Hearing Panel Report

Based on a Public Hearing Held
April 4, 2013

Addressing the Milk Movement Incentives
Contained in the
Pooling Plan for Market Milk and the
Stabilization and Marketing Plans
for Market Milk for the
Northern and Southern California Marketing Areas

— HEARING PANEL REPORT —

APRIL 4, 2013 PUBLIC HEARING

ADDRESSING MILK MOVEMENT INCENTIVES CONTAINED IN THE
MILK POOLING PLAN FOR MARKET MILK AND THE
STABILIZATION AND MARKETING PLANS FOR MARKET MILK
FOR NORTHERN AND SOUTHERN CALIFORNIA

This report of the Hearing Panel (Panel) regarding proposed amendments to the Milk Pooling Plan for Market Milk (Pool Plan) and to the Stabilization and Marketing Plans for Market Milk for Northern California and Southern California (Stab Plans) is based on the April 4, 2013, hearing record. The record includes the exhibits prepared by the California Department of Food and Agriculture (Department), written statements and comments received from interested parties, written and oral testimony received, and written post hearing briefs.

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INTRODUCTION AND LIST OF WITNESSES

California Food and Agricultural Code (Code) Section 61801, *et sec*., provides the authority, procedures and standards for establishing minimum farm prices by the Department for the various classes of milk that handlers (processors) must pay for milk purchased from dairy farmers (producers). These statutes provide for the formulation and adoption of the Stab Plans.

The Gonsalves Milk Pooling Act, Code Section 62700, *et sec*., authorizes the Secretary to operate a statewide pooling system under specified guidelines. These statutes provide for the formulation and adoption of Pool Plans.

One petition was submitted by:
1. Wallaby Yogurt Company (Wallaby)

Two alternative proposals were submitted by:
1. California Dairies, Inc. (CDI)*
2. Dairy Farmers of America (DFA)*

A total of 4 witnesses testified including the Department's witnesses:
Department - Steven Donaldson
Milk Producers Council (MPC) - Rob Vandenheuvel
Western United Dairymen (WUD) – Annie AcMoody
Dairy Institute of California (Institute) – Bill Schiek

Written statements were received and entered into the hearing record from:
California Dairy Campaign (CDC)

An "*" indicates witness/organization submitted a post-hearing brief.

SUMMARY OF PROPOSALS

Transportation Allowances. The proposed changes to transportation allowance rates and mileage brackets are summarized in Table 1.

***Table 1*: PROPOSED CHANGES TO TRANSPORTATION ALLOWANCES:** *Ranch-to-Plant*

AREAS	CONSTRUCTIVE MILES	Current since September 2008	Wallaby Proposal	CDI Proposal	DFA Proposal
		In Dollars per Hundredweight			
Bay Area Receiving Area [1]	0 to 78	$0.36	-	-	
	78 to 199	$0.45	-	-	
	199 +	$0.47	-	-	
	0 to 78				**$0.48**
	78 to 139				**$0.55**
	139 +				**$0.72**
North Bay Receiving Area [2]	0 to 45	$0.23	-	-	$0.23
	45 to 96	$0.35	-	-	**$0.37**
	96 +	$0.44	-	-	**$0.52**
Proposed Change to Area Counties			**Add Napa Co.**	-	-
Sacramento Receiving Area	0 to 59	$0.15	-	-	**$0.17**
	59 +	$0.23	-	-	$0.23
Shasta Receiving Area [3]	0 to 29	$0.13	-	-	-
	29 to 49	$0.16	-	-	-
	49 +	$0.19	-	-	-
San Diego Receiving Area	0 to 79	$0.15	-	-	-
	79 to 119	$0.46	-	-	-
	119 +	$0.84	-	-	-
Southern California Receiving Area [4]	0 to 93	$0.15	-		
from San Bernardino	93 +	$0.46	-		
and Riverside counties					
	0 to 45			$0.15	$0.15
	45 to 93			**$0.30**	**$0.30**
	93 +			$0.46	$0.46
from all other counties	0 to 79	$0.15	-		-
	79 to 99	$0.46	-		-
	99 to 119	$0.67	-		-
	119 +	$0.84	-		-
	0 to 79			$0.15	
	79 to 99			$0.46	
	99 to 119			$0.67	
	119 to 139			$0.84	
	139 +			**$1.00**	

[1] Alameda, Contra Costa, San Francisco, San Mateo, Santa Clara, and Santa Cruz Counties.
[2] Marin, Solano and Sonoma counties.
[3] Transportation Allowances for the Shasta Receiving Area have not been used since mid-1996.
[4] Los Angeles, Orange, Riverside, San Bernardino, and Ventura Counties.
[5] **Numbers in bold and yellow shading represent proposed changes**

Transportation Credits. The proposed changes to transportation credit rates are summarized in Table 2.

Table 2 **- PROPOSED CHANGES TO TRANSPORTATION CREDITS:** *Plant-to-Plant*

WALLABY and DFA proposals would not affect transportation credits.

Area differentials based on whole milk $0.27 = $0.0031 x 87.8; for skim the differential would be $0.28 = $0.0031 x 90.9; for condensed skim $0.21 = $0.0031 x 68.0

SUPPLY COUNTIES	DEFICIT COUNTIES		CURRENT SINCE Sep 2008	CDI Proposal
			In Dollars per Hundredweight	
Los Angeles	Orange, Riverside,	Differential	$0.00	$0.00
	San Bernardino,	Credit	$0.45	**$0.54**
	San Diego and Ventura	Total	$0.45	**$0.54**

Values in bold and yellow shading represent proposed changes

BACKGROUND

The 1967 Gonsalves Milk Pooling Act (Act) allowed the Department to implement the Milk Pooling Plan for Market Milk (Pooling Plan). Class 1 fluid milk and Class 2 cream and cultured milk can only be produced with market milk; unlike Class 3 ice cream, Class 4a butter/powder and Class 4b cheese that can be made with manufacturing milk. Accordingly, the Act authorized the Secretary to include provisions that promote the availability of market milk for Class 1, 2, and 3 usages within the Pooling Plan.

Producers received the same price for their milk no matter how their milk was utilized after the implementation of the Pooling Plan in 1969. Producers no longer received more revenue for shipping milk to processors that paid producers higher class prices. As a consequence, producers had an incentive to ship their milk to local manufacturing plants rather than to more distant plants with higher class prices, to minimize their hauling costs. Milk movement incentives were implemented to address this problem.

By 1981, transportation credits (credits) were established as part of the Stabilization and Marketing Plans for Market Milk (Stab Plans). Credits offset a portion of the hauling costs expended by some processors who ship plant-to-plant milk and condensed skim to Class 1 processors located in designated market milk deficit counties. They specifically serve the needs of fluid milk/bottling plants in these deficit areas. In 1982, transportation allowances (allowances) were implemented to provide incentives to supply market milk to plants with Class 1, 2, and 3 utilization located in designated market milk deficit areas. All producers share the costs of these credits and allowances through the Pooling Plan.

Economic Factors Considered by the Panel

The Panel supports these milk movement incentives and considered various economic factors in formulating its recommendations, including but not limited to the following:

1. The closest milk available should be encouraged to move to qualifying plants with Class 1, 2, and 3 utilization.
2. Allowance and credit rates should be justified based on recent cost data that indicates the actual cost comparison between hauling milk to local manufacturing plants and to qualifying plants with Class 1, 2, and 3 utilization located further away from dairy farms.
3. The total cost to the Pool for transportation allowances and credits should be minimized.
4. Incentives should be provided to encourage milk movement where there exists a clear choice between shipping milk to a local manufacturing plant or to a qualifying plant with Class 1, 2, and 3 utilization, located further away. However, if local manufacturing facilities are not available to compete for milk supplies with qualifying plants, then the milk movement incentive provided to such milk should be minimized.

Changes in Milk Marketing Conditions in California

Over the last few decades, the concentration and location of dairy farms and processing plants have shifted, resulting in changing milk marketing conditions. The dairy industry has experienced significant consolidation both at the plant level as well as the producer level. During this time, the number of processing plants and dairies has decreased, but the volume of milk processed and produced, respectively, has increased.

Consistent with this consolidation of plants and dairies, there has been significant concentration of farm milk production. A much greater percentage of California's milk supply is now being produced in the San Joaquin Valley, and in particular, the southern San Joaquin Valley (Kings, Kern, and Tulare counties). Conversely, there has been a decrease in milk production in Southern California, particularly in the major Southern California milk production areas of Chino and San Jacinto. Hence, milk production in the state is heavily concentrated in the San Joaquin Valley.

A comparison of milk production data from 1982 and 2012 substantiates this transformation. In 1982, 31 percent of the state's milk was produced in Southern California, 56 percent was produced in the San Joaquin Valley, and the remaining 13 percent was produced in the other areas of the state. By 2012, 88 percent of the state's milk was produced in the San Joaquin Valley, with only 7 percent produced in Southern California and 5 percent produced in the other areas of the state. Such a dramatic concentration of the state's total milk production in the San Joaquin Valley has caused changes in milk marketing that have forced more and more milk from the San Joaquin Valley to be shipped to other areas of the state, particularly to Southern California.

Milk Marketing from the San Joaquin Valley to Southern California

According to Department data, milk usage by processing plants in Southern California peaked in 2002 at approximately 23.1 million pounds per day. By 2012, it declined to approximately 16.7 million pounds per day, a decline caused primarily by reduced demand from manufacturing plants. Despite this reduced milk usage, milk production in Southern California was not sufficient to cover the needs of plants with Class 1 utilization, much less plants with Class 2, 3, 4a, and 4b utilization, as it only averaged approximately 8 million pounds per day during 2012. As a result, shipments of milk from Northern California, primarily from the southern San Joaquin Valley, are needed to meet the milk demands of these plants. Such shipments amount to approximately 9.1 million pounds per day.

Meanwhile, milk production in the San Joaquin Valley, especially the southern San Joaquin Valley, has increased. Kern County milk production has increased from approximately 10 million pounds per day in 2009 to 11.1 million pounds per day in 2012, with milk production in Kings and Tulare counties increasing during this time as well. Processing capacity has increased as well, in butter, nonfat dry milk powder, and cheese plants. While the increased plant capacity accommodates most valley milk production, milk production has on occasion taxed that capacity.

Because of the shortfall in milk production in Southern California compared to milk demand by processing plants in the area, large volumes of milk produced in the San Joaquin Valley must be shipped to Southern California. Competition for milk between Southern California and San Joaquin Valley plants is generating marketing dynamics not experienced in the past when milk production in Southern California was mostly sufficient to meet total milk demand, or at least the milk demand of qualifying plants with Class 1, 2, and 3 utilization. Milk production was more evenly distributed across the state and the marketing of farm milk was different when transportation allowances and credits were implemented in the early 1980s. Even though there was some milk that was shipped from the San Joaquin Valley to Southern California at that time, the current volumes are much greater and are necessary to serve all five classes of milk, not just the higher valued classes that are covered by transportation allowances and credits. As a result, milk marketing conditions exist that differ from those that were in place when the current transportation allowances and credits were designed.

In summary, the Panel recognizes the continuing need to move milk to Southern California plants. Southern California remains a deficit area and requires milk from the San Joaquin Valley for its plants. The Panel understands, however, that moving milk from distant locations has significantly increased hauling costs in general, thereby increasing the cost of transportation allowances. The Panel therefore believes that the current system of transportation incentives may no longer be the most adequate mechanism to move milk in the state given the current marketing conditions and recommends that the industry consider alternatives.

DISCUSSION AND RECOMMENDATIONS FOR TRANSPORTATION ALLOWANCES

Background

The issues described in the previous section concerning the structural changes that have taken place in the dairy industry, regarding the shifting of dairy farms away from the major metropolitan areas, are applicable in both Northern California and Southern California. As the local milk supply has declined, current sources of local milk are unable to meet the demand from Class 1, 2, and 3 plants. This also applies to milk demand and supply for manufacturing plants as well. As a result, milk supply areas have become more concentrated in the northern San Joaquin Valley and the longer distance traveled has been a key factor behind increased haul rates for milk movement in the Northern California deficit areas. Similarly, Southern California processors have become more dependent on sourcing milk from distant milk supply areas such as the southern San Joaquin Valley. In conjunction, those fluid and manufacturing milk processors located in the San Joaquin Valley also compete for that milk being moved into the Southern California deficit area. Witnesses stated that the distance traveled has become an increasingly important reason behind increased haul costs.

Likewise, increases in diesel fuel prices and related hauling expenses were also stated as contributing factors to increases in transportation costs to ship milk to qualifying plants located in the Northern and Southern California county deficit areas. Witnesses testified that diesel prices have continued on an upward trend since 2008 which has further added to higher milk hauling costs. Although current diesel prices have not shown the same level of increase, as was the case preceding the 2008 transportation allowance and credit hearing, overall fuel prices remain relatively high on a historical basis. Many witnesses agreed that overall fuel costs have and will continue on an upward trend in the long term.

There was agreement among witnesses that changes in transportation allowances were necessary to better portray current milk movements and costs given the changes in milk production and receiving areas since 2008. In addition, witnesses were concerned about minimizing the costs to the Pool in the adoption of and/or changes to proposed transportation allowance rates and mileage brackets. Although some witnesses recognized there was a need to increase transportation rates to maintain milk movement incentives to higher class usage plants, they also expressed concern about the increase in cost to the Pool.

Witnesses that proposed changes to allowance rates and mileage brackets directed their testimony to those areas in which they supplied milk. The hearing record contains information regarding the actual costs incurred by producer cooperatives and comparisons to the Department’s most recent haul survey (October 2012 data released in February 2013). Witnesses testified their proposed changes were reasonable and consistent with recent Department hauling and fuel cost estimates.

NORTHERN CALIFORNIA

Proposals

Wallaby proposed including Napa County among those counties in the North Bay Receiving Area (North Bay) that are identified as deficit counties and qualify for transportation allowances. The proposal did not include any changes to current transportation allowance mileage brackets or rates.

DFA proposed to change rates in all three active Northern California receiving areas and amending the middle and distant mileage brackets to the Bay Area Receiving Area (Bay Area). These proposed changes are found in Table 1 of this Panel report.

Discussion and Analysis

Bay Area Receiving Area (Alameda, Contra Costa, Santa Clara, Santa Cruz, San Francisco, and San Mateo counties)

Overall, DFA proposed a rate increase for the Bay Area in all mileage brackets in addition to changing the middle and distant mileage brackets. According to DFA testimony, these changes are needed to better depict current milk supply areas, milk movements to qualifying plants, and increased hauling costs they are experiencing in supplying milk to qualifying plants located in the Bay Area. DFA noted the absence of any close-in milk in the Bay Area and all milk needed to meet current customer demand was being imported from more distant areas. Since milk production areas have become more defined, DFA noted the increase in sourcing milk from the northern San Joaquin Valley to service the qualifying plants in the Bay Area. DFA provided supporting documentation showing their specific haul distances and costs, with substantial cost impacts on longer distance hauls. DFA testified that the proposed transportation rate changes for the Bay Area were based on recent haul rates and in agreement with the Department's most recent haul survey.

DFA proposed to increase rates for the zero to 78 mileage bracket and addressed the issue of moving milk into the Bay Area. Milk imported to the Bay Area from the northern San Joaquin Valley must pass a manufacturing plant located in Tracy. Because of the transportation allowance system and incentives needed to move milk to higher class usage plants, the milk nearest to the manufacturing plant (or local milk as referred to by DFA) is instead transported farther distances to the qualifying fluid milk plants. Because the close-in milk is designated for qualifying plants, the local milk that would normally serve the manufacturing plants must be replaced with milk from distant supply areas.

DFA testified that for the zero to 78 mileage bracket, when moving local milk, its current costs are lower than the Department's most recent haul survey, but when moving milk to the higher class usage plants, their costs exceed the proposed $0.48/cwt. rate. Because of consolidation in supply areas and the increased competition for local milk from both fluid and manufacturing plants, DFA argued that there are increased haul costs associated with the milk shipped to manufacturing plants in the northern San Joaquin Valley due to local milk being shipped into the Bay Area to service qualifying plants. DFA testified that these increased costs suggest shortfalls should no longer be accounted for in determining transportation allowance rates. In addition, DFA stated that the impacts of moving milk from farther distances will create shortfalls over the long run (this statement also applies to all DFA transportation allowance area proposals).

DFA proposed reducing the higher range of the 78 to 199 mileage bracket to 78 to 139 miles. DFA stated there is an apparent divide in milk supply and mileage costs around 139 miles, and in January 2013, 98 percent of the milk it supplied to the Bay Area was sourced within 139 miles. Further testimony indicated that DFA does not source milk from over 199 miles, as the incentive is minimal and therefore adjusting the higher range of the bracket to 139 and Over aligns more with current milk movements.

The Panel recognizes, due to structural changes in terms of milk supply and fluid milk demand areas, milk is moving farther distances to qualifying plants in the Bay Area and is a key contributing factor to rising haul costs. Based on current milk movement patterns and volumes into the Bay Area, the Panel does not recommend changing mileage brackets as proposed by DFA. The proposed change in mileage brackets appears to target a specific milk supply located in and around Glenn County that lacks a local manufacturing plant in that area, which causes the milk to move long distances. In addition, the milk located within the middle and distant mileage brackets do pass by other qualifying plants in route to the Bay Area. The Panel does not believe a change to the mileage brackets, as proposed, is warranted because the targeted milk supply is not close-in milk and does not have a choice of shipping to a local manufacturing facility or a further distant qualifying plant.

The Panel believes that the original intent of transportation allowances to incentivize local milk to move to qualifying higher usage plants versus distant milk needs to be accounted for in current transportation rates. In addition, those rates should be justified based on recent cost data that indicates the actual cost comparison between hauling milk to local manufacturing plants and to qualifying plants located further away from dairy farms.
The proposed rate increases appear relatively high and may eliminate any shortfall that has incurred from hauling milk from distant supply areas. In addition, the proposed rates may be at a level that could create an advantage to move distant milk past other deficit supply areas.

The hearing record and Department data show that the principle milk supply, or close-in milk supply, moving into the Bay Area is sourced from the northern San Joaquin Valley, so the milk supply in this area was used to determine the local haul rate for the Bay Area. According to the Department's most recent haul survey, the local haul cost for northern San Joaquin Valley is estimated at $0.39/cwt. Based on mileage brackets, the average haul cost for the zero to 78 mileage bracket is $0.81/cwt. and the 78 to 199 mileage bracket is $0.87/cwt. Based on the Department's most recent haul survey, on average, haul costs have shown modest increases. The Department's haul survey confirms DFA testimony that there is no milk moving from 199 miles and further, as the estimated mileage and haul costs are zero. However, for milk moving from 151 to 200 miles, the haul survey shows the average cost is $1.15/cwt.

Comparing the Department's most recent haul survey and corresponding distances of milk source and usage for milk movements into the Bay Area. The Panel recommends a modest increase in current transportation allowance rates. The Panel's recommendation is based on: concerns about minimizing the costs to the Pool from higher transportation rates; encouragement of close-in milk being shipped first into qualifying plants; hauling costs obtained from the Department's most recent haul survey; and the potential competition of the same milk supplies from qualifying plants in all three Northern California receiving areas. Because milk from the middle and distant mileage brackets could be procured by plants in the other receiving areas, the Panel considered the incentives to move this milk into the other receiving areas as well, in order to not provide an advantage to plants in different receiving areas competing for the same milk supplies.

Based on current average haul costs and milk movements, for the zero to 78 mileage bracket, the Panel recommends a rate increase from $0.36/cwt. to $0.41/cwt. and for the 78 to 199 mileage bracket a rate increase from $0.45/cwt. to $0.47/cwt. Both rate increases reflect current costs for the two mileage brackets. Additionally, the middle mileage bracket increase takes into consideration the relative incentives for this milk to move into the other Northern California receiving areas, in order to not provide an unnecessary advantage in the procurement of this milk by plants in these other areas. For the distant mileage bracket of over 199 miles, an increase from $0.47/cwt. to $0.65/cwt. is recommended. The Panel recognizes that essentially no milk is being hauled from locations over 199 miles into qualifying plants in the Bay Area (e.g. from the southern San Joaquin Valley). However, if the need to move such distant milk were to arise, the recommended rate increase to $0.65/cwt. would provide an appropriate incentive, while resulting in a $0.10/cwt. shortfall based on current costs. The shortfall should deter unnecessarily moving milk from that mileage bracket into the Bay Area.

North Bay Receiving Area (Marin, Solano, Sonoma Counties)

As testified by Wallaby, Napa County is situated among Marin, Solano, and Sonoma counties and milk processors located in these counties benefit from transportation allowances. Wallaby competes directly with these processors, and based on location, faces similar economic conditions but is at a disadvantage due to not receiving transportation allowances. Wallaby testified that they believe Napa County was not included in the North Bay Receiving Area because, until 1999, there were no milk processing companies located in that Napa County.

The Panel is in agreement with Wallaby's reasoning that Napa County be included in the North Bay based on the argument presented, the current milk movements in the area, and conforms to the economic factors considered by the Panel outlined previously. Department analysis of the proposed change to include Napa County would result in a minimal cost increase to the Pool compared to the total monthly cost for transportation allowances. There were no specific objections to this proposal among the majority of organizations that testified at the hearing or submitted written testimony.

DFA proposed rate increases for the middle and distant mileage brackets, but left the lowest mileage bracket rate unchanged. These rate increases reflect the need to source milk from more concentrated milk supply areas of the northern San Joaquin Valley and Sacramento Valley to supply qualifying plants in the North Bay Area. DFA testified that the proposed transportation rate changes for the North Bay were based on recent haul rates and in agreement with the Department's most recent haul survey. DFA provided documentation showing current haul distances and costs. DFA's average haul cost for the 45 to 96 mileage bracket and 96 and above mileage bracket were below the Department's most recent average haul costs. However, DFA stated that with a local haul cost of $0.32/cwt., its proposed rate increases to $0.37/cwt. and $0.52/cwt., respectively, were reasonable.

The Panel compared the Department's most recent haul survey and corresponding mileage to determine current milk movement patterns from milk supply areas into the North Bay. The Panel concurs that because milk supply areas have become more distinct, milk has to move longer distances to supply qualifying plants in the North Bay. The Panel also notes that after review of the Department's most recent haul survey and witness testimony, that haul costs on average, have been moving on an upward trend since 2008.

In regards to the middle mileage bracket, this milk could be procured by qualifying plants located in the Sacramento Receiving Area when in route to the North Bay. Because of this, the Panel felt the transportation allowance incentive needed to move milk from this mileage bracket to the North Bay should not be greater than the incentive needed to move milk to the Sacramento Receiving Area. Comparing the costs of milk supplied to the North Bay from the northern San Joaquin Valley versus Sacramento Valley, would suggest a rate increase of $0.02/cwt. Therefore, the Panel agrees with the proposed 45 to 96 mileage bracket rate increase from $0.35/cwt. to $0.37/cwt. However, when reviewing the current haul costs for milk moving over 96 miles (primarily from the northern San Joaquin Valley) and the incentives to move this same milk into the other northern California receiving areas, the Panel believes a rate increase from $0.44/cwt. to $0.46/cwt. is more reasonable. This rate increase is in line with the level of rate increase for the 45 to 96 mileage bracket and also would leave a shortfall to provide greater incentive to move close-in milk.

Sacramento Receiving Area

DFA proposed a modest increase in the rates for the Sacramento Receiving Area for the zero to 59 mile range. DFA testified that the volume of milk moving to qualifying plants is rather small, with most milk sources moving within 59 miles. The proposal is based on increased costs in haul charges since 2008, and according to DFA, is in agreement with the Department's most recent haul survey using a local haul of about $0.32/cwt.

The Panel recognizes the need to increase rates for the Sacramento Receiving Area based on the Department's most current haul survey and because close-in milk generally supplies the qualifying plants in this area. The October 2012 Department haul cost survey estimates the local haul at $0.49/cwt. with the haul cost for the zero to 59 mileage bracket essentially equal to the local haul. The Panel is concerned that in establishing milk movement incentives, rates are not set at a level which may encourage milk movement that bypasses shorter distant qualifying milk plants for longer distant qualifying milk plants. Because the industry has become more defined in its milk supply areas relative to higher class usage demand areas, the issue of creating an advantage in longer versus shorter haul milk incentives exists for the Sacramento Receiving Area of 59 miles and up when compared to the North Bay middle mileage brackets. As discussed in the previous section for the North Bay, comparing haul costs for these mileage brackets would indicate a rate increase of not more than $0.02/cwt. would ensure indifference in moving milk between these two supply areas. The Panel recommends adopting the proposed change to $0.17/cwt. for the zero to 59 mileage bracket based on current costs and the relative incentives provided by the three Northern California receiving areas.

Panel Recommendations

For the Bay Area Receiving Area:

- For 0 to 78 miles, increase the rate from $0.36/cwt. to $0.41/cwt.; no change in the mileage bracket.
- For 78 to 199 miles, increase the rate from $0.45/cwt. to $0.47/cwt.; no change in the mileage bracket.

- Over 199 miles, increase the rate from $0.47/cwt. to $0.65/cwt.; no change in the mileage bracket.

For the North Bay Receiving Area:
- Add Napa County
- For 0 to 45 miles, no change in rate or mileage bracket.
- For 45 to 96 miles, increase the rate from $0.35/cwt. to $0.37/cwt.; no change in the mileage bracket.
- Over 96 miles, increase the rate from $0.44/cwt. to $0.46/cwt.; no change in the mileage bracket.

For the Sacramento Receiving Area:
- For 0 to 59 miles, increase the rate from $0.15/cwt. to $0.17/cwt.; no change in the mileage bracket.
- Over 59 miles, no change in rate or mileage bracket.

SOUTHERN CALIFORNIA

Proposals

CDI and DFA proposed to change the mileage brackets and rates for the Southern California receiving area from the counties of San Bernardino and Riverside. CDI also proposed amending the mileage brackets and rates for California's 56 other counties as well. A summary of the current and proposed transportation allowance rates and mileage brackets for the Southern California Marketing Area is described in Table 1 of this Panel report.

Discussion and Analysis

From Riverside and San Bernardino Counties

CDI and DFA both proposed changing the current two mileage brackets into three mileage brackets with a new rate for the middle mileage bracket. According to both CDI and DFA, these changes are needed to better reflect current haul costs and current milk movement trends from supply areas to qualifying plants. CDI and DFA provided evidence showing their current hauling charges were comparable to the Department's most recent haul survey. Of note, CDI testified that it agreed with transportation allowances being based on the difference between the cost of the local hauls and the cost of the distant hauls to milk deficit markets.

CDI testified that it currently is sourcing milk from dairies located in San Bernardino County in the zero to 93 mileage bracket with haul rates ranging from $0.65/cwt. to $0.75/cwt., which is well above the $ 0.15/cwt. subsidy provided and leaves producers with a far higher hauling rate for the zero to 93 mileage bracket. DFA testified the intent of its proposal was to distinguish between the San Jacinto and Chino milk sheds, as done in the Department's haul survey. DFA's estimated hauling cost for the proposed 45 to 93 mileage bracket was $0.62/cwt., slightly less than the haul survey's average haul cost for 51 to 100 miles.

The Panel reviewed current milk movement patterns from Riverside and San Bernardino counties and current haul survey costs for corresponding mileage brackets. In particular, haul costs and milk volumes transported from the Chino and San Jacinto supply areas to the Southern California deficit area were compared. The Panel finds the local milk (milk falling within the zero to 93 mileage bracket) for these counties does not have an alternative market to send milk to, other than to the Southern California deficit area because of a lack of local milk processing plants located in these supply areas. Since 2008, milk produced in the Chino and San Jacinto areas has had little alternative but to move to plants with higher class usage. This milk, whether shipped to a manufacturing plant or higher usage plant, has similar haul costs. The incentive to move milk from the Riverside and San Bernardino areas to fluid milk plants does not need to be as great when compared to other milk supply areas that experience more competition from various processing facilities.

The Panel maintains that the current milk movement relationships between the Riverside and San Bernardino supply counties to the Southern California area does not show justification to create an additional 45 to 93 mileage bracket. The majority of the milk that falls into this mileage bracket originates in the San Jacinto and Hemet areas. Given the structural changes mentioned above, the Panel questions the need to increase transportation allowances for milk produced in Riverside or San Bernardino counties. Evidence of this is contained in the Department's most recent haul survey that shows virtually no difference in the haul cost to move milk to local plants within each of the Chino and San Jacinto areas compared to the haul cost to move milk from each of these areas into Los Angeles. This provides evidence that increased incentives in the form of higher transportation allowance rates are not necessary to continue the movement of this milk into the Los Angeles deficit area. Based on current transportation allowance rates and the recent hauling costs reported in the Department's haul survey, the Panel finds the current transportation allowance rates are adequate and sufficient to maintain milk movement needs for the area.

From California's 56 Other Counties

CDI proposed amending the mileage bracket of Over 119 miles into two brackets, 120 to 139 miles and a distant bracket of Over 139 miles. Although not submitting any proposed changes, DFA testified that it supported CDI's mileage bracket proposals. CDI testified that Southern California is the largest deficit market in the state and it continues to ship more milk from the southern San Joaquin Valley into Southern California. CDI further testified that due to declines in CDI milk production in Southern California (20 percent since 2008) and relatively stable milk production in Kern County, it is now having to source milk from more distant areas of Tulare County. These changes in milk movements are the basis for CDI's proposal to distinguish between hauls of more than 119 miles by changing it to 119 to 139 miles and then hauls beyond 139 miles. CDI also proposed a haul rate for the Over 139 miles of $1.00/cwt., supported by their haul from Tulare County to Southern California and the Department's hauling costs survey.

In review of current milk movement patterns, the Panel recognizes that an increasing amount of milk is being shipped from the southern San Joaquin Valley into Southern California. Department analysis (as provided in the Pre-Hearing Workshop) confirms that milk production and the amount of local milk sourced from Southern California has declined since 2008. These declines have been replaced by milk supplied mainly from Northern California, as its share of Southern California milk sources has increased when compared to 2008. Kern County accounts for the majority of Northern California milk shipped to the Southern California deficit region. When compared to 2008, Kern County's share of

Northern California milk sent to Southern California has grown, while milk production for the county has only modestly increased.

For 2012, analysis shows Southern California milk usage for Class 1, 2, and 3 purposes was flat when compared to 2008. However, from 2008 to 2012, manufacturing milk usage declined, with Class 4b usage accounting for the largest percentage decline of total milk usage. With regards to how milk supplies and movements have changed and the need for incentives to move milk into Southern California, CDI testified that incentives were still needed based on the location of milk supplies compared to the location of both higher class usage and manufacturing plants. CDI further testified that incentives helped in moving milk into those areas of Southern California that do not have a large supply of milk available. Additionally DFA testified that in 2008 there was already a significant volume of milk being sourced from the San Joaquin Valley into the Southern California Receiving Area.

In assessing milk movement from the southern San Joaquin Valley into Southern California, the Panel finds a mileage break of 119 to 155 miles better represents milk moving from Bakersfield and its surrounding area into Southern California versus the proposed 119 to 139 mileage bracket. If more milk is being sourced from northern Kern County and southern Tulare County as stated by CDI, then a mileage bracket of Over 155 would better conform to the Panel's belief that close-in milk should have the greatest milk movement incentives compared to more distant milk. Therefore the Panel agrees to amend the distant mileage brackets for California's 56 other counties, however the Panel recommends splitting the current Over 119 mileage bracket into 119 to 155 miles and Over 155 miles. The Panel does not expect any changes in milk movements from the recommended mileage brackets.

The Department's most recent haul survey showed the local haul cost for the southern San Joaquin Valley (specifically Kern County to Tulare County) is an average $0.35/cwt. Because milk needs to be hauled from Kern County to Southern California due to insufficient local milk supplies, the Panel agrees that the need for any shortfall for moving milk within 119 to 155 miles should be minimal. The Panel recommends leaving the rate at $0.84/cwt. for the 119 to 155 mileage bracket, which would cover the majority of the milk in Bakersfield and its surrounding area. The average haul cost for milk shipped between 150 and 200 miles into the Southern California deficit area was $1.26/cwt., with the cost of milk hauled in excess of 200 miles at an average $1.42/cwt. This more distant milk would fall in the Panel's recommended Over 155 mileage bracket. The Panel does believe a shortfall should exist for these distant milk supplies shipped into Southern California because milk production data shows that Kern County produces enough milk to supply the needs for Southern California fluid milk usage. However, due to marketing issues and competition for local milk, it cannot be assumed all Kern County milk is or would available for Southern California.

The Panel recommends for the distant 155 miles and Over mileage bracket, the transportation allowance rate be set at $0.91/cwt. This would leave an average $0.16/cwt. shortfall for milk sourced north of Kern County (i.e. southern Tulare County). The Panel's recommendation will incentivize the closest milk supplies, minimize the cost to the Pool, and is based on the Department's most recent haul survey.

Panel Recommendations

From the counties of Riverside and San Bernardino:

- No changes.

From California's 56 Other Counties:

- For 0 to 79 miles, no change in the mileage bracket or rate.
- For 79 to 99 miles, no change in the mileage bracket or rate.
- For 99 to 119 miles, no change in the mileage bracket or rate.
- Eliminate Over 119 miles bracket, establish mileage bracket of 119 to 155 miles, rate remains at $0.84/cwt.
- Establish an Over 155 mileage bracket, with a rate of $0.91/cwt.

DISCUSSION AND RECOMMENDATIONS FOR TRANSPORTATION CREDITS

SOUTHERN CALIFORNIA

Proposal

CDI proposed to change the transportation credit rates for the designated supply county of Los Angeles to the designated deficit counties of Orange, Riverside, San Bernardino, San Diego, or Ventura. A summary of the current and proposed transportation credit rates is shown in Table 2 of this Panel report.

Background

Transportation credits serve as an incentive for plant-to-plant milk movement to effectively serve the specific needs of the fluid milk/bottling plants. The Department's haul survey data shows that the plant-to-plant haul costs have increased similar to the ranch-to-plant haul costs. As stated previously, witnesses testified that the cost of diesel fuel has historically been on an upward trend since 2008, which has added to increases in milk hauling costs for plant-to-plant shipments. There was consensus among the witnesses about concerns of increasing haul costs, which in part are influenced by historically high diesel fuel prices.

Discussion and Analysis

CDI proposed an increase in transportation credit rates for the designated supply county of Los Angeles to the designated deficit counties of Orange, Riverside, San Bernardino, San Diego, or Ventura. The basis as testified by CDI was to align transportation credits with current plant-to-plant hauling costs. According to CDI testimony, their provided data, and the Department's most recent plant-to-plant haul survey, an increase of $0.45/cwt. to $0.54/cwt. would be more accurate with interplant haul costs nearest to its Artesia plant and still leave a shortfall for farther hauls to plants located in Riverside County.

In reviewing of the Department's most recent haul survey and witness testimony, the Panel agrees that since 2008, plant-to-plant haul costs on average, have increased. In 2008, from Los Angeles County to Chino (represents San Bernardino County), the average plant-to-plant haul cost was $0.54/cwt. compared to $0.64/cwt. in 2012. The Panel agrees with CDI's proposal to increase this transportation credit to $0.54/cwt., leaving a $0.10/cwt. shortfall which is consistent with prior Departmental transportation credit changes.

Panel Recommendation

- Increase the transportation credit from the designated supply county of Los Angeles to the deficit counties of Orange, Riverside, San Bernardino, San Diego, and Ventura from $0.45/cwt. to $0.54/cwt.

This Hearing Panel Report has been prepared and submitted by:

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ATTACHMENT A–1

SUMMARY OF PANEL RECOMMENDATIONS

RECOMMENDATIONS FOR TRANSPORTATION ALLOWANCES

For Northern California

For the Bay Area Receiving Area:

- For 0 to 78 miles, increase the rate from $0.36/cwt. to $0.41/cwt.; no change in the mileage bracket.
- For 78 to 199 miles, increase the rate from $0.45/cwt. to $0.47/cwt.; no change in the mileage bracket.
- Over 199 miles, increase the rate from $0.47/cwt. to $0.65/cwt.; no change in the mileage bracket.

For the North Bay Receiving Area:

- Add Napa County
- For 0 to 45 miles, no change in rate or mileage bracket.
- For 45 to 96 miles, increase the rate from $0.35/cwt. to $0.37/cwt.; no change in the mileage bracket.
- Over 96 miles, increase the rate from $0.44/cwt. to $0.46/cwt.; no change in the mileage bracket.

For the Sacramento Receiving Area:

- For 0 to 59 miles, increase the rate from $0.15/cwt. to $0.17/cwt.; no change in the mileage bracket.
- Over 59 miles, no change in rate or mileage bracket.

For Southern California

From the counties of Riverside and San Bernardino:

- No changes.

From California's 56 Other Counties:

- For 0 to 79 miles, no change in the mileage bracket or rate.
- For 79 to 99 miles, no change in the mileage bracket or rate.
- For 99 to 119 miles, no change in the mileage bracket or rate.
- Eliminate Over 119 miles bracket, establish mileage bracket of 119 to 155 miles, rate remains at $0.84/cwt.
- Establish an Over 155 mileage bracket, with a rate of $0.91/cwt.

RECOMMENDATIONS FOR TRANSPORTATION CREDITS

For Southern California

- Increase the transportation credit from the designated supply county of Los Angeles to the deficit counties of Orange, Riverside, San Bernardino, San Diego, and Ventura from $0.45/cwt. to $0.54/cwt.

ESTIMATED FINANCIAL IMPACT TO THE POOL

Based on actual 2012 milk movement, the estimated average monthly cost increase to the Pool for the Panel's recommendations, if implemented, would be:
Transportation Allowances: $101,730
Transportation Credits: $26,207
Total estimated average monthly cost increase to the Pool: $127,937 or $0.004/cwt.

ATTACHMENT A-2

SUMMARY OF TESTIMONY AND POST-HEARING BRIEFS

WALLABY YOGURT – Claudia Suh

<u>Testimony</u>

- Include Napa County in the North Bay Transportation Receiving Area:
  - Wallaby Yogurt located in Napa County.
  - Wallaby receives daily shipments of milk from producers in North Bay.
  - Some producers approximately 50 miles from plant.
  - Since 2008, CDFA recognized Marin, Solano, and Sonoma counties as part of the North Bay Receiving Area.
  - Napa County is located in-between the three counties in the North Bay Receiving Area.
  - Wallaby is the only milk processor in Napa County, yet located in vicinity of several competitors that are in the North Bay Receiving Area.
  - Competitors benefit from the transportation allowances.
  - Wallaby is at a disadvantage compared to other processors since it is unable to take part in the transportation allowance program.
- Excluding Napa not intentional:
  - Wallaby does not see past exclusion of Napa County as intentional.
  - Considers exclusion as a previously unconsidered given absence of producers and processors in Napa County.
- Wallaby history:
  - Began operations in Santa Rosa in mid-1990's.
  - Primary focus on producing organic yogurt.
  - Also produce organic sour cream and organic raw milk cream in bulk.
  - Since starting operations both staffing and product line have expanded.
  - Relocated to Napa after exceeding plant capacity in prior facility.
  - Expanded distribution from Northern California to nationwide.

CALIFORNIA DAIRIES, INC. – Eric Erba

<u>Testimony</u>

- Requested rate increases/bracket changes for transportation allowances in Southern California due to increases in diesel fuel prices and changing landscape of accommodating Southern California customers:
  - Important to consider increases in diesel prices and hauling rates since prior amendment to the transportation allowance system in 2008.
  - Fuel costs were high in 2008 and again in 2013.
  - These high fuel costs create hauling cost shortfalls in the Bay Area and Southern California Class 1 markets.

- Southern California market is the largest deficit market:
  - Milk has to be moved longer distances to accommodate Southern California.
  - Due to a reduction in CDI member dairies in Southern California, CDI moves more milk from the South Valley to Southern California customers.
  - In 2008 there was sufficient milk from Kern and Tulare counties to accommodate Southern California.
  - CDI's Southern California milk production has decreased 20 percent since 2008.
  - CDI's milk production in Kern and southern Tulare counties has been flat since 2008.

- CDI 2008 testimony advocated disincentives to discourage milk being shipped from area north of southern Tulare County, however CDI now ships milk from north of Visalia to service Southern California.
- Requested increases to the transportation credit under the Northern and Southern California Milk Stabilization Plans for Southern California deficit region:
  - Proposed in order to address actual plant-to-plant hauling costs related to increases in diesel fuel prices and changing landscape of accommodating Southern California customers.
  - CDFA data indicates there is no one deduction that can be taken to cover hauling costs from the CDI Artesia plant.
  - The proposed increase will cover interplant hauls that are closest to the Artesia plant.
  - However, there will be a shortfall for milk from Artesia to Riverside County.
  - The shortfall is consistent with the intent of the transportation subsidy programs.
- CDI is mindful of the increasing cost of maintaining the transportation and allowance programs. However, CDI also must consider increased hauling costs in order to service customers.
- CDI understands that actual and regular milk movements are increasing in distance traveled and the cost of moving milk is going up.

<u>Post-Hearing Brief</u>

- Transportation subsidy system has served California well for decades.
- However, based upon current conditions the current system was not meant to accomplish all its stated goals.
- DFA and CDI have significant milk sales to Southern California customers.
- Both cooperatives forced to use identical milk allocation procedures to service customers.
- Though concerned about minimizing increased costs to the transportation allowance and credit system, CDI concerned about cost of transportation in general.

DAIRY FARMERS OF AMERICA – Gary Stueve

<u>Testimony</u>

- Requested rate increases due to increases in haul rates.
- Diesel prices have been volatile and trend lines indicate increased fuel costs.
- Fuel price increases directly impact overall hauling costs.
- There has been a reduction of milk production around plants, thus there is a growing need to import milk from distant higher producing central valley areas.
- The Bay Area has no local production, and relies on imported milk. Milk en route to the Bay Area passes by manufacturing facilities. A majority of this milk originates from the San Joaquin area:
  - By removing milk that is local to the manufacturing plant, which itself competes for local milk and moving it to the Bay Area requires consideration for the cost of replacing that milk.
  - Thus, increases have been requested to the Bay Area deficient area.
  - Without consideration of secondary haul costs associated with replacing the manufacturing plant’s local supply, DFA has reduced incentive to move this milk directly out of a local manufacturing plant into a qualified plant.
- Requesting bigger increases for allowances into the Bay Area as prior increases have made this area less competitive with competing plants in other areas.
- Sacramento Receiving Area:

- Only a modest rate in the lowest bracket and no change to second bracket based upon current supplies of milk into this region.

- North Bay Receiving Area:
  - No request to change brackets, however DFA does request an increase in some of the rates in order to be in alignment with transportation costs.
- Southern California Receiving Area:
  - Requesting change in mileage brackets that deal with shipments originating in Riverside and San Bernardino.
  - This change will recognize the San Jacinto milk shed and separate that from the Chino milk shed.
  - DFA is supportive of CDI's alternative proposal calling for a break in the Southern California bracket and the insertion of an additional bracket.

<u>Post-Hearing Brief</u>

- Milk supplies in the areas are now well defined, with a large reliance on milk from the high producing valley areas.
- Though true in the past, few milk supply alternatives exist.
- Unless clearly required there is no incentive to pull additional longer distance milk that is necessary to supply a qualifying plant. This will only remove milk from manufacturing plants and create secondary haul costs.
- Need for shortfalls is no longer essential.
- DFA not the only cooperative serving the market, yet CDFA haul data indicate existence of shortfalls.

MILK PRODUCERS COUNCIL – Robert Vanden Heuvel

<u>Testimony</u>

- MPC expressed that based upon the alternative proposals submitted, that CDFA must consider significant modifications to the transportation subsidies.
- Much of the basis for changes to the transportation subsidies relies on data from CDFA's transportation haul survey.
- In comparing the April 2012 and October 2012 CDFA hauling surveys, MPC indicated that fuel costs between the two periods did not have a significant change, however there was a significant increase in the cost of hauling milk into Southern California, with no other explanation as to why.
- Without a known reason for the hauling cost increase, MPC indicated it was difficult to analyze any proposal to increase the transportation allowances.
- MPC supports the goals of the subsidies to attract and incentivize the nearest milk moving first to the Class 1, 2, and 3 markets.
- This policy helps ensure funds pulled from the Pool to cover the transportation subsidies are kept low.
- MPC asked CDFA to consider potential imbalances related to alternative hauling costs to a local manufacturing plant against the alternate proposals, where in some cases it may make sense to haul farther milk compared to local milk.
- MPC shared that with increasing costs out of the Pool to fund the transportation subsidies, that the Southern California Class 1 price be increased in order to service that market.
- MPC cited the increase in the transportation subsidies from $6 million in 1997 to $30 million in 2007 and that in 2012 it will cost $34 million. The alternative proposals will increase the subsidies to $36 million a year.
- MPC referenced that the current subsidy system may need to be restructured in order to deal with the changes in the industry.

WESTERN UNITED DAIRYMEN – Annie AcMoody
<u>Testimony</u>

- Transportation Allowance principals:
  - Allowances partially compensate cost to producer for hauling from ranch-to-plant in designated milk deficit receiving areas.
  - When setting allowances CDFA must look at:
    - Audited hauling costs.
    - Take into consideration distances.
    - Local alternative hauling costs.
    - Encourage local milk be shipped first.
    - Local competition for milk, and
    - Relative cost to the Pool of milk shipped under the transportation subsidies.
- WUD would like the costs of funding the transportation allowance system kept to a minimum.
- WUD supports Wallaby petition.
- WUD took no position regarding the alternative proposals from CDI and DFA.

DAIRY INSTITUTE OF CALIFORNIA – William Schiek
<u>Testimony</u>

- Institute reviewed the transportation allowance and credit system principals and provided a historical perspective on the enactment of the Pool Plan.
- Institute continues to believe the milk movement incentive program is necessary but it is also sometimes necessary to review the existing system to determine if changes are needed, when industry consolidation and milk distribution patterns change.
- Institute is concerned with notion that over order premiums or surcharges should be relied upon as a means to attract milk for Class 1 purposes.
- Institute maintains that existing order prices paid by processors provide more than enough revenue to attract milk for Class 1 and mandatory Class 2 purposes.
- Given high Class 1 price differential in California relative to the state's low Class 1 utilization, it is even more obvious that processors need not subsidize hauling.
- In general, Institute supports proposals that seek to make cost justified adjustments to the transportation allowance and credits.
- For allowances, rates equal net cost of distant haul less cost of local haul, with a modest shortfall only for most distant milk.
- For credits, rates equal cost of haul less any area differential. Any shortfalls should be limited so that needed milk can move to Class 1 uses.
- Institute supports cost justified allowances and credits.
- CDI's proposals appear to be cost justified based upon CDFA hauling rate information and CDI testimony regarding costs in serving their customers.
- Institute believes adding additional transportation allowance bracket into Southern California makes sense given change in milk shed sources.
- Institute believes the CDI proposed transportation credit to be cost justified.
- Institute generally supports DFA's proposed increase to the Bay Area, Sacramento, and North Bay transportation allowance.
- Institute urges adoption and sees no reason to deny Wallaby's petition to add Napa County to the North Bay Receiving Area as Napa is geographically contiguous to both Solano and Sonoma counties.
- Institute supports continuation of call provisions.

CALIFORNIA DAIRY CAMPAIGN – written testimony submitted

<u>Testimony</u>

- CDC urges rejection of petitions submitted to adjust the transportation allowances and credits.
- CDC does not believe increases to the transportation allowances and credits are necessary and question need for the system.
- Unlike producers, processors have the ability to pass on higher production costs, therefore producers should not bear burden of higher transportation allowances and credits submitted in the petitions.
- Transportation allowances and credits provide a false incentive for milk shipments to certain parts of the state and foster inefficient milk movement.
- Latest CDFA data indicates 105 dairies ceased operation in 2012, more than in 2009 which was another devastating year for the industry.
- Dairies continue to close at alarming rate due to lack of equity in the state pricing system combined with higher production costs.
- California Milk Advisory Board data indicates a typical dairy generates $33.1 million in economic activity and 232 jobs. Closure of 105 dairies would lead to $3.48 billion in economic activity and elimination of 24,360 jobs.
- Fourth quarter CDFA cost of production data indicates it costs $20.08/cwt. to produce milk, while the overbase price paid in January 2012 was $16.60/cwt.
- Because of financial problems affecting producers, now is not the time to increase the transportation allowances and credits.
- CDC expressed concern about loss of dairies, high cost of producing milk and low milk prices.