it wasn't difficult. It is difficult,  
23 it's a challenge every year, but we didn't have problems  
24 where we had to result in penalties being assessed this  
25 year.

1 MR. EASTMAN: Based on what you're seeing, how do  
2 you view the situation going into the summer and the fall in  
3 terms of milk supply or the amount of milk that you'll have  
4 available?

5 DR. ERBA: Our projection right now is to have  
6 approximately -- it sounds kind of funny -- an average year,  
7 whatever that is. We expect to be higher than we were last  
8 year by a significant amount because we did experience such  
9 a huge drop-off last year. We hit our lowest point in  
10 September last year since 2005. I don't expect we're going  
11 to have that kind of an issue again.

12 But I expect that we are going to have more milk  
13 to deal with this year than we did last year for a number of  
14 different reasons. We did pick up a number of new producers  
15 as of January 1st this year that we didn't have last year  
16 and that adds to the milk supply that we have. I don't  
17 expect we're going to have milk handling problems for the  
18 rest of this year.

19 MR. EASTMAN: And then on page four of your  
20 testimony also you talk about how the temporary price  
21 increase that affected Class 4a prices affected your  
22 operation. Obviously CDI is a large butter/powder  
23 manufacturer in the state. You mention that the pool is a  
24 revenue sharing mechanism where regardless of where a  
25 producer will ship his or her milk, the revenue from that

1 would be shared through the pool. Obviously your producer-  
2 members have invested money in your manufacturing plants but  
3 can that be said of all the manufacturing plants in the  
4 state, that there's definitely been investments by certain  
5 entities, organizations, that producers in general are able  
6 to take advantage of, even though you may not have shared in  
7 the investment in such manufacturing facilities?

8 DR. ERBA: I suppose you could make that argument,  
9 although there should really be a distinct difference  
10 between what a cooperative is and how it functions and what  
11 a proprietary plant is. And when you have price increases,  
12 as you saw from the December 2012 hearing, and it hits the  
13 4a classes primarily owned by producers, there's a  
14 differential impact on the producers as far as the pricing  
15 received out of the pool and I think that needs to be  
16 recognized.

17 In the many years that I spent here we always  
18 recognized that Class 4a was something that definitely had  
19 issues with in terms of how much of an increase you could  
20 put on it because it had that differential effect. I was  
21 really surprised to see the results of the 2012 hearing  
22 because we had never had that kind of an issue where we'd  
23 say that the Class 4a and 4b ought to be treated the same.  
24 In my time they never were treated the same. And it was  
25 recognized that was because they were largely owned by the

1 producers that were putting milk and money into that effort.

2 MR. EASTMAN: So if dairy producers are producer  
3 cooperatives that invest in either 4a or Class 4b plants do  
4 you feel that maybe those plants shouldn't participate in  
5 the pool because, obviously, they are producer-owned and  
6 that would be a way to --

7 DR. ERBA: That would be a major departure from  
8 the laws that we have today.

9 MR. EASTMAN: Sure. But you mention here in your  
10 testimony that the concept of increasing milk prices for  
11 equity is to all producers. So if there are certain  
12 producer-cooperative members or producers that have invested  
13 in whatever manufacturing capacity is available, by  
14 definition of the concept of pooling, they are always going  
15 to have to end up during times contributing to the pool.  
16 Any sort of increase would always be less than the producers  
17 that haven't. And so is there is -- it seems that there is  
18 no way to really fix that issue as long as there's producers  
19 who have invested in manufacturing facilities.

20 DR. ERBA: That may be, as I said, difficult to  
21 fix because of the way that the state laws are written for  
22 milk pricing and milk regulation in California. You  
23 wouldn't necessarily have those same kind of constraints  
24 outside of California because cooperatives are viewed  
25 differently outside California than they are within the

1 state. But I am going to bring you back to where we are  
2 today, Mr. Eastman, this hearing is not focused on that at  
3 all, unfortunately.

4 MR. EASTMAN: Okay. And then the final question I  
5 have is you mentioned you, obviously, there's been a lot of  
6 negotiations with regards to finding a compromise through AB  
7 31 and the legislation that is currently being worked on  
8 across the street. At this point your proposal mimics what  
9 the language of AB 31 was. Do you feel that if that bill  
10 were to be passed with some other sort of language, some  
11 other level of increase, do you feel that at that point  
12 that's what our pricing should revert to? For example, if  
13 the Secretary were to actually implement the proposal that  
14 we have here today and AB 31 eventually passes with some  
15 sort of different language or numbers do you think that's  
16 when -- do you think that would be adequate? Whatever is  
17 determined at the Legislature should be then what is then  
18 incorporated?

19 DR. ERBA: There needs to be some consistency  
20 there. I would suggest that with all of the things that are  
21 happening outside of this hearing, the legislation being  
22 discussed, the task force, the working groups, the easiest  
23 thing to do in that list of things to be done is to call  
24 another hearing again, remove some section of the  
25 Stabilization Plan or make it revert to something else.

1 That's a fairly simple process and can be done pretty  
2 easily. The other things we're working on are far more  
3 complicated and time consuming.

4 MR. MASUHARA: Dr. Erba, setting aside the  
5 discussion on the impacts of 4a on the equity and to the  
6 asset owner base, can you share anything about how it  
7 affected your ability to compete in your end product for the  
8 past few months with the previous increase that you are  
9 proposing to repeal now?

10 DR. ERBA: Well, without going into a lot of  
11 detail about the actual costs to the cooperative I'd suffice  
12 it to say with our kind of processing capacity, with our  
13 kind of ability to handle milk through our butter/powder  
14 plants it's millions of dollars a month that we are not  
15 going to be able to count towards cooperative profits that  
16 we would have otherwise.

17 MR. MASUHARA: Is there any way you could just in  
18 a summary sense, was it a severe impact the past few months,  
19 was it a moderate impact, was it relatively innocuous?

20 DR. ERBA: I would say it's tending toward severe  
21 and if it were in place for more than four months it would  
22 be a significant impact to the profitability of the  
23 cooperative.

24 MR. MASUHARA: And then I may have missed it but  
25 in your proposal did you guys state a specific time line or

1 are you aligned with until something comes out of AB 31 or  
2 some other situation or event occurs?

3 DR. ERBA: Right. And I did not put anything  
4 specifically in the testimony that looked like a time line  
5 for the same reasons I spoke with Mr. Eastman about. Of all  
6 the things we're working on outside this hearing the easiest  
7 thing we have to do is to call another hearing to simply  
8 remove some language from the Stabilization Plan. What I am  
9 suggesting today as a proposal ought to be in place until  
10 something else comes along and causes us to have another  
11 hearing called to remove it. And it's the same approach  
12 we'd have for any hearing. All decisions are temporary  
13 until they are changed again.

14 MR. MASUHARA: And then also since being a  
15 cooperative you are more in tuned to the producer  
16 experience. Can you make any comments on how a 50 percent  
17 increase to the overbase price is going to address the  
18 current situation being experienced by producers with the  
19 high feed costs and the erosion of equity?

20 DR. ERBA: As I said in the testimony, the \$.50 we  
21 feel is already a concession and it is not going to fix all  
22 of the issues that we've had to this point. If we were to  
23 get some producers here to speak their mind I'd think we'd  
24 probably be tending closer to \$1/cwt., which is what they  
25 need to get fixed and we realize that that's out of the

1 realm of possibilities. We figured that the \$0.50  
2 represents some kind of middle ground and it's definitely a  
3 concession on the part of the producers to get back to where  
4 they need to be.

5 MR. MASUHARA: That's all I have.

6 HEARING OFFICER SUTHER: Thank you for your  
7 testimony, Mr. Erba.

8 DR. ERBA: Thank you.

9 HEARING OFFICER SUTHER: Mr. Schiek.

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

12 DR. SCHIEK: Yes. My name is William Schiek,  
13 that's S-C-H-I-E-K, and I'm with the Dairy Institute of  
14 California.

15 Whereupon,

16 DR. WILLIAM SCHIEK

17 Was duly sworn.

18 HEARING OFFICER SUTHER: I would like to enter  
19 Exhibit 42 into the record.

20 (Exhibit 42 was received into evidence.)

21 HEARING OFFICER SUTHER: You may proceed.

22 DR. SCHIEK: Thank you. Mr. Hearing Officer and  
23 members of the Hearing Panel:

24 My name is William Schiek and I am Economist for  
25 the Dairy Institute of California. I am testifying on the

1 Institute's behalf. Dairy Institute is a trade association  
2 representing 30 dairy companies which process approximately  
3 75 percent of the fluid milk, cultured and frozen dairy  
4 products, over 85 percent of the cheese products and a small  
5 percentage of the butter in the state. Member firms operate  
6 in both marketing areas of the state and the position  
7 presented at this hearing was approved and adopted  
8 unanimously by Dairy Institute's Board of Directors.

9 Dairy Institute appreciates the opportunity to  
10 testify at this emergency pricing hearing to propose a  
11 temporary and modest adjustment to certain prices. Dairy  
12 Institute is proposing that the same temporary price  
13 increases that have been in effect during the February  
14 through May 2013 period be extended for the six months  
15 encompassed by the July through December 2013 period. We  
16 understand, given the timing of this hearing, that it is not  
17 possible or practical to keep the emergency price increases  
18 in effect for June 2013 and that is why we are proposing  
19 that they be reinstated beginning in July. Our proposal is  
20 manifested in the amendment extract from the Stabilization  
21 and Marketing Plans for Northern and Southern California,  
22 which is included as Attachment 1.

23 Some explanation as to how we arrived at our  
24 proposal is warranted. It has become clear to us that  
25 California's end-product pricing system has reached the end

1 of its useful life. Industry consolidation has made it  
2 impossible for us to continue to get the data needed to hold  
3 hearings to update make allowances, product yields or FOB  
4 adjusters without disclosing individual company information  
5 or making it available to competitors. While some may see  
6 this as an opportunity to put seemingly attractive pieces of  
7 Federal Order formulas into our pricing system, doing so  
8 would violate many of the tenets of regulated pricing and  
9 foster an inconsistent and ill-suited pricing system that  
10 would fail to adequately address the legitimate needs of  
11 stakeholders on both producer and processor sides of the  
12 industry.

13           Also, the nature of our markets is changing.  
14 Globalization impacts are driving a new economic reality  
15 that will challenge the industry. A key point here is that  
16 shocks that are global in their market impact are largely  
17 responsible for the increased price volatility and  
18 additional cost pressures. California dairymen used to  
19 compete with dairymen in the Midwest and the Northeast and  
20 win easily due to their production cost advantage. Today,  
21 California dairymen are competing with milk producers in New  
22 Zealand, Europe, Australia, South America as well as other  
23 regions of the United States. There is more pressure than  
24 ever to increase productivity and efficiency.

25           We continue to recognize these challenges that

1 face dairy farmers in California and nationally. The 2008-  
2 2009 economic collapse eroded farmers' equity. While we saw  
3 a recovery in the next few years, the drought in 2012 drove  
4 feed prices to record levels and profit margins on farms  
5 were again squeezed. Farms have exited but others have  
6 expanded in what has been and continues to be a national  
7 trend. Through all these changes the milk supply in  
8 California has trended higher.

9           While globalization of dairy markets creates  
10 challenges, it also creates opportunity. The US is selling  
11 a significant amount of product abroad and volumes are  
12 expected to continue growing in the future. Worldwide dairy  
13 demand is expected to grow faster than supply at recent  
14 historic prices, and therefore, higher average prices will  
15 be necessary to ration demand and bring needed products to  
16 the market. Increasingly, our industry must look to the  
17 international market to sell our products because of the  
18 need to realize growth opportunities there and to offset  
19 both the growing competition from states located closer to  
20 our domestic markets and the increasing costs of reaching  
21 customers in those markets.

22           Finally, for the market to deliver the maximum  
23 possible revenue to producers, there must be adequate  
24 investment in California. The pricing structure that is  
25 most encouraging of investment will do a better job of

1 delivering returns that are both higher and sustainable to  
2 dairymen. Taking advantage of the rising global demand  
3 means we must have an industry and policy environment that  
4 encourages the investment needed to access and serve new  
5 customers and that fosters the proper business decision-  
6 making needed to thrive in the global marketplace. We  
7 continue to believe that developing a policy that supports  
8 our international marketing efforts is crucial.

9           Based on what we have observed over the past few  
10 years, neither processors nor producers are fully satisfied  
11 with our regulated system as it currently exists. Producers  
12 believe that it does not deliver enough revenue, while  
13 processors feel that it distorts markets and creates  
14 disincentives to investment in plants, processing  
15 technology, new products and new markets. So there is  
16 recognition that the pricing system needs to change in order  
17 to be consistent with new marketplace realities. The Dairy  
18 Future Task Force, composed of both producers and  
19 processors, was formed to identify the changes that are  
20 needed. To meet these challenges, the Secretary's Dairy  
21 Future Task Force will be vital to guiding the industry in  
22 replacing our outdated pricing system with one designed to  
23 position California producers and processors to succeed in  
24 both the domestic and global markets. Dairy Institute  
25 supports the CDFA Dairy Task Force and its effort toward

1 reforms that will deliver more for the industry over the  
2 long run.

3           In late 2012, Western United Dairymen announced  
4 that they would be sponsoring legislation, what would  
5 eventually become AB 31, authored by Assemblyman Richard  
6 Pan. This bill, as introduced, would have put into statute  
7 a specific formula for the whey contribution to the Class 4b  
8 price. The bill's impact would have been an increase in the  
9 Class 4b price by an estimated \$1.20/cwt., adding over \$200  
10 million per year to the producer revenue pool. While we  
11 understand producers' desire for higher revenue in the wake  
12 of increased feed costs, many of the state's cheese makers  
13 simply do not have the margins to support such a large  
14 revenue transfer to producers, nor are they able to get such  
15 revenues from the market in today's competitive environment.

16       Especially when such proposed price increases or proposed  
17 price levels are optional in Federal Orders and mandatory in  
18 California. And the proposed increase takes no account of  
19 the true total cost of moving cheese products to eastern  
20 markets, which is essential to market all of California's  
21 growing milk supply. So in the end, AB 31, as it was  
22 introduced, was not a viable solution because it attempted  
23 to support one part of the industry by damaging the other.  
24 What is ultimately needed is a solution that provides a  
25 future for both sides, and the California Dairy Future Task

1 Force is the appropriate vehicle for achieving that  
2 solution.

3           As part of our discussions surrounding AB 31,  
4 Dairy Institute and its members have committed to the  
5 Legislature that we would work to solve the industry's  
6 problems. Our commitment is two-fold, support of both  
7 short- and long-term solutions. For the short-term, we are  
8 supporting the continuation of existing price relief under  
9 consideration at this hearing. For the longer-term, we will  
10 support the active engagement of the dairy Future Task Force  
11 to modernize California's regulated milk pricing system to  
12 meet the opportunities and challenges facing producers and  
13 processors in both the new global marketplace and a more  
14 competitive domestic marketplace. So we are proposing the  
15 extension of price relief as part of an effort to give our  
16 industry the time it needs to address the longer-term  
17 pricing issues and to create an environment where the work  
18 of the task force can proceed with the active engagement of  
19 producers and processors toward a successful solution. The  
20 additional emergency price relief will help some of the  
21 dairies that lost equity during 2009 and 2012 rebuild their  
22 balance sheets and will put them on a more optimistic  
23 footing for the future.

24           Because it is difficult for processors to pass on  
25 these temporary price increases in the market, and because

1 some of the economic fundamentals of the producer sector  
2 appear to be improving, it is important that the price  
3 increases established as a result of this hearing are no  
4 greater than what we have proposed. Specifically, we have  
5 noted that feed costs appear to be falling, future milk  
6 prices are likely to be higher than in 2012, and California  
7 milk production, barring the same kind of system shocks  
8 endured last year, appears to be on track to finish 2013 at  
9 or above the record level reached in 2012. More detail on  
10 these recent trends follows.

11           With regard to feed costs, the primary culprit  
12 behind higher costs for milk production in recent years has  
13 been the increase in cost for feed. Based on USDA data for  
14 prices received by farmers and CME futures prices as of May  
15 17th for the remainder of 2013, the average price for corn  
16 in 2013 is projected to be \$0.50 per bushel lower than in  
17 2012. The projected corn price drop, from the peak in  
18 August 2012 to the December 2013 projection is \$2.44 a  
19 bushel. For soybean meal the average 2013 price is expected  
20 to be \$88 per ton lower than the average in 2012 and the  
21 August 2012 to December 2013 drop is projected at \$298 a  
22 ton, based on the most recent CME futures settlement prices.

23       USDA prices for California alfalfa for the first four  
24 months of 2013 averaged \$35 per ton lower than in the same  
25 period last year. Feed prices have moderated somewhat

1 compared to the latter half of 2012, but even lower prices  
2 are expected during the second half of this year.

3 Milk and Dairy Commodity Prices.

4 Based on historic prices and CME futures prices  
5 for key dairy commodities as of May 17th, the 2013 average  
6 price for cheese is expected to be about \$0.10 per pound  
7 higher than the 2012 average, while the butter price is  
8 expected to average \$0.05 per pound higher and the nonfat  
9 dry milk price is projected to average \$0.30 per pound  
10 higher than 2012. Dry whey prices are projected to average  
11 about the same as last year. The strongest prices for all  
12 dairy commodities are expected in late summer or early fall,  
13 so they are still ahead of us. Utilizing existing Class 4a  
14 and Class 4b formulas, the futures prices indicate that  
15 Class 4b prices will average \$1.00/cwt. higher than in 2012,  
16 while 4a prices will average \$2.90 per cwt. higher. These  
17 projections don't include the price increases that have been  
18 in effect since February or our proposed increases at this  
19 hearing.

20 With milk production in the first three months of  
21 2013, milk production has been behind 2012's lofty levels,  
22 but the latter half of last year saw milk production fall  
23 sharply as an August heat wave combined with drought-induced  
24 feed price increases. But in 2013, milk production has been  
25 increasing strongly on a month-to-month basis. Compared to

1 2011, California production in 2013 has been up about 2.2%  
2 during the first three months. Projecting that increase  
3 forward through the remainder of the year would put 2013  
4 production almost 1.4% above the total for 2012. This  
5 percentage increase amounts to an extra 1.5 million pounds  
6 of milk per day.

7           In summary, Dairy Institute and its members  
8 believe that the temporary price increases that we have  
9 proposed will provide additional revenue on top of the price  
10 increases that we believe the market will deliver in the  
11 months ahead. The combined impact of improved revenues and  
12 lower feed costs should improve dairy farm margins  
13 significantly from what was experienced in 2012. We urge  
14 the Secretary to consider our proposal, which we are  
15 advocating as part of our commitment to the Legislature for  
16 short-term relief for California dairy farmers. We remain  
17 committed to finding long-term solutions for our industry's  
18 success through the Dairy Future Task Force, and we believe  
19 that the short-term relief we are proposing is an important  
20 step for creating an environment where industry stakeholders  
21 can come together to seek common solutions for the benefit  
22 of all. However, because of the difficulty, and in some  
23 cases the impossibility of passing price increases on to  
24 customers, we request that the relief granted as a result of  
25 this hearing be no greater than the amount and duration that

1 we propose. Thank you for the opportunity to testify today.

2 And that concludes my testimony.

3 MR. EASTMAN: I have a couple of questions. At  
4 the end of your testimony you mentioned your six month  
5 duration. Is it based solely on the idea of marketing  
6 products and the competitive pressures that result from  
7 higher -- increased prices? Does your duration at all  
8 correlate to any sort of time frame where either AB 31 or  
9 the Task Force will reach some sort of traction or progress?

10 DR. SCHIEK: Yeah. The relief to the end of the  
11 calendar year was what we originally proposed in the  
12 Legislature, so that's the first piece of it. We also  
13 believe that the intention of the Legislature is that the  
14 task force, you know, get busy and get to work and have  
15 something to put forward by the end of the year in terms of  
16 solutions. And I think the third thing is, six months seems  
17 to be what our members feel like they can agree to so that's  
18 the reason the duration is six months.

19 MR. EASTMAN: How have the temporary price  
20 increases that have been in effect since February affected  
21 your members?

22 DR. SCHIEK: I think it depends on the member but  
23 in all cases, you know, it comes out of the margins. It's a  
24 greater hardship for some members than for others. You've  
25 had one of our members up already, you'll hear from some

1 more today, and that might be a good question to ask them  
2 specifically.

3 MR. EASTMAN: Just in case some of those members  
4 don't testify today, do you have any sense of generalities?  
5 Or is that something that you are not able to --

6 DR. SCHIEK: Well, all I can tell you is we  
7 haven't lost any of our members yet during that four month  
8 period so they are bearing up under it at this point. I  
9 don't, I don't know any specifics as to whether they've lost  
10 business or what other hardship it's brought to them.

11 HEARING OFFICER SUTHER: Thank you for your  
12 testimony. I think right now would be a good time to take a  
13 ten minute break.

14 (Off the record at 9:54 a.m.)

15 (On the record at 10:07 a.m.)

16 HEARING OFFICER SUTHER: We are now back on the  
17 record. I'd like to call Renee Peets.

18 Could you please state your full name, spell your  
19 last name and spell your affiliation for the record, please.

20 MS. PEETS: Yes. Renee Peets, P-E-E-T-S, and I am  
21 affiliated with Kraft Foods.

22 Whereupon,

23 RENEPEETS

24 Was duly sworn.

25 HEARING OFFICER SUTHER: Are you testifying on

1 behalf of an organization or individually?

2 MS. PEETS: On behalf of Kraft Foods.

3 HEARING OFFICER SUTHER: You may proceed.

4 Excuse me, this will be Exhibit 43.

5 (Exhibit 43 was received into evidence.)

6 MS. PEETS: Mr. Hearing Officer and members of the  
7 Hearing Panel:

8 My name is Renee Peets and I am the Senior  
9 Director of Cheese and Dairy Procurement for Kraft Foods.  
10 Kraft operates a dairy plant in Tulare, California, which  
11 produces Parmesan and other hard Italian cheeses and  
12 cultured products, including sour cream and cottage cheese,  
13 under the Knudsen brand. This facility also produces dry  
14 whey powder. In addition to this manufactured volume, Kraft  
15 purchases cheese and other dairy ingredients from several  
16 companies located in California.

17 I am here today to testify in support of extending  
18 the temporary emergency price relief that was granted as a  
19 result of the hearing on December 21, 2012, at the same  
20 amounts, and for a period not to exceed six months. Kraft  
21 supports this extension in fulfillment of a commitment made  
22 to the California Legislature during recent negotiations of  
23 Assembly Bill 31. The six month extension of emergency  
24 price relief will allow time for the Secretary's Dairy  
25 Future Task Force to fulfill the purpose for which it was

1 created, namely to create a pricing system in California to  
2 replace the current pricing system, which is no longer  
3 useful. The Task Force must create a pricing system that is  
4 viable for the long-term and allows producers and processors  
5 to maintain and grow their businesses while securing the  
6 California dairy industry's position as a leader within both  
7 the United States and the expanding global dairy  
8 marketplace.

9           We recognize that there have been difficult  
10 economic conditions for US farmers since 2009 and the 2012  
11 drought and resultant record feed prices served to further  
12 drive down profitability. California and several other US  
13 regions were affected the most, and while some farms did go  
14 out of business, others grew, allowing California milk  
15 production to remain relatively stable. The outlook for  
16 farmer profitability for 2013 is much more positive than it  
17 was at this time last year, and if all of the fundamentals  
18 are in line with predictions, then it is likely that farmer  
19 margins will improve drastically over the course of 2013.  
20 This should eliminate the need for further temporary relief  
21 following the proposed six month extension. If the  
22 fundamentals do not turn out to result in improved farmer  
23 financial conditions then further discussions can be entered  
24 into after the six month extension.

25           Recently, legislation has been introduced with the

1 intended result being permanent mandated pricing in  
2 California at even higher levels than current, but this  
3 methodology will not create a long-term system that is  
4 sustainable for all stakeholders. The way to resolve the  
5 current pricing situation is to let the Dairy Future Task  
6 Force fulfill its purpose and bring all parties together to  
7 construct a system that works for producers and processors  
8 alike.

9 Kraft is supportive of the work of the Dairy  
10 Future Task Force and we are hopeful that the proposed six  
11 month extension period produces better weather conditions,  
12 lower feed costs, improved farmer profitability and an  
13 opportunity for the Dairy Future Task Force to fulfill its  
14 purpose and create a pricing system that works for all  
15 parties for the long-term benefit of the California dairy  
16 industry.

17 Please extend the existing temporary price relief  
18 at current levels and for a period of no more than six  
19 months. Thank you.

20 MR. EASTMAN: I have a question. Can you describe  
21 how the temporary price increase that is coming to an end,  
22 how it has affected your operation in the marketing of the  
23 products you make.

24 MS. PEETS: Sure. Without going into specific  
25 dollar amounts I can say that the four month temporary

1 increase has impacted us to the extent of several million  
2 dollars and that money comes directly out of our bottom  
3 line. That's not something that we can price for. The  
4 cheese industry and cultured products industry have very  
5 small margins and we have had to take that out of our  
6 margin.

7 MR. EASTMAN: So does that mean you aren't -- you  
8 didn't pass any of the price increase along to the --

9 MS. PEETS: No.

10 MR. EASTMAN: -- to consumers?

11 MS. PEETS: We did not. It's an extremely  
12 inelastic pricing marketplace, we couldn't.

13 MR. MASUHARA: Would you be at liberty to gauge  
14 between the different ones, between the cheese and your  
15 cultured products which one suffered more negatively? Is  
16 that something you can --

17 MS. PEETS: Well in our case, because of our  
18 product mix, more cheese is coming out of our Tulare  
19 facility so cheese took more of that.

20 HEARING OFFICER SUTHER: Any further questions?

21 Thank you for your testimony.

22 MS. PEETS: Thank you.

23 HEARING OFFICER SUTHER: Mr. Hofferber.

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

1 MR. HOFFERBER: My name is Scott Hofferber, H-O-F-  
2 F-E-R-B-E-R, and I am the Controller with Farmdale Creamery.

3 Whereupon,

4 SCOTT HOFFERBER

5 Was duly sworn.

6 HEARING OFFICER SUTHER: At this point I'd like to  
7 enter Exhibit 44.

8 (Exhibit 44 was received into evidence.)

9 HEARING OFFICER SUTHER: You may proceed.

10 MR. HOFFERBER: Thank you. Good morning, Hearing  
11 Officer and members of the Hearing Panel. I am Scott  
12 Hofferber, Controller of Farmdale Creamery, and I am here at  
13 the direction and on the authority of our Board of  
14 Directors. Farmdale is a third-generation family-owned and  
15 operated dairy processing facility in Southern California.  
16 With about 80 employees, Farmdale is processing an average  
17 24.2 million pounds of milk and cream per month, about 100  
18 loads a week, into cheese, sour cream and buttermilk. And I  
19 am grateful for this opportunity to provide Farmdale's  
20 perspective on the matters before the panel.

21 We stated in our testimony from December's  
22 hearing, and reiterate here: Regulatory stability is a  
23 necessary component to planning and executing a growth  
24 strategy in manufacturing industries requiring large capital  
25 investment and long-term physical plant assets. Farmdale

1 has relied heavily on the fundamental precept in the  
2 Marketing and Stabilization Plan that "orderly marketing"  
3 would rule the process. Our reliance on that precept led us  
4 to undertake a substantial investment and improvement to our  
5 facilities late last year, which i still a work in progress.  
6 The current climate of continual petitions, along with legal  
7 and legislative actions, are undermining that stability and  
8 creating a negative environment that may lead to a  
9 disastrous outcome for our investment and inhibit the future  
10 of other processing growth.

11 We are submitting herewith five articles taken  
12 from industry new outlets that have much to say about the  
13 impossible situation in which our industry finds itself.  
14 These are Appendices A through E and I am certainly not  
15 going to read all of those into the record. There's four  
16 articles there from the *AgWEB* - Dairy Fiscal Fitness area  
17 written by attorney Riley Walter. He discusses at length  
18 what he observes about some of the reasons for the crisis  
19 that we are currently addressing. And the fifth article was  
20 out of the very recent *Cheese Market News*, it was a Letter  
21 to the Editor by Randall Stoker that kind of discusses the  
22 intrusive nature of regulatory systems in general.

23 Farmdale desires this sampling of recent and  
24 impartial information to be in the hearing record for  
25 reference by those observers of our processes looking for

1 balance in the rhetoric. The content of these articles  
2 speaks for themselves.

3 We continue to beat ourselves up in hearings like  
4 this one and we must find a new discussion. The discussion  
5 must transcend the apparent and expressed adversarial tone  
6 for its only customers exhibited by the louder voices in the  
7 producer leadership and move to a collaborative discussion  
8 designed to foster a vertical partnership in the exclusive  
9 and special industry in which we all participate.

10 We believe this can best be developed in the  
11 context of the Dairy Future Task Force under Secretary Ross'  
12 leadership, now with legislative mandate to go there and get  
13 something accomplished. We encourage continued  
14 participation in the task force by those persons who are  
15 ready to collaborate in finding a better way of doing  
16 business together.

17 Milk prices are up and holding since our last  
18 discussion on this point. The outlook for feed costs has  
19 significantly improved since our last discussion on his  
20 point. The conditions of an emergency seem to have  
21 improved. However, as a result of the legislative  
22 discussions surrounding AB 31 we have agreed to support  
23 extending the price relief, at the current rates for each  
24 class, for a six month period in order to foster a more  
25 positive and fruitful environment in which the task force

1 can operate. It would be Farmdale's desire that the task  
2 force efforts succeed and we are committed to seeing that  
3 process through in our continued participation with it.

4           Respectfully submitted.

5           MR. EASTMAN: I have a question. How has the  
6 temporary price increase affected your operations. And if  
7 you can speak to the difference, if there is one, between  
8 cultured products and your cheese products.

9           MR. HOFFERBER: Sure. As Renee stated we have --  
10 the pricing in cheese is basically tied to the CME market,  
11 the way our contracts are negotiated, and you don't  
12 renegotiate those easily. So we have taken the entire \$0.03  
13 a pound to our bottom line, against our bottom line. If we  
14 make a million pounds of cheese -- what do we make, two  
15 million pounds of cheese in a month at \$0.03 a pound, that's  
16 the number, it's not hard to come to by information we  
17 already have in the public record.

18           As far as the Class 2, it's about an equal amount  
19 of product so you can apply the cents per pound. Again, we  
20 haven't gone to any kind of special price increases,  
21 understanding that this was a short-term emergency price  
22 relief adjustment. We just decided to suck it up and not  
23 drive that out to our customers.

24           MR. EASTMAN: Now that your proposal is to extend  
25 it for six more months do you feel that you will have to

1 pass those price increases along or are you going to suck it  
2 up?

3 MR. HOFFERBER: We probably will continue in the  
4 spirit of offering that back to the producer community to  
5 come to the table and really deal at the task force. Let's  
6 get a pricing system that keeps us from having to have this  
7 hearing every six months. End of commercial.

8 MS. GATES: I just wondered if you could give us  
9 just a quick crib note synopsis of the articles that are in  
10 here just so that we can get that on the record.

11 MR. HOFFERBER: Well, Mr. Walter goes through and  
12 speaks -- I mean, his focus is on what's called Fiscal  
13 Fitness in his articles and he speaks a lot to lack of  
14 business acumen with a number of the farmers that he went  
15 through the bankruptcy process with. That's primarily what  
16 those four articles is discussing, lots of facets.

17 I'm a CPA, I've done public practice, I've worked  
18 with lots of businesses, and a lot of what he said resonates  
19 across my profession. It's not just dairy farmers, it's a  
20 lot of the small mom and pops and whatnot that I've dealt  
21 with over time. But the focus that he has in the dairy  
22 community I think is really educational to anybody looking  
23 at this discussion and saying, well it's just this problem  
24 or it's just that problem, you know, being fingers pointed  
25 at the processing community. Well no, it's really not,

1 there is a very broad problem here at all levels in all  
2 vectors in this matrix. That we really have to sit down and  
3 figure this thing out.

4 MS. GATES: Thank you.

5 MR. HOFFERBER: Sure.

6 HEARING OFFICER SUTHER: Thank you for your  
7 testimony. Mr. Wegner.

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

10 MR. WEGNER: Tom Wegner, that's W-E-G-N-E-R, I'm  
11 with Land O'Lakes, Inc.

12 Whereupon,

13 THOMAS WEGNER

14 Was duly sworn.

15 HEARING OFFICER SUTHER: Mr. Wegner's testimony  
16 will be Exhibit 45.

17 (Exhibit 45 was received into evidence.)

18 HEARING OFFICER SUTHER: And you may proceed.

19 MR. WEGNER: Mr. Hearing Officer and members of  
20 the Panel. My name is Tom Wegner. I am here to testify on  
21 behalf of Land O'Lakes. My business address is 4001  
22 Lexington Avenue North, Arden Hills, Minnesota, 55164. My  
23 current title is Director of Economics and Dairy Policy.  
24 Land O'Lakes thanks the Department for calling this hearing  
25 on its own motion to consider amendments to the Marketing

1 Plans. This hearing will address issues of critical  
2 importance to the future of both our California dairy  
3 producer members and the entire California dairy industry.

4 Land O'Lakes is a dairy co-operative with 3,000  
5 dairy farmer member-owners. Land O'Lakes has a national  
6 membership base, whose members are pooled on the California  
7 State Program and five different Federal Orders. Land  
8 O'Lakes members own and operate several cheese, butter/  
9 powder and value-added plants in the Upper Midwest, East and  
10 California. Currently, our 240 California member-owners  
11 supply us with over 16 million pounds of milk per day that  
12 are primarily processed at our Tulare and Orland plants.

13 Land O'Lakes proposes the following increases in  
14 class prices:

15 Increase the Class 4b price proximately \$1.20/cwt.  
16 by raising the 4b milk solids-not-fat by \$0.138 per pound.

17 We strongly suggest that the Department the Class  
18 4b increase as soon as possible and that the increase remain  
19 in place until a suitable alternative to the current Class  
20 4b formula is agreed upon and adopted by the Department.

21 And here I have the Article and Section citation,  
22 for the record.

23 Our proposal focuses solely on the Class 4b price.

24 As we have noted in previous testimony, the Federal Order  
25 Class III has chronically exceeded the Class 4b price.

1 Since January 2012, the Federal Order Class III price has  
2 exceeded the Class 4b price by an average of \$1.85/cwt.

3           It is important to note that the monthly western  
4 dry whey price series used by the Department in the whey  
5 portion of the Class 4b formula has continued to exhibit  
6 significant market strength in the first quarter of 2013.  
7 The monthly averages for the Dairy Market News dry whey  
8 western mostly has averaged just under \$0.60 for the first  
9 three months of 2013.

10           Equally important, many dairy market analysts are  
11 projecting that whey prices will remain at levels of 50 to  
12 60 cents for the rest of 2013, which will continue to ensure  
13 that the large California cheese plants will return  
14 significant margins on their processed whey operations. In  
15 light of the continued strength forecasted for the whey  
16 market and the administrative price constraints under which  
17 the 4b price is presently calculated, Land O'Lakes proposes  
18 an increase of \$1.20 in the Class 4b price.

19           Applying the average Class 4b utilization of the  
20 California state milk order from calendar year 2012, we  
21 estimate that our proposal would result in an increase of  
22 roughly \$0.50 on the overbase prices. Adding \$0.50 to the  
23 overbase price would have a significant, positive financial  
24 impact on California's dairy farm families. This would also  
25 send an important message to the California dairy farmers

1 that the CDFA Secretary understands the seriousness of the  
2 financial pressure that California dairy farmers experienced  
3 in 2012 and have continued to experience in 2013.

4 We'd also like to point out to the Department that  
5 raising the 4a price does not address the chronic inequity  
6 between the Federal Order Class III and the California Class  
7 4b price. As you know, Land O'Lakes members have benefitted  
8 from the temporary increase in class prices approved by the  
9 Department for the four month period February through May  
10 2013. However, the lion's share of the increase in the  
11 overbase price to Land O'Lakes members, roughly two-thirds  
12 of the \$0.25 increase in overbase, came from Land O'Lakes'  
13 Class 4a contribution to the marketwide pool.

14 In other words, the additional dollars contributed  
15 by our Tulare plant to the marketwide pool represented  
16 nearly 17 of the 25 cents that Land O'Lakes dairy members  
17 drew from the pool as a result of the four month class price  
18 increases. More specifically, the \$0.30 increase on the  
19 Class 4a price transferred monies from the investment of  
20 Land O'Lakes members to the pool and back to Land O'Lakes  
21 members. Only \$0.08 came from the pool contributions of the  
22 processors of the other four classes of milk.

23 Compared to the 4b price, 4a has historically  
24 tracked very closely to the comparable Federal Order Class  
25 IV price. In 2012 the 4a ice averaged \$0.37 lower than the

1 Federal Order Class IV. The four month \$0.30 increase in 4a  
2 has effectively eliminated this difference and has resulted  
3 in the 4a price exceeding the Class IV by an average of  
4 \$0.10 for the three month period February through April  
5 2013. Clearly, the increase in the 4a price has had some  
6 unintended negative consequences for the producers whose  
7 cooperatives handle and process the vast majority of the 4a  
8 milk in California.

9           By contrast, cheese processors have continued to  
10 enjoy the benefits of a discounted 4b price even with the  
11 four month \$0.30 increase. Recall that in 2012 the 4b price  
12 averaged \$1.91 lower than the Federal Order Class III.  
13 Taking into account the \$0.30 increase, the 4b price has  
14 still offered a significant discount to cheese processors.  
15 The 4b discount has averaged \$1.47/cwt. lower than the Class  
16 III price for the three month period February through April  
17 2013. In effect, the increase of \$0.30 required cheese  
18 processors to contribute 20% of this 4b discount to the  
19 pool, they still have retained nearly 80% of this discount,  
20 or \$1.47/cwt. purchased in February through April.

21           As noted in our testimony on December 21st, 2012,  
22 dairy farmers had experienced negative margins in the first  
23 three quarters of 2012. Recall that when comparing the  
24 Department's statewide cost of production estimates with the  
25 Department's statewide blend price, we identified how

1 California dairy farmers absorbed a loss of \$0.70/cwt. in  
2 the first quarter of 2012, a loss of \$2.22/cwt. in the  
3 second quarter and a loss of \$1.97/cwt. in the third  
4 quarter. Although margins improved in the fourth quarter  
5 they did not come anywhere near to offsetting the losses  
6 accumulated in the first nine months. Presently, this  
7 margin improvement has been short-lived due to the drastic  
8 decrease in milk prices since last fall.

9 More importantly, milk prices have steadily  
10 decreased each month since the peak levels of November 2012.

11 For example, the Department has reported that the overbase  
12 price decreased by \$3.56/cwt. to \$16.33 in April, down from  
13 the November peak of \$19.89. The California all-milk price  
14 decreased \$1.52 from the same five month period and the  
15 statewide blend decreased by \$2.71/cwt. from November to  
16 March 2013.

17 On a quarterly basis, the Department reported that  
18 the statewide blend decreased \$1.73 from the fourth quarter  
19 of 2012 to the first quarter of 2013. Production costs  
20 would have needed to decrease by over \$1/cwt. in order for  
21 California dairy farmer to break even. The Department has  
22 not released production cost data for the first quarter of  
23 2013, but based on conversations with Land O'Lakes'  
24 producers, production costs have not decreased by \$1/cwt.

25 We'd also like to point out a number of market

1 factors that could turn 2013 into another very financially  
2 challenging year for California dairy farmers. These  
3 factors include the water supply, the corn crop and the hay  
4 supply.

5           As of April 30th the snowpack water equivalent  
6 stood at only 15% of normal statewide. Precipitation for  
7 the year was 75% of normal statewide. Numerous  
8 precipitation stations are reporting the lowest levels in 90  
9 years. The availability of water is critical to growing  
10 both corn and hay crops. Less precipitation will mean less  
11 water for surface irrigation, leading to more reliance on  
12 well water which is typically more expensive. As costs of  
13 irrigation rise, costs of growing corn and hay also rise.

14           US corn farmers have made significant progress in  
15 planting the 2013 crop over the past couple of weeks. The  
16 cold, wet conditions in the corn belt have put them well  
17 behind typical planting schedules. As planting dates move  
18 into late May, the likelihood of negative impacts on yield  
19 increase. By June, farmers in the northern corn belt begin  
20 to switch to soybeans. California's dairy farmers will be  
21 watching the progress of the corn crop and its impact on  
22 prices closely.

23           Hay prices will likely rise above 2012 levels for  
24 California dairy farmers. Alfalfa acreage in California is  
25 expected to be down by 6% this year. Additionally, the

1 University of Wisconsin Extension Service has estimated that  
2 as many as one million acres of alfalfa may have suffered  
3 from winter kill. One million acres represents an estimated  
4 one-half of Wisconsin's hay acres. The Extension Service in  
5 Minnesota is also reporting winter kill and winter injury of  
6 alfalfa in Southern Minnesota.

7           In short, production costs could again rise to  
8 levels in 2013 that could result in major losses on  
9 California dairy farms. We encourage the Department to  
10 consider the potential impacts of less irrigation water,  
11 less hay acreage and late season corn planting on milk  
12 production costs. Our proposal would help to offset some of  
13 the losses that continue amongst our California dairy  
14 families.

15           We again want to thank the Secretary of  
16 Agriculture and the Department for calling this emergency  
17 hearing on their own motion. Cooperative producer-owners  
18 request a response from the Department that benefits all  
19 California dairy farmers equally. There is no question that  
20 our proposed increase in the 4b price will have a positive  
21 financial impact on all California dairy farmers at a time  
22 when they could really use it.

23           We want to thank the Secretary again. That  
24 concludes my testimony.

25           MR. EASTMAN: I have a couple of questions. You

1 touched briefly on what production costs could possibly be  
2 or what margins could be in the first part of 2013. Do you  
3 have any sort of numbers that really -- is it too early for  
4 any such data to be out to have a sense of how your members  
5 are responding to that?

6 MR. WEGNER: I don't have any additional numbers  
7 than what I have already offered.

8 MR. EASTMAN: And then in terms of, obviously last  
9 year with the large amount of milk production the state  
10 experienced, many of the cooperatives and proprietary plants  
11 were putting in production bases and other such measures on.  
12 Has Land O'Lakes instituted or continued any of those  
13 measures at all this year?

14 MR. WEGNER: Our production base has been in place  
15 since 2008 and remains in place and is in place for 2012 and  
16 '13.

17 MR. EASTMAN: And is that just a hard, fixed cap  
18 or if a producer were to exceed that do they just get  
19 penalized? I can't remember how that program works.

20 MR. WEGNER: It depends on the conditions. At  
21 this point there have been no penalties in 2013, if that's  
22 the question you're really asking. Am I understanding your  
23 question?

24 MR. EASTMAN: I just couldn't remember how that  
25 worked.

1           MR. MASUHARA: A couple clarifications, Tom. You  
2 give some information based on various sources here. The  
3 water situation that you described here, are you taking  
4 purely California conditions when you describe that?

5           MR. WEGNER: Yes, I did, yes.

6           MR. MASUHARA: Because you also talk about the  
7 growing of corn and very little of the actual corn is going  
8 to come from California, most of it will come from the  
9 Midwest, but you did a good job describing how they're  
10 behind on their planting schedule.

11           But on the winter kill on alfalfa that came out of  
12 the University of Wisconsin. Was that one million acres  
13 just in the Upper Midwest or was that a wider region?

14           MR. WEGNER: That was specifically in Wisconsin.

15           MR. MASUHARA: That was specifically to Wisconsin.

16           MR. WEGNER: Yes.

17           MR. MASUHARA: Just to give me a little context  
18 then, are you saying that the reduced amount of alfalfa  
19 available there might have an impact to California?

20           MR. WEGNER: Yes.

21           MR. MASUHARA: Do you think hay is going to move  
22 from the west Coast all the way to that region of the  
23 country?

24           MR. WEGNER: Not necessarily move, hay moves out  
25 of California. But if there is less hay available to the

1 rest -- part of the country that hay may be bid out of  
2 California at a higher price.

3 MR. MASUHARA: So you think that those conditions  
4 are likely?

5 MR. WEGNER: It could definitely have an impact on  
6 hay costs here.

7 MR. MASUHARA: And do you think that there is  
8 going to be any corresponding impact to the Upper Midwest  
9 dairy production because of the lack of hay available to  
10 them? Do you think their feeding patterns may change up  
11 there, which would result in differences in their milk  
12 production?

13 MR. WEGNER: It depends on where they're able --  
14 at what price they're able to get the hay. But it certainly  
15 could have an impact in the Upper Midwest as well in terms  
16 of production.

17 MR. MASUHARA: Thanks.

18 HEARING OFFICER SUTHER: Thank you for your  
19 testimony. Lynne McBride.

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

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

24 Whereupon,

25 LYNNE McBRIDE

1 Was duly sworn.

2 HEARING OFFICER SUTHER: And Ms. McBride's  
3 testimony will be Exhibit number 46.

4 (Exhibit 46 was received into evidence.)

5 MS. McBRIDE: Mr. Hearing Officer and members of  
6 the Panel, my name is Lynne McBride. I currently serve as  
7 Executive director of the California Dairy Campaign. The  
8 testimony I will present today is based on positions adopted  
9 by the CDC Board of Directors.

10 I would like to begin by thanking California  
11 Department of Food and Agriculture Secretary Karen Ross for  
12 holding this hearing today to consider amendments to the  
13 class prices. We call for an increase in the 4b price in  
14 the amount of \$1.20/cwt. to bring the California 4b price in  
15 closer relationship with prices paid in other states. We  
16 consider this increase to be a compromise position due to  
17 the fact that it represents just 80 percent of the  
18 equivalent federal order Class III whey value. We believe  
19 this increase should remain in effect until substantial  
20 changes are made to our state dairy pricing system.

21 The turmoil among dairy producers in our state  
22 continues until this day due to the fact that current dairy  
23 prices paid to producers do not cover production costs.  
24 Although dairy producer prices have increased since this  
25 time last year, prices paid to producers have not kept pace

1 with production costs in our state. California mailbox  
2 prices are consistently the lowest of any regulated state in  
3 the nation. The most significant reason for the lower  
4 prices paid here is due to the inequity in the 4b price  
5 formula that fails to reflect the value of whey in the  
6 marketplace.

7           According to the latest Dairy Market News from the  
8 United States Department of Agriculture Agricultural  
9 Marketing Service, the mailbox price in California was once  
10 again the lowest in any regulated state in the nation. In  
11 February of 2013, the California mailbox price was just  
12 \$17.58/cwt. while costs to produce milk in our state totaled  
13 approximately \$20.00/cwt. February 2013 prices were a vast  
14 improvement from February 2012 prices when dairies were  
15 losing twice as much per month. So while prices have  
16 improved, the losses from 2012 were record-setting, the  
17 number of dairies that exited last year was the highest in  
18 memory and the dairy operations that remain today continue  
19 to struggle to stay in business.

20           Included on the second-to-the-last page of our  
21 testimony is a graph that shows the monthly losses that  
22 dairy producers have incurred since January 2002 through the  
23 end of 2012. The pattern is clear that under our current  
24 pricing system the periods of net losses far exceed periods  
25 of profitability and the downturns are far more severe. The

1 profitability experienced in 2011 was too short-lived to  
2 counteract the tremendous losses incurred in 2009. The  
3 profits generated that year did not come close to  
4 outweighing the tremendous losses of 2009 and those losses  
5 continued until 2010. Looking back at 2012 it is clear that  
6 dairy producer income was substantially below production  
7 costs for much of the year. Though in the fall of last year  
8 it looked as though dairy operations would finally break  
9 even, soon after income started to drop and producers began  
10 once again to incur significant losses.

11           The need for a price adjustment is clear. Dairy  
12 operations cannot continue to sustain chronic losses while  
13 there is considerable profitability experienced further up  
14 the food chain. Also please find on the last of our  
15 testimony a graph based on data from the Bureau of Labor  
16 Statistics and CME prices that shows the significant and  
17 increasing margins between the CME cheddar prices and retail  
18 prices. Dairy producers are currently being left out of  
19 this substantial profit opportunity. The most direct and  
20 effective way to restore some equity to our state dairy  
21 pricing system is by increasing the 4b price so that it is  
22 in a reasonable relationship with prices in federal order  
23 states.

24           According to data from CDFA, California lost 105  
25 dairies in 2012, more dairies than were lost in the

1 devastating year that was 2009. Dairy operations continue  
2 to close due to a lack of equity in our state producer  
3 pricing system combined with record high feed production  
4 costs. The fourth quarter CDFA cost of production data  
5 indicates that the cost to produce a hundredweight of milk  
6 reached \$20.08/cwt., while based on today's CME prices, the  
7 overbase price paid to producers is likely to be in the  
8 \$17/cwt. range. Dairy producers around the state continue  
9 to suffer significant losses and are continuing to exit. It  
10 is critical that immediate action is taken to increase  
11 California producer prices so that they are closer to prices  
12 paid in federal order states.

13           According to CDFA fourth quarter cost of  
14 production data from 2012, feed costs increased by 10%  
15 compared to the fourth quarter of 2011. The latest cost of  
16 production data confirms that total costs and allowances to  
17 produce milk in California now totals again \$20.08/cwt.  
18 including return on investment and management. The cost of  
19 production data from the fourth quarter of 2012 reports that  
20 income was \$19.83/cwt., confirming that dairy producers did  
21 not reach break-even levels even last year. Since then,  
22 prices have decreased substantially and again based on the  
23 latest CME prices, the overbase price paid to producers in  
24 our state will be in the \$17/cwt. range while costs continue  
25 to remain at approximately \$20/cwt.

1           Dairies that have been in operation for  
2 generations are continuing to close their doors due to the  
3 fact that prices do not cover costs. The message that we  
4 and other organizations representing dairy producers have  
5 conveyed has led to considerable debate in the state capital  
6 about how to address the inequity in our current 4b pricing  
7 system. Lawmakers in the California State Legislature are  
8 concerned about the conditions facing dairy farm families in  
9 this state. It is important to recognize and respond to the  
10 interest and level of concern among our elected officials  
11 about the crisis that persists among dairy producers across  
12 our state. An increase in the 4b price of \$1.20/cwt. is the  
13 most effective action CDFA can take in the short term to  
14 address some of the concerns raised by lawmakers.

15           During the December CDFA hearing last year, our  
16 organization called for CDFA to increase all class prices so  
17 that they aligned with federal order prices. We continue to  
18 believe that alignment with the federal order is the only  
19 way to end the inequity in our state pricing system. As a  
20 compromise for this hearing we are instead focused on  
21 changes to the 4b price where the greatest gap between the  
22 California -- the federal order class price and the  
23 California price continues to exist. In order to send a  
24 unified message to the Department we have joined with other  
25 dairy producer organizations and cooperatives in our state

1 to call for 80% of the federal order whey value, which  
2 amounts to \$1.20/cwt. Adoption of this proposal will bring  
3 California prices in closer relationship to prices paid in  
4 other states.

5           The increase will not solve all the problems that  
6 exist in our state dairy pricing system, but it would  
7 provide additional revenue that is well deserved by dairy  
8 producers who have continued to lose substantial income over  
9 countless months. We believe this change should remain in  
10 effect until comprehensive changes are made in our state  
11 dairy pricing system that recognize the cost of production  
12 in our pricing formula and other critical factors.

13           And below it outlines the specific changes to the  
14 formulas.

15           In conclusion, we urge CDFA to increase the price  
16 paid on 4b by \$1.20/cwt. Our proposal is a compromise  
17 position that would bring our prices closer to prices paid  
18 to dairy producers in the federal milk marketing order  
19 system. Adoption of the producer price increases that we  
20 have called for today will provide much needed relief to  
21 dairy producers across the state who continue to struggle to  
22 remain in operation under incredibly difficult  
23 circumstances.

24           The California Dairy Campaign would like to thank  
25 the Department for the opportunity to present our testimony

1 today. We look forward to working with CDFA to improve the  
2 outlook for California dairy producers now and in the  
3 future. Thank you.

4 MR. EASTMAN: I have one question regarding the  
5 graph that's the second-to-the-last page of your testimony.

6 MS. McBRIDE: Yeah.

7 MR. EASTMAN: Just so I can understand. So you're  
8 looking, obviously, at a sort of margin. So the milk price  
9 you're using, you say the Blend less \$0.20. By blend do you  
10 mean the overbase price or the statewide blend --

11 MS. McBRIDE: That's the published -- yeah, the  
12 statewide blend.

13 MR. EASTMAN: The statewide blend. And then in  
14 using that price you subtract \$0.20. Is there a reason for  
15 the \$0.20?

16 MS. McBRIDE: Just to recognize the fact that 50%  
17 of the producers in the state hold about 10% of the quota  
18 value. So a lot of the producers are not getting the blend  
19 price so that's we subtracted \$0.20.

20 MR. EASTMAN: So it's just a counter-correct for  
21 the quota price, then.

22 MS. McBRIDE: Correct.

23 MR. EASTMAN: And then the cost. You've just  
24 taken the cost -- was that from the Department's cost of  
25 production survey?

1 MS. McBRIDE: Yes. We study those. And many of  
2 our members participate in those studies.

3 MR. EASTMAN: Right.

4 MS. McBRIDE: And find them very valuable.

5 MR. EASTMAN: Perfect.

6 HEARING OFFICER SUTHER: Thank you for your  
7 testimony.

8 MS. McBRIDE: Okay.

9 HEARING OFFICER SUTHER: Mr. Vandenneuvel.

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

12 MR. VANDENHEUVEL: The full name is Rob  
13 Vandenneuvel, V-A-N-D-E-N-H-E-U-V-E-L, I'm the General  
14 Manager of Milk Producers Council.

15 Whereupon,

16 ROB VANDENHEUVEL

17 Was duly sworn.

18 HEARING OFFICER SUTHER: Mr. Vandenneuvel's  
19 testimony will be Exhibit 47.

20 (Exhibit 47 was received into evidence.)

21 HEARING OFFICER SUTHER: You may proceed.

22 MR. VANDENHEUVEL: Thank you. Mr. Hearing Officer  
23 and Members of the Panel, my name is Rob Vandenneuvel and I  
24 am the General Manager of Milk Producers Council. MPC is a  
25 nonprofit trade association with office locations in

1 Ontario, Bakersfield and Turlock, California. We represent  
2 a voluntary membership of dairy families throughout Southern  
3 and Central California. My testimony today is based on  
4 positions adopted by the MPC Board of Directors.

5 The California Food and Ag Code outlines some  
6 general purposes for why CDFA is involved in establishing  
7 minimum prices for milk. One of the purposes is, and I  
8 quote, to:

9 "Enable the dairy industry, with the aid of  
10 the state, to develop and maintain satisfactory  
11 marketing conditions, bring about and maintain a  
12 reasonable amount of stability and prosperity in  
13 the production of market milk, and provide the  
14 means for carrying on essential educational  
15 activities."

16 Given the discussion both inside and outside of  
17 this building over the past two years, it is clear that this  
18 particular goal, outlined by the California Legislature, is  
19 not being achieved. Fortunately, the Secretary has an  
20 opportunity in this hearing today to take a significant step  
21 towards rectifying that.

22 Included in the call of today's hearing, as has  
23 been mentioned before, is the Secretary's decision today  
24 will include consideration of all relevant economic factors  
25 including the reasonableness and economic soundness of

1 market milk prices for all classes, giving consideration to  
2 combined income from those classes in relation to the cost  
3 of producing -- production and marketing for all purposes  
4 including manufacturing.

5           This language is pulled straight out of Section  
6 62062(a) of the Food and Ag Code, although it does omit the  
7 additional clause which states: "In determining the costs,  
8 the director shall consider the cost of management and a  
9 reasonable return on necessary capital investment." This  
10 language is also cited on the CDFA website as the reason why  
11 the Department maintains data on the cost of producing milk  
12 in California.

13           Given the stated focus of this hearing, and the  
14 fact that CDFA maintains data specifically on this point, it  
15 seems logical to start by looking at CDFA's own data. The  
16 table and chart below show the average statewide cost of  
17 production, as calculated by the Cost of Production unit  
18 here at CDFA, compared to the statewide blend price.

19           And I won't get too into the numbers there, you  
20 guys have heard from other witnesses on it, but I looked at  
21 the three year period starting in 2010 through 2012. And  
22 the difference between the cost of production and the  
23 California statewide blend was a net loss of \$0.63/cwt.

24           As CDFA's own data demonstrates, California's  
25 dairy families have been subjected to financial losses in

1 two out of the last three years, with an average loss of  
2 \$0.83/cwt. To put these figures in perspective, a 1,000 cow  
3 dairy producing 65 pounds of milk per cow per day, which I  
4 believe is still about the average here in California, that  
5 dairy would reasonably expect to have lost - according to  
6 CDFA's own economic data - about \$450,000 during that three  
7 year period, or about \$450 per cow. This data does not  
8 include the historic levels of debt accumulated by  
9 California dairy families during the economic devastation of  
10 2009 when the state cost of production was reported at  
11 \$16.86/cwt. compared to the statewide blend of \$11.56, a  
12 \$5.30 gap. I did not include that in the chart, that was  
13 more of a larger, more widespread economic collapse. I will  
14 close the loop on this example here in the next section.

15           When examining the California pricing system, one  
16 of the common themes you will hear today is how the  
17 regulated prices compare to the regulated prices announced  
18 in the Federal Milk Marketing Orders around the country,  
19 which is the predominant regulatory structure in dairy areas  
20 outside of California. Class 4a and 4b make up a vast  
21 majority of the milk produced and sold in California, and  
22 the Federal Order system provides an excellent reference for  
23 comparison, as it, too, has monthly minimum prices for these  
24 two classes, Federal Order Class III and Federal Order Class  
25 IV.

1           As you can see on that chart on page two, there is  
2 a significant difference between the 4a/Federal Order Class  
3 IV relationship on butter/powder manufacturers and the milk  
4 they buy, and the 4b/Federal Order Class III relationship.  
5 While both of these California classified prices are  
6 consistently below their Federal Order counterpart price,  
7 the 4b has a significantly larger discount. You can see that  
8 over that same three year period, 2010 to 2012, there is a  
9 \$0.29/cwt. difference between the average 4a price and the  
10 Federal Order Class IV; and there is a \$1.72/cwt. difference  
11 between the Federal Order Class III and the California Class  
12 4.

13           Looking specifically at the gap between the 4b  
14 price and the Federal Order Class III another interesting  
15 fact is exposed. Over the 2010-2012 period, we've already  
16 established that the CDFA data indicates that California  
17 dairy farmers received a statewide blend price that was  
18 \$0.63/cwt below the state's estimated cost of producing that  
19 milk. Over the same period of time, the California 4b price  
20 was below the Federal Order Class III by an average of  
21 \$1.72/cwt. About 42% of the total pooled solids in  
22 California were sold to 4b manufacturers during that time,  
23 so that \$1.72/cwt. gap represents about \$0.72/cwt. when  
24 blended through the California pool,  $\$1.72 \times 42\%$ .

25           So in short, based on CDFA's own cost of

1 production and milk price data, the significant discount in  
2 the California 4b price is arguably the difference between  
3 dairy farmers' profits and losses in California. This is  
4 significant as the Department considers what changes to make  
5 to the California pricing structure. The problem has been  
6 and continues to be specific to the way the state prices the  
7 Class 4b milk that is sold to cheese manufacturers and the  
8 significant discount the formula provides.

9           While we cannot do anything about the damage that  
10 has already occurred, today's hearing provides an  
11 opportunity to make sure we right this wrong going forward.

12           That leads to MPC's position in this hearing,  
13 which is to support the producer proposal explained earlier  
14 for an increase to the Class 4b price of \$1.20/cwt. This  
15 proposal is the only logical response to the fact outlined  
16 above.

17           While there will undoubtedly be testimony today on  
18 several efforts currently underway to make longer-term  
19 structural changes to the California pricing structure, and  
20 there has been mention of it before, such as the discussions  
21 about crafting a California Federal Milk Marketing Order or  
22 the Department's task force or the legislative options that  
23 have been discussed earlier, dairy families are in need of  
24 this price adjustment immediately. Per the call of the  
25 hearing, the relief will be temporary in nature, ultimately

1 giving way to broader reforms coming out of those  
2 discussions. But while those efforts are ongoing California  
3 dairy families are desperately in need of a pay price that  
4 meets the standards laid out in the call of the hearing and  
5 in the California Food and Ag Code.

6           Finally, I would like to bring up some points that  
7 MPC brought up in the December 2012 hearing with regard to  
8 the function of pooling in California. Those points provide  
9 further evidence as to why a meaningful increase in the  
10 Class 4b price is critical.

11           The dairy producer community has been extremely  
12 vocal and active in the past two years, pointing out the  
13 need for an increase in the pay price for milk, particularly  
14 with respect to Class 4b. While producers have been  
15 fighting for their financial lives, we've seen a specific  
16 line of rhetoric emerge from those who oppose the increase,  
17 mostly the state's cheese manufacturers. Their basic  
18 argument is that the minimum prices are fine where they are,  
19 in the past some have even proposed lowering them, that is  
20 not the case here today, but that premiums should be the  
21 only we use to increase our pay price for milk. And I've  
22 got some examples there, they're already in the record from  
23 the last hearing.

24           To those that don't fully understand how milk is  
25 marketed in California this rhetoric sounds pretty logical.

1 Why would we worry about minimum prices? Why not focus on  
2 generating higher premiums? The reason is actually quite  
3 simple when you step back from the minimum pricing formulas  
4 and look at the pooling system as a whole.

5 One of the Secretary's considerations specifically  
6 spelled out in the California Food and Ag Code is the  
7 reasonableness and soundness of the relationship between the  
8 various classes. This consideration was also specifically  
9 included in the official notice for today's hearing. Why is  
10 it there? The reason is simple. While today's hearing is  
11 specifically on the five minimum prices established each  
12 month, we need to remember that these minimum prices do not  
13 exist in a vacuum. California operates under a Pooling Plan  
14 that pools the revenues from the sale of milk into the five  
15 classes. One of the fundamental tenets of that pooling  
16 structure is that each of the five classes must make a fair  
17 and equitable contribution to the pool.

18 We recognize that this does not mean all five  
19 class prices must be equal, but the Secretary is nonetheless  
20 tasked with maintaining a fair and reasonable relationship  
21 between the classes. Today, let's specifically look at the  
22 relationship between our two main manufacturing classes, 4a  
23 and 4b.

24 Over the past three years, since January 2010, the  
25 Class 4b price has averaged \$15.05/cwt. while the Class 4a

1 price has averaged \$16.51/cwt., an average difference of  
2 \$1.46/cwt. At the same time, the overbase price, which is  
3 the price the plants are obligated to pay their milk  
4 suppliers, has averaged \$15.76/cwt. What this means is that  
5 since January of 2010, in order to be able to pay their  
6 producers the blended overbase price, Class 4b plants have  
7 collectively received more than \$410 million out of the  
8 California pool. At the same time, Class 4a plants have not  
9 only had to pay their milk suppliers the blended overbase  
10 price, but on top of that they have collectively contributed  
11 more than \$323 million into the California pool. I don't  
12 know if the other classes have also made contributions, they  
13 are just not calculated in this testimony.

14           What does that mean? Through California's  
15 regulated pooling system, our butter/powder plants, as well  
16 as the plants that buy Class 1, 2 and 3 milk, have been  
17 heavily subsidizing the cheese plants over the past three  
18 years. Without our pooling system how much milk would that  
19 cheese manufacturer have been able to purchase at \$15.05/cwt  
20 while every other class, including the other main  
21 manufacturing classes, are paying significantly more.  
22 Instead, those cheese plants were able to compete for milk  
23 on an equal playing field with the butter/powder plants,  
24 since hundreds of millions of dollars were being taken from  
25 the butter/powder plants and given to the cheese plants.

1           It's frankly dishonest for cheese manufacturers to  
2 lecture dairy farmers and cooperatives about "going to the  
3 marketplace" for additional revenue, while the regulated  
4 system has overseen the transfer of more than \$410 million  
5 in pool revenues they did not earn in order to pay a market  
6 price for the milk they need. This is why Milk Producers  
7 Council believes that the dairy producer proposal, which  
8 would result in a significant increase in the Class 4b  
9 price, is an appropriate adjustment for CDFA to make. It's  
10 about fairness and justice, something the Secretary is sworn  
11 to uphold.

12           In conclusion, for all the reasons stated in this  
13 testimony, MPC strongly urges the Secretary and the  
14 Department to utilize the authority granted under the law to  
15 increase the Class 4b price. The facts certainly justify  
16 this critical adjustment. That's my testimony.

17           MR. EASTMAN: I have a question. In terms of the  
18 duration of your proposal. Do you suggest that it would  
19 continue until there is a compromise, whether that comes  
20 through legislation or the task force or a federal order,  
21 whatever the case may be? Is that your sense?

22           MR. VANDENHEUVEL: Yes, yes. We recognize that  
23 this is a bridge, it's a temporary bridge. But in terms of  
24 trying to put a definite end date at this point, not knowing  
25 what some of the results of those would be, you're exactly

1 right, we would see this until one of those other  
2 alternatives comes up.

3 HEARING OFFICER SUTHER: Thank you for your  
4 testimony. Mr. Ahlem.

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

7 MR. AHLEM: David Ahlem, the last name is A-H-L-E-  
8 M, and I am representing Hilmar Cheese Company.

9 Whereupon,

10 DAVID AHLEM

11 Was duly sworn.

12 HEARING OFFICER SUTHER: Mr. Ahlem's testimony  
13 will be Exhibit 48.

14 (Exhibit 48 was received into evidence.)

15 HEARING OFFICER SUTHER: You may proceed.

16 MR. AHLEM: Thank you. My name is David Ahlem. I  
17 am the Vice President and, General Manager for Hilmar Cheese  
18 Company. Hilmar Cheese Company is a whey -- a cheese and  
19 whey products manufacturer with locations in California and  
20 Texas. In Hilmar -- in California, Hilmar Cheese Company  
21 processes over 13 million pounds of milk per day, that's  
22 more than ten percent of the milk produced in California,  
23 and purchases milk directly from over 200 dairies. Finished  
24 products are sold to over 50 countries around the globe.

25 Hilmar Cheese Company was formed in 1984 by a

1 group of innovative, market-oriented Jersey dairymen who  
2 sought to capture the full value of their high quality milk.  
3 They founded the company on the ideal that producers should  
4 receive a competitive market-driven price for their milk.  
5 Hilmar Cheese Company supports a low regulated minimum price  
6 that allows the market to efficiently set high market-driven  
7 prices.

8 I am here today to represent Hilmar Cheese Company  
9 and our dairy producer owners. As a member of Dairy  
10 Institute we have committed to the Legislature that we would  
11 support continuation of the current emergency price relief  
12 increases that have been in effect since February of 2013  
13 and which would otherwise expire on May 31st.

14 Our commitment is two-fold, support of both short-  
15 term and long-term solutions: One is, to support the  
16 continuation of the price relief being considered at this  
17 hearing; and Two, support the active engagement of the Dairy  
18 Future Task Force to modernize California's regulated milk  
19 pricing system to meet the opportunities and challenges  
20 facing producers and processors in both the global  
21 marketplace and the more competitive domestic marketplace.

22 As the Department does consider the continuation  
23 of this price relief, it is important to note that this is a  
24 time of rising markets and increasing milk prices.  
25 Regulatory price relief should be no larger an amount than

1 is currently in place, and for no longer than six months to  
2 minimize disruption of market signals.

3           The Situation.

4           High feed prices, which are a direct result of  
5 intrusive federal policy to promote ethanol production, have  
6 dramatically changed the competitive position of producers  
7 throughout the Western United States. Those who have the  
8 ability to grow their own feed are in a much better  
9 financial position than those who purchase outside  
10 feedstuffs. The purchased feed model that was once integral  
11 to California's success is now a detriment to some and the  
12 industry is undergoing a painful adjustment to this changing  
13 dynamic.

14           The outcome, while many farms have exited, many  
15 others have expanded. This is a national trend. Cow  
16 numbers have remained consistent and the milk supply in  
17 California has remained relatively steady. In fact, our  
18 milk supply has grown year over year. Hilmar Cheese Company  
19 continues to enforce contract caps. And we have a waiting  
20 list of producers who wish to increase their contract caps  
21 and are also aware of several suppliers who are selling  
22 their milk right now to calf ranches to stay within their  
23 contract limitations.

24           Hilmar Cheese Company Supports High Market-Driven  
25 Prices.

1           Our company was founded to pay more for milk. The  
2 dairymen who established this company sought to get more  
3 value out of milk and pay high market-driven prices to its  
4 suppliers. Hilmar Cheese Company continues to invest,  
5 innovate and remains a leader in returning value to dairymen  
6 in California.

7           California producers should ask why they receive  
8 less for their milk than many of their domestic and global  
9 peers. Why do producers in regions with no minimum  
10 regulated prices get more for milk, for example Idaho and  
11 New Zealand? What are the fundamental market conditions  
12 that drive these differences? It's not the regulated price.

13       It has much more to do with the market supply and demand  
14 conditions and competition than regulated prices.

15           Increases in the regulatory price will not  
16 generate more revenue for the industry. Unless driven by  
17 market fundamentals, regulated price increases are  
18 artificial and the benefits to producers will be short  
19 lived. In the end, these changes are simply about income  
20 and revenue redistribution. Our industry must shift its  
21 focus from debating about how the pie is sliced to what we  
22 must do to grow the revenue pie for all.

23           Markets Can Respond; Minimums are Minimums, Not  
24 Maximums.

25           Minimum prices are just that, minimums. Nothing

1 precludes processors from paying more and nothing prevents  
2 milk sellers from asking for more from milk buyers. Many  
3 California processors pay premiums to producers above the 4b  
4 price. Hilmar Cheese Company is one such example of a  
5 processor who pays market-driven premiums for milk. Since  
6 its inception, Hilmar Cheese Company has consistently paid  
7 premiums to its producers well above the 4b price.

8           As market conditions change, the marketplace can  
9 and will respond. Hilmar Cheese Company already responded  
10 to concerns about the supply situation last October when we  
11 made significant increases in our pay price above and beyond  
12 the premiums that we have paid for years.

13           Furthermore, California cooperatives that control  
14 80 to 85 percent of the milk in California have the ability  
15 to increase the price for their milk to all of their  
16 customers tomorrow. But Instead of going to the marketplace  
17 and asking their customers, processors, for a higher price,  
18 these cooperatives have chosen to delegate this  
19 responsibility to the Department of Food and Ag. This is  
20 not the intended function of the regulatory system. The  
21 regulated minimum price should be a market clearing price,  
22 not a market making price. If allowed to function, the  
23 marketplace will drive premiums and establish a value for  
24 milk above and beyond the regulated price, which often  
25 occurs today.

1 Our competitors Have a Choice.

2 Out of state competitors have the ability to  
3 choose whether or not to participate in the Federal Order.  
4 Participation in the Federal Orders is optional for cheese  
5 manufacturers. This is not the case in California. The  
6 proposed minimum price increase puts California cheese  
7 processors at a further disadvantage to our primary  
8 competitors in regulated and unregulated markets, both  
9 domestically and abroad.

10 Regulatory Uncertainty Impedes Investment.

11 In the past 11 years we have had more than 26 milk  
12 price hearings in California, not including the one we are  
13 in the middle of today. Each of these changes have  
14 significantly impacted margins and the returns for all  
15 processors. As individual companies consider long-term  
16 investments that require massive amounts of capital this  
17 frequently changing regulatory environment discourages  
18 investment by creating uncertainty. This uncertainty adds  
19 tremendous risk to investment decisions.

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

1           Increases in the Minimum Price Do Not Benefit All  
2 Producers.

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

9           In 2012 more than \$6 million of Hilmar Cheese  
10 Company premiums were redistributed through the pool as a  
11 result of the past two 4b hearings, not including emergency  
12 price relief. This means our producers took home \$6 million  
13 less than they would have if there had been no change in the  
14 4b price. When the minimum 4b price increases our producers  
15 lose income and this doesn't help them in a tight margin  
16 environment.

17           And this argument, I would just add, is the same  
18 for 4a and for 4b. So whenever those increases, we hear  
19 similar arguments on the side of the 4a manufacturers who  
20 market those products the same thing occurs. As long as we  
21 have a pool we'll continue to subsidize lower value products  
22 and redistribute those revenues.

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

25           Trade organizations and cooperatives in California

1 have been trained by our state pricing system to look for  
2 artificial ways to inflate prices. Their efforts have  
3 resulted in several milk pricing hearings over the past  
4 years, with a recent emphasis on the whey factor portion of  
5 the 4b formula. Recent tactics have included unsuccessful  
6 litigious attempts to force the CDFA to increase the whey  
7 factor and now the introduction of AB 31, which bypass the  
8 CDFA and tries to legislate a price. These are all varying  
9 forms of "regulated solutions." None of these efforts  
10 contribute to increasing the market value of milk or the  
11 finished products it's converted into. Increasing the  
12 regulatory price does not create more revenue or increase  
13 the value of milk.

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

23           If we really want to grow the value of milk in  
24 California we must pursue market-based solutions.  
25 Regulatory solutions are unsustainable and will only yield

1 more of the same results.

2           As a producer-owned entity, we believe we would be  
3 better served to focus on fundamental reform that moves us  
4 towards growing the value of milk over time. The whey  
5 factor debate is a symptom of a much larger problem and a  
6 simple adjustment to the whey factor will not solve our  
7 problem longer-term. As long as we remain entrenched in  
8 formula pricing, we will continue to have contentious  
9 debates around value sharing, producers will continue to  
10 bear all the market risk, and our industry focus will be on  
11 the system, not the customer.

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

19           The McKinsey Report and the Innovation Center on  
20 Globalization, and most recently a Rabobank study, have all  
21 concluded that there is tremendous opportunity for  
22 California and the US in the global marketplace. However,  
23 they all suggest that the dairy industry must adopt market-  
24 oriented policy initiatives and pricing reform. They warned  
25 that failure to do so might compromise our competitive

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

8           Continuing to seek regulatory solutions in the  
9 short-term is a long-term choice. As long as we continue to  
10 avoid real reform we will continue to see more of the same  
11 results. Reform can and will lead to real value creation  
12 which will benefit all industry participants over time.

13           While recognizing that any increase in the  
14 regulatory price is artificial, disruptive and will not  
15 generate more revenue for the industry, our decision to  
16 support continuation of emergency price relief is based  
17 rather on our short-term commitment to the Legislature and  
18 our long-term desire to reform our outdated pricing system.

19 We will continue to support the efforts of the Dairy Future  
20 Task force and are committed to see it through to completion  
21 and implementation.

22           Thanks for your time and consideration. Be happy  
23 to answer any questions.

24           MS. GATES: David, on page two of your testimony  
25 you spoke to being aware that there are suppliers who are

1 selling milk to calf ranches to stay within their contract.

2 MR. AHLEM: Correct.

3 MS. GATES: Is that right now, was that over a  
4 length of time?

5 MR. AHLEM: Yes, yes.

6 MS. GATES: It's just a current situation, just  
7 recently?

8 MR. AHLEM: A current situation. Probably -- We  
9 establish contract caps for producers, we will be X up to X  
10 amount. And generally in the springtime or when folks are  
11 -- we have not extended as much contract as they would like  
12 over time they will sell surpluses to calf ranch or other  
13 alternative markets. And that is going on right now.

14 MS. GATES: So you'd say just in May or April/May?

15 MR. AHLEM: We have had some in April and we have  
16 had some in May.

17 MS. GATES: Okay, thank you.

18 MR. AHLEM: Must be nearing lunchtime. Okay,  
19 thank you.

20 HEARING OFFICER SUTHER: Thank you for your  
21 testimony.

22 Emily Rooney, please. Please state your full  
23 name, spell your last name and state your affiliation for  
24 the record, please.

25 MS. ROONEY: Emily Rooney, R-O-O-N-E-Y, President

1 of Agricultural Council of California.

2 Whereupon,

3 EMILY ROONEY

4 Was duly sworn.

5 HEARING OFFICER SUTHER: Ms. Rooney's testimony  
6 will be Exhibit 49.

7 (Exhibit 49 was received into evidence.)

8 MS. ROONEY: Thank you, Mr. Hearing Officer and  
9 members of the Panel. Thank's for the opportunity to  
10 testify today. My name is Emily Rooney. I am President of  
11 Agricultural Council of California. Ag Council represents  
12 approximately 15,000 farmers throughout the state of  
13 California ranging from small, farmer-owned businesses to  
14 some of the world's best-known brands.

15 Our dairy membership includes the three California  
16 cooperatives, California Dairies, Inc., Dairy Farmers of  
17 America and Land O'Lakes. We represent collectively over  
18 80% of the fluid milk in California.

19 While I defer to the co-ops for their individual  
20 testimony there are a few points I wanted to offer for the  
21 record today.

22 First, the financial hardship of dairymen and  
23 women in this state is widespread. As such, I thank you for  
24 responding to the requests of Assembly Members Eggman and  
25 Olsen in asking for a hearing to consider the extension of

1 the temporary price increases. I have a copy of those  
2 letters, which I submitted with my written testimony.

3           Second, I agree with the California cooperatives  
4 that we seek an elevated price for 4b, specifically. Due to  
5 increased input costs and various other factors we have lost  
6 387 dairies since 2007. Over 100 were lost last year alone.  
7 We must stop this trend. We are down to approximately 1500  
8 dairies. Not only is the loss of a dairy family devastating  
9 to the state but also the local community as it impacts  
10 banks and other related businesses such as feed companies  
11 and tractor dealers.

12           The 4b pricing is not incidental. You heard more  
13 detailed testimony from the co-ops but the impacts are real-  
14 world and they are generational. The dairy families  
15 supported bringing cheese processors to California. And we  
16 have families that still continue to support cheese  
17 processing in California, but the time is now to be  
18 practical and reasonable. We need a short-term and a long-  
19 term solution to this crisis.

20           Ag Council supports the Secretary's Dairy Future  
21 Task Force and is hopeful for a positive outcome. However,  
22 while a long-term solution is vital to this effort we cannot  
23 ignore the short-term, immediate needs of dairy families  
24 throughout the state. A short-term solution such as  
25 improving the 4b price would allow dairy families some



1 individually today?

2 MR. BARCELLOS: Yes I am.

3 HEARING OFFICER SUTHER: You may proceed.

4 MR. BARCELLOS: Thank you.

5 HEARING OFFICER SUTHER: Hold on one moment.

6 Mr. Barcellos' testimony will be Exhibit 50.

7 (Exhibit 50 was received into evidence.)

8 HEARING OFFICER SUTHER: You may proceed.

9 MR. BARCELLOS: Thank you. Tom Barcellos, T-Bar  
10 Dairy, 14851 Road 168, Porterville, California.

11 Mr. Hearing Officer and Panel:

12 Thank you for the opportunity to testify today and  
13 especially to Secretary Ross for calling this emergency  
14 hearing. I am here to request that the panel give careful  
15 consideration to the call of the hearing.

16 The purpose of this hearing is for emergency  
17 relief in the pricing of milk and all classes are to be  
18 considered. It has been documented and testified to in past  
19 hearings that the only real discrepancy has been in the whey  
20 factor of 4b price. In light of that, it is the charge of  
21 the panel and the Secretary to make the necessary correction  
22 to bring the 4b price in a reasonable relationship with  
23 surrounding states. It is for that reason I fully support  
24 the adjustments requested in the testimony of Western United  
25 Dairymen.

1           The California pooling system has worked as it was  
2 designed to do for many years. When necessary, hearings  
3 would be called for and corrections would be made to pricing  
4 formulas, yield calculations, class descriptions and make  
5 allowances. All done to benefit the dairy industry as a  
6 whole. This is how the pooling plan was designed to work  
7 and it worked well until recent years when the whey factor  
8 was changed.

9           The dairy producer derives his income from the  
10 milk he produces and all of its components. That is where  
11 the money should come from, not an arbitrary and occasional  
12 premium from an individual plant to an individual producer.

13          That should be over and above the reasonable price paid for  
14 that milk. All producers in turn, whether they ship to that  
15 plant or not, have supported a reasonable make allowance to  
16 enable the plants to invest in capacity and efficiency along  
17 with technology. The most recent make allowance hearing for  
18 4b was in 2007 and the plants were given a nearly 12%  
19 increase in their make allowance. That was to ensure the  
20 future of the plants and capacity.

21          The testimony today is requesting less than 3% on  
22 the value of milk returned to the producer, and that would  
23 have been enough over the last several years to have kept  
24 some from going out of business. Should the plants require  
25 additional support then they should request the same through

1 a make allowance hearing as has been done in the past. It  
2 is the only fair way to do this.

3           The claim has been made that it can't be that bad  
4 since milk production hasn't gone down. I am sorry that you  
5 feel the need to penalize us as we continue to get more with  
6 less. We have no choice but to produce as regulatory and  
7 compliance costs have gone up and the dollar amount of our  
8 payments increase as well. I and many other producers  
9 reduced production last year as our plant was at capacity  
10 and instituted bases for milk delivery. That is who should  
11 manage the supply, not the department with pricing.

12           My request is that the adjustment to the 4b price  
13 recommended by Western United Dairymen should be implemented  
14 on an emergency basis until the Dairy Futures Task Force has  
15 completed its work. Without such a time line there is no  
16 urgency for some in the processing community to offer or  
17 even negotiate going forward as has been evidenced from past  
18 discussions for the benefit of all producers. If certain  
19 processors deem the need for additional assistance in  
20 funding capacity for whey facilities, then by all means,  
21 call for a hearing and make the request for a make allowance  
22 adjustment. That is the right way to move the California  
23 dairy industry back into the future.

24           Respectfully submitted.

25           HEARING OFFICER SUTHER: Thank you for your

1 testimony, Mr. Barcellos.

2 Mr. Clement.

3 MR. CLEMENT: I'm sorry, I don't have a handout to  
4 give, I can show it to you.

5 HEARING OFFICER SUTHER: Oh.

6 MR. CLEMENT: Will I be able to give testimony?

7 HEARING OFFICER SUTHER: Yes.

8 MR. CLEMENT: Would it be all right? Thank you  
9 very much.

10 HEARING OFFICER SUTHER: Please state your full  
11 name, spell your last name and state your affiliation for  
12 the record, please.

13 MR. CLEMENT: Yes. I'm John Clement, the last  
14 name C-L-E-M-E-N-T, I'm from Los Altos Foods, Southern  
15 California. I'm here to give testimony on behalf of my  
16 company.

17 Whereupon,

18 JOHN CLEMENT

19 Was duly sworn.

20 MR. CLEMENT: Mr. Hearing Officer and members of  
21 the Hearing Panel: Again, I apologize for being unprepared  
22 with a handout for you today and I appreciate your allowing  
23 me to testify on behalf of Los Altos.

24 On behalf of Los Altos, we're a small, mid-size  
25 cheese manufacturer in Southern California with about 249

1 employees who make a line of specialty cheeses, have been in  
2 business for many, many years, okay.

3 I want to give thanks to Secretary Ross for  
4 calling this hearing and I am here to show support for the  
5 Dairy Future Task Force and support the Dairy Institute's  
6 proposals.

7 We recognize challenges faced by dairy farmers and  
8 we do support an extension of six months of the emergency  
9 price relief issue as a temporary fix to be reviewed at a  
10 later date. We feel this will give them time necessary for  
11 the Dairy Future Task Force to provide a solution to these  
12 issues.

13 Producers and processors have both faced  
14 challenges due to the rising costs, along with the  
15 uncertainties in operating costs. Today I have heard many  
16 testimonies revolving around the increase in the whey factor  
17 in the 4b formula. From our vantage point this is an unfair  
18 focus and shift to one class of buyers. Whey is of no value  
19 to my company. It is a byproduct and we have had to pay up  
20 to \$300,000 per year to dispose of the whey, so it is a cost  
21 factor to us. But we do believe that the extension of the  
22 emergency price is important for the dairy farmers to keep  
23 on going and to provide some support for them.

24 Margins at our company have been the lowest I have  
25 seen for many years and it has a real effect on us because

1 our competition is so keen in our industry. We have had to  
2 keep our prices very low in order to maintain our costs at a  
3 reasonable level. Our market share would be impacted quite  
4 heavily if we had to raise prices as our competition would  
5 take advantage of that upon our, our downfall.

6           Increased costs also keeps our wages lower and  
7 also has an affect on investments in the future. Currently  
8 we had a project that we had to put on hold for solar panels  
9 in our building to provide some green energy investment in  
10 the future. We have had one project a couple of years ago,  
11 solar panels on the carports, but this one we have had to  
12 put on hold as we look at what is going to happen with the  
13 uncertain price that is going to happen with milk. Milk is  
14 the largest component in cheese, as we all know, and for us  
15 it is the uncertainty of the price that is stopping our  
16 investments in the future.

17           It is also the increased health benefits increases  
18 that we all face as manufacturers. Those prices keep on  
19 going up and our margins keep on going down, so we are  
20 offset by uncertainty.

21           Finally, we feel the Dairy Future Task Force will  
22 provide those necessary resolutions equitable to all, both  
23 processors and producers, and we hope and we are committed  
24 to seeing that process to completion.

25           Again I want to thank Secretary Ross for calling

1 this meeting together. I want to thank you for your time  
2 and your allowing me to speak without my handouts. And if  
3 there's any questions I'd be more than happy to, to discuss.

4 HEARING OFFICER SUTHER: Thank you for your  
5 testimony.

6 MR. CLEMENT: Thank you so much.

7 HEARING OFFICER SUTHER: Sue Taylor, please.

8 MS. TAYLOR: I also apologize because I saw Dennis  
9 on the list ahead of me so I was going to crank up my  
10 computer when he was on the witness stand; so if you'll bear  
11 with me while it comes out of hibernation a moment.

12 MR. EASTMAN: Now is the chance to tell your  
13 favorite jokes.

14 (Laughter.)

15 MS. TAYLOR: You're better at that than I am.

16 HEARING OFFICER SUTHER: Please state your full  
17 name, spell your last name and state your affiliation for  
18 the record, please.

19 MS. TAYLOR: My name is Sue Taylor, T-A-Y-L-O-R,  
20 and my affiliation is Leprino Foods Company in Denver,  
21 Colorado.

22 Whereupon,

23 SUE TAYLOR

24 Was duly sworn.

25 HEARING OFFICER SUTHER: And you have no exhibits?

1 MS. TAYLOR: That's correct.

2 HEARING OFFICER SUTHER: You may proceed.

3 MS. TAYLOR: I am Sue Taylor, Vice President of  
4 Dairy Policy and Procurement for Leprino Foods Company.  
5 Leprino operates ten mozzarella plants in the United States.  
6 Three of those are located in California, one in Tracy and  
7 two in Lemoore. We also process our whey into sweet whey or  
8 whey protein concentrate and lactose. Our whey stream from  
9 our California plants is processed into whey protein  
10 concentrate and lactose.

11 I am testifying today in support of the Dairy  
12 Institute proposal to extend a temporary price increase that  
13 has been in place from February through May to the period  
14 from July through December 2013. This support is consistent  
15 with Dairy Institute's commitment to support emergency price  
16 relief in the context of negotiations to reach a mutually  
17 agreeable way forward in legislative discussions associated  
18 with AB 31. This commitment includes support for an  
19 extension of the current temporary price relief through  
20 December in support for a thorough review of the existing  
21 milk pricing system by an industry task force.

22 This support is reflective of our interest in  
23 moving forward with a more comprehensive review of the  
24 current milk pricing system in the context of the CDFA Dairy  
25 Future Task Force. It is my hope the task force will

1 identify the needed reforms that will allow every sector of  
2 the California dairy industry to thrive.

3           We recognize that the dairy production sector in  
4 California suffered through financial stress last year as  
5 drought-driven feed price increases led to milk price  
6 increases. The feed cost inflation was felt most  
7 dramatically by dairies that had built their production  
8 model around purchased feed. While this is true regardless  
9 of geographical location around the country, the  
10 preponderance of dairies relying on purchased feed in  
11 California resulted in disproportionate stress in  
12 California.

13           The national marketplace has responded to the  
14 supply and demand balance shift created by milk supply  
15 adjustments last year with increased commodity prices. The  
16 calendar year to date through April, the average cheddar  
17 prices have been 17.63 or 11.6% -- \$0.1763, 11.6% higher  
18 than the same period last year. Nonfat dry milk has been  
19 \$0.1879 or 14.1% higher and butter has been \$0.1084 or 7.3%  
20 higher than the same period last year. Whey prices averaged  
21 \$0.0266 or 4.4% less during the same period. Class 4a  
22 prices have been \$2.31 or 15% higher and Class 4b prices  
23 have been \$2.11 or 15.4% higher than a year ago.

24           If the temporary price increases of \$0.30/cwt.  
25 effective in February 2013 had not been in place the Class

1 4a price would have still been 13.5% higher and 4b would  
2 have been 13.8% higher than the same period of the prior  
3 year. Strong export markets and declining feed costs are  
4 anticipated to result in improved margins during the second  
5 half of this year.

6 In addition to relief provided through the  
7 regulated system, Leprino responded to the farm financial  
8 stress by significantly increasing its over-order premium  
9 structure effective with September 2012 milk. We strongly  
10 believe that this kind of marketplace response is far  
11 superior to regulated price adjustments that are less  
12 responsive and timely.

13 The regulated milk pricing system is ripe for  
14 review and reform in the context of today's marketplace.  
15 The global marketplace is having an increasing impact upon  
16 the US dairy industry and exports have grown to nearly 14%  
17 of US milk supply. The impact is even more dramatic in  
18 California, which is a source for a high percentage of these  
19 exports.

20 The current pricing system with split  
21 manufacturing classes was developed in the context of a  
22 dairy price support program that resulted in government  
23 purchases of surplus product from the market. While it may  
24 have been viewed at one time as a benefit to bias milk  
25 allocation to the butter/powder complex is the balancing

1 wheel. That program and the incentives and opportunities  
2 that were created by it have not existed as a practical  
3 matter for several years. All indications are that the  
4 support program will be eliminated from law with this farm  
5 bill.

6 In addition to the changing marketplace in the  
7 national policy context, the existing end-product pricing  
8 formula approach that is currently used in California's  
9 formulas is in jeopardy due to lack of publishable data.  
10 This issue has been discussed within CDFA's Dairy Advisory  
11 Committee and no transparent solution has been identified.  
12 While the Department could theoretically collect the  
13 necessary data for its internal use and withhold it from  
14 publication due to the confidentiality rules, that approach  
15 would preclude the kind of industry discussion and debate  
16 that is an important part of policy development. We have  
17 reached the time when we must rethink our approach to the  
18 milk pricing system.

19 And finally, the continued focus by producer  
20 groups to hook their wagon to a Federal Order whey valuation  
21 while not accepting the Federal Order pooling rules is  
22 emblematic of the need for a deeper understanding of milk  
23 price policy, how regulated prices are applied and  
24 implications in the marketplace. It is in all of these  
25 contexts that the work of CDFA's Dairy Future Task Force is



1 CERTIFICATE OF REPORTER  
2

3 I, RAMONA COTA, an Electronic Reporter, do hereby  
4 certify that I am a disinterested person herein; that I  
5 recorded the foregoing California Department of Food and  
6 Agriculture consolidated public hearing; that I thereafter  
7 transcribed it.

8 I further certify that I am not of counsel or  
9 attorney for any of the parties to said public hearing, or  
10 in any way interested in the outcome of said matter.

11 IN WITNESS WHEREOF, I have hereunto set my hand  
12 this 24th day of May, 2013.

13  
14  
15 /s/ Ramona Cota

16 RAMONA COTA, CERT\*\*478  
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