Hearing Panel Report

Based on a Public Hearing Held On
December 21, 2012

Addressing the Class 1, 2, 3, 4a, and 4b Pricing Formulas
Contained in the
Stabilization and Marketing Plans
for Market Milk for the
Northern and Southern California Marketing Areas

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This Report of the Hearing Panel regarding proposed amendments to the Stabilization and Marketing Plans for Market Milk for Northern California and Southern California (Plans) is based on evidence received and entered into the Department of Food and Agriculture's hearing record. The evidence includes the Departmental exhibits, written statements and comments received from interested parties, and written and oral testimony received at a public hearing held on December 21, 2012.

Table of Contents

INTRODUCTION/WITNESSES

California Food and Agricultural Code (Code) Section 61801, *et sec*., provides the authority, procedures, and standards for establishing minimum prices by the California Department of Food and Agriculture (CDFA) for the various classes of milk that handlers must pay for milk purchased from producers. These statutes provide for the formulation and adoption of Stabilization and Marketing Plans for Market Milk.

A total of 19 witnesses testified including the Department's witness:
CDFA, Mike Francesconi
Dairy Farmers of America, Inc. (DFA), Gary Stueve and Perry Tjaarda
Western United Dairymen (WUD), Michael Marsh and Annie AcMoody
California Dairies, Inc. (CDI), Eric Erba
Dairy Institute of California (DI), Dr. William Schiek
BESTWHEY, LLC, Barry Murphy
California Dairy Campaign (CDC), Lynn McBride
Farmdale Creamery, Inc. (Farmdale), Scott Hofferber
Land O'Lakes, Inc. (LOL), Tom Wegner
R. Doornenbal Ranches, Rien Doornenbal
Milk Producers Council (MPC), Rob Vandenheuvel
Leprino Foods Company (Leprino), Sue M. Taylor
Hilmar Cheese Company (Hilmar), David Ahlem
Dairy Producer, Loren Lopes
California Dairy Women Association, Linda Lopes
Marquez Brothers International, Inc. (Marquez), Jose T. Maldonado
Dairy Producer, Geoffrey Vanden Heuvel

Special 3-Minute Testimony Given:
Duarte Dairy, Inc., Antoinette Duarte
Tony Martin Dairy, Dairy Goddess Farmstead Cheese, Dairy Goddess Pork, Barbara Martin

Correspondence Received Prior to the Close of the Hearing:
Stiefel Dairy
Lori and Jim Bylsma
Alfred and Reis Soares
Walter & Wilhelm Law Group
Western Dairy Advisors
California State Grange
Moss Tucker, Attorneys at Law
Dana Koetsier

BACKGROUND: CALIFORNIA'S DAIRY LANDSCAPE

The Panel Report contains economic data and statistics available at the time of the hearing. The following background statistics reflect the California dairy situation at the time of the hearing and were considered, along with all available data, when examining and evaluating the proposals and testimony submitted at the hearing.

Cost of Producing Milk

- For 2011, the cost of producing milk increased in all four areas of the state when compared to the same period for the previous year, with statewide average costs at $15.79 per hundredweight (cwt.) (up $2.09/cwt. from 2010). When including return on investment and management, the cost of producing milk in 2011 was $17.40/cwt. (up $2.21/cwt. compared to 2010).
- For the third quarter of 2012, the statewide average cost of producing milk was $18.46/cwt., up $1.66/cwt. from 2011 third quarter costs of $16.80/cwt.

Mailbox Milk Prices

- California mailbox milk prices for 2011 averaged $18.13/cwt., an increase of $3.76/cwt. compared to the average 2010 mailbox price of $14.37/cwt.
- For the first eight months of 2012, the California mailbox milk prices averaged $15.06/cwt., a decrease of $3.11/cwt. compared to the average mailbox milk price for the same time period in 2011 of $18.17/cwt.

California Milk Production

- California's annual milk production has increased at an average annual rate of 2.2 percent over the last 10 years, compared to the 10-year U.S. average annual rate of 1.7 percent.
- For the twelve months ending October 2012, California milk production has shown a 1.7 percent increase over the same time period ending October 2011.

Milk Cows

- Annual California cow numbers have increased at an average rate of 1.1 percent over the last 10 years – while U.S. cow numbers have increased 0.1 percent over the last 10 years.
- Most recent USDA cow number reports indicate that for November 2012 compared to November 2011, California reported an increase in the number of dairy cows by 2,000 head to a total of 1.78 million cows.

Class 1 Sales

- For 2011, 13.5 percent of California's total pooled milk production was used to produce packaged fluid milk.
- For November 2011-October 2012, total Class 1 sales showed a decrease of 2.0 percent when compared to November 2010-October 2011.
- For the first ten months of 2012, total Class 1 sales have shown a decline of 2.0 percent compared to the same time period in 2011.

Cheese Production (Class 4b)

- For 2011, California cheese production increased to 2.25 billion pounds, close to 2007 levels.

- In 2011, 43.1 percent of California's total milk production was used to produce Class 4b products.
- For January-October 2012, total cheese production was up 0.3 percent when compared to January-October 2011.

Butter and Nonfat Dry Milk (NFDM) Production (Class 4a)

- In 2011, 35.0 percent of California's total milk production was used to produce Class 4a products.
- For 2011, California NFDM production totaled 775.1 million pounds and butter production totaled 622.4 million pounds.
- For January-October 2012, total butter production was up 7.2 percent and total NFDM (Human Consumption) production was up 14.6 percent compared to January-October 2011.

Cottage Cheese, Yogurt, Ice Cream, as well as other soft and frozen dairy products (Class 2 and 3)

- For 2011, 8.4 percent of California's total milk production was used to produce Class 2 and 3 products.
- For 2011 compared to 2010, frozen dairy product production showed an increase of 2.3 percent to 173.9 million gallons, total cottage cheese production increased to 101.0 million pounds, and yogurt production decreased to 626.7 million pounds.
- For January-October 2012 compared to January-October 2011, total frozen dairy product production was down 3.3 percent, total cottage cheese production was up 10.5 percent, and yogurt production was down 6.8 percent.

Resources: CDFA Dairy Information Bulletin, CDFA Dairy Statistics 2011 Data Annual, CDFA California Cost of Production 2011Annual

SUMMARY OF THE PROPOSALS

Table 1 - **Specific Temporary Changes Proposed for the Class 1, 2, 3, 4a, 4b Pricing Formulas Including Proposed Time Period for Temporary Pricing Changes (In Dollars Per Pound)**

The Department received six specific proposals in the format prescribed by the Hearing Announcement and all proposals resulted in increases to the per pound component prices of the class pricing formulas

Proposal	Class 1			Class 2		Class 3		Class 4a		Class 4b		Time
	Fat	SNF	Fluid	Fat	SNF	Fat	SNF	Fat	SNF	Fat	SNF	Period
Dairy Farmers of America, Inc.												
	0.0035	0.0298	0.0009	0.0390	0.0390	0.0390	0.0390	0.0205	0.0205	0.0205	0.1689	6 Months
Western United Dairymen												
	0.0105	0.0893	0.0026	0.0820	0.0820	0.0820	0.0820	-	-	-	0.1150	6 Months
California Dairies, Inc.												
	0.0035	0.0298	0.0009	0.0205	0.0205	0.0205	0.0205	0.0082	0.0082	0.0082	0.0542	6 Months
Dairy Institute												
	-	-	-	-	-	-	-	0.0082	0.0082	0.0082	0.0082	3 Months
California Dairy Campaign												
	0.0350	0.0247	0.0007	0.0327	0.0327	0.0327	0.0327	0.0246	0.0246	0.1557	0.1557	6 Months
Land O'Lakes, Inc.												
	0.0040	0.0340	0.0010	0.0369	0.0369	0.0369	0.0369	0.0082	0.0082	0.0082	0.1864	6 Months

ESTIMATED IMPACTS OF THE PROPOSALS ON CALIFORNIA CLASS AND POOL PRICES

- The table below shows the impacts of the proposed amendments on class and pool prices relative to current prices
- The analysis assumes that the proposed amendments and current formulas were in effect throughout the entire period.
- When a change is a "plus", the proposal would have increased the price.
- When a change is a "minus", the proposal would have decreased the price.

Table 2 - **Estimated Impacts[1] on Class 1, 2, 3, 4a, 4b, and Pool Prices If the Hearing Proposals had been in Effect for the Five-Year Period: November 2007 to October 2012 Five-Year Averages**

	Class 1 ($/cwt.)	Class 2[2] ($/cwt.)	Class 3[2] ($/cwt.)	Class 4a ($/cwt.)	Class 4b ($/cwt.)	Pool[3] ($/cwt.)
Dairy Farmers of America, Inc. Proposal						
5-year average	+$0.35	+$0.48	+$0.48	+$0.25	+$1.54	+$0.86
Western United Dairymen Proposal						
5-year average	+$1.04	+$1.00	+$1.00		+$1.00[4]	+$0.69
California Dairies, Inc. Proposal						
5-year average	+$0.35	+$0.25	+$0.25	+$0.10	+$0.50	+$0.33
Dairy Institute Proposal						
5-year average				+$0.10	+$0.10	+$0.08
California Dairy Campaign Proposal						
5-year average	+$0.40	+$0.40	+$0.40	+$0.30	+$1.90	+$1.00
Land O'Lakes, Inc. Proposal						
5-year average	+$0.40	+$0.45	+$0.45	+$0.10	+$1.65	+$0.86

[1] Compares proposed amendments with current California formulas

[2] Estimated Class 2 and 3 price impacts assume no pass through effects from proposed Class 4a price adjustments.

[3] Quota and overbase price

[4] In their testimony, WUD stated they intended Class 4b prices to be $1.25/cwt. higher, but their actual proposal only increases the Class 4b price by $1.00/cwt.

PREVIOUS AND CURRENT ECONOMIC CONDITIONS FACING CALIFORNIA DAIRY PRODUCERS PROMPTING THE CALL OF THE HEARING

Over the past five years, the California dairy industry has experienced volatility with increasing and decreasing milk prices, increasing and decreasing milk production, the cost of production, rising feed costs relative to historical levels, and the exiting of California dairy operations.

Looking Back At the Past Five Years

In the latter part of 2007, milk prices were at historic highs, milk production was growing, and feed costs were beginning to rise. Milk prices however, declined in 2008 and continued downward into the first half of 2009. From the end of 2008 to the beginning of 2010, dairy producers experienced financial difficulties due to relatively large, average negative margins on the dairy caused by low milk prices and increasing feed costs, in part due to domestic and international demand for corn. During this time, milk prices were at low levels because of reduced demand for dairy products caused by macroeconomic recession in the U.S. and the world. At the same time, feed prices rose to levels higher than historically observed prior to 2008. Because of the prolonged duration of negative dairy producer margins, many dairies went out of business in California and across the nation. Many dairies that continued to operate after this time were left in a situation of depleted equity that weakened their financial status.

As a result of the financial difficulties of this time, milk production in California decreased. Monthly milk production decreased every month, when compared to the same month in the previous year, from October 2008 to April 2010. This type of consecutive monthly milk production decreases had not been observed in California since the late 1970s. In 2009 and 2010, annual milk production decreased 1.68 billion and 811 million pounds, respectively, when compared with 2008 levels.

One outcome of decreasing milk production during this time was a change in the balance between the state's milk supplies and its manufacturing capacity. In 2007 and 2008, milk prices were robust and California's milk supplies exceeded manufacturing capacity, causing issues with handling the surplus milk. Testimony from past hearings showed milk leaving the state at discounted prices in order to find a market, milk being sold to calf ranches, producer cooperatives and proprietary manufacturers instituting milk production bases, and some producers losing a processing home for their milk. However, after the milk production decreases from 2008 to 2010, manufacturing capacity ceased to be an issue as the state was able to effectively process its milk supplies, and according to testimony from past hearings, the state even lacked the needed volume of milk to meet demand at times.

By the end of 2010 and the beginning of 2011, margins on the dairy improved and turned positive. Compared to the cost to produce milk, milk prices rose to profitable levels in response to increased demand for dairy products in the domestic and international markets, both recovering from macroeconomic recession. At the same time, feed costs tempered from historic high levels observed in 2008 and 2009 and milk prices matched or exceeded the cost of production throughout 2011, providing a positive margin, on average.

Throughout 2011, California recorded its highest year of milk production. From April 2011 to December 2011, every month had the highest milk production on record when compared to the same month of any previous year. Because of strong international demand for dairy products, primarily in Asia and Mexico, milk supplies were generally balanced in relation to demand. Additionally, there was increased plant capacity due to new construction and expansion of existing facilities in California since 2008. Strong demand, coupled with increased plant capacity allowed California to generally handle its milk supplies during 2011.

The California Dairy Industry in 2012

By the close of 2011 and the beginning of 2012, financial conditions on the dairy began to change. Feed costs began to rise in the middle of 2010 and continued an increasing trend throughout 2012. As a percentage of total cost of production, feed costs increased to a record high of approximately 65 percent by the end of 2011 and continued at that level throughout 2012. As feed costs were rising through 2012, milk prices were decreasing in large part due to increasing domestic and international milk supplies that exerted downward pressure on dairy product prices. California and U.S. milk production increased 4.7 percent and 3.6 percent, respectively, in the first half of 2012 compared to the first half of 2011. Those are significant increases when considering that 2011 was the largest milk production year on record for California and the U.S. Internationally, the exporting regions of Europe and Oceania were experiencing milk production growth in their respective milk production seasons according to the U.S. Dairy Export Council (USDEC). The resulting international and domestic milk production growth caused dairy product prices to soften, and in turn, caused milk prices in the U.S. and in California to decrease, squeezing margins on the dairy. Ultimately, milk prices decreased below the cost of production on the dairy, resulting in negative margins, on average.

As a result of large milk production increases during the first half of 2012, producer cooperatives and proprietary manufacturers once again enforced production bases and capped the amount of milk they would accept in order to manage the growing milk supply during the spring flush period. In addition to production base programs, one producer cooperative organization implemented a buy-out program that allowed some of their financially stressed members to exit the industry. These measures were implemented in order to address stressed plant capacity concerns that occurred during the 2012 spring flush period.

By the third quarter of 2012, noticeable changes in the productive condition of California dairies were observable. Starting with July 2012 and continuing through November 2012, California monthly milk production decreased every month when compared with the same month of the previous year, according to data from the United States Department of Agriculture (USDA). The average monthly decrease over this time was approximately 3.3 percent. According to testimony provided by producer cooperative and trade associations, milk production decreases were caused by high temperatures over the summer, some feed ration adjustments causing milk per cow decreases, and dairies exiting the business. According to the hearing record, decreased milk production during this time period reduced the state’s milk supply in relation to the demand for farm milk, below desired levels of some manufacturers. Although the cyclical nature of milk production tends to cause reduced milk supplies in the fall, the hearing record indicates the milk production declines of this time period reached beyond the normal cyclical trends.

In the third quarter of 2012, the financial situation of California dairies noticeably worsened further with the sharp increase in already inflated feed costs resulting from drought conditions in the nation's corn growing regions. In the summer of 2012, above average temperatures and lack of precipitation caused drought conditions throughout the principle corn and feed grain growing areas of the U.S. As cited in the hearing record, the drought caused corn feed prices to sharply increase beginning in the third quarter of 2012. CDFA's cost of production survey information confirms the price of corn feeds paid by California dairies increased to historically high levels in the third quarter from the relatively high levels observed in the second quarter. CDFA data show that the cost of production including allowances for returns on investment and management increased from $18.09/cwt. and $18.22/cwt., respectively, in the first and second quarters of 2012 to $19.94/cwt. in the third quarter of 2012. Corn feed cost accounted for approximately 20-40 percent of the increase in the feed costs for typical California dairies.

Because corn feeds are the principle grain fed to milk cows, corn prices heavily influence the cost to produce milk on California dairies. As testimony indicates, those dairies that rely on purchasing corn and other feed grains from the principle markets in the Midwest are more vulnerable to feed cost increases compared to dairies that have the ability to grow portions of their feed. This is because California does not produce enough corn to meet its demand and in essence relies heavily on sourcing corn from markets outside of California such as the Midwest. CDFA data indicate that many California dairies have based their business model on purchasing a significant percentage of their feed, thus making them susceptible to cost increases in feed grains.

Based on preliminary analysis for the fourth quarter of 2012 compared to the third quarter of 2012, it appears feed costs remained at elevated levels, while milk prices increased in the face of reduced milk production. Although estimates for fourth quarter cost of production are not available, it is likely that they may be similar to those from the third quarter. Very preliminary data indicates that the cost of feeds paid by California dairies may remain at comparable levels to the third quarter; however, it is not possible to obtain a precise measurement based on data available at the time of the hearing. With regards to milk prices, there has been an increasing trend since the summer. As mentioned previously, California monthly milk production decreased every month since July 2012 when compared to the corresponding month in the previous year. At a national level, USDA data show that U.S. monthly milk production growth was slowing in the second half of the year compared to the first half of the year. The reduced milk production in California and slowing milk production growth nationwide contributed to increased prices of dairy products, which increased milk prices paid to dairy farmers.

For much of the third and fourth quarters, the overbase price (the minimum, regulated producer pay price) increased from $14.44/cwt. in July 2012 to $18.49/cwt. in November 2012. The mailbox price during this time is expected to be higher than the overbase price because the hearing record shows that certain dividends and premiums were being paid above the minimum regulated price. Although estimates of the actual margins on California dairies are not known for the fourth quarter, margins may have improved from the third quarter because of higher milk prices and constant feed costs, albeit at elevated levels.

The financial situation of California dairies deteriorated in 2012. In contrast to 2011, the hearing record shows that, on average, California dairies experienced negative margins in the first half of 2012, which challenged the viability of California dairies weakened by previous financial difficulties. Testimony indicates that the extended financial difficulties from 2008 to 2010 depleted the available equity in many dairies currently in operation. As a result, these dairies were left vulnerable to any future financial stress. The hearing record provides evidence of California dairies going bankrupt as a result of the financial stress of 2012. Although California (and the U.S.) has a decade-long trend of declining dairy numbers due to many factors including financial stress, the hearing record indicates the declining numbers of dairies leading up to the hearing extend beyond this observable trend and are directly correlated with current financial conditions. The following section of this Panel report provides a review and discussion of the differing proposals presented at the hearing.

REVIEW OF THE PROPOSALS

Against this backdrop, the December 21, 2012 hearing was held to consider amendments to the class pricing formulas on a temporary basis, not exceeding six months. The hearing record shows that representatives of both producer and processor organizations acknowledged that dairies have been experiencing challenging financial circumstances primarily due to elevated feed costs. Despite acknowledgement of these challenges, there were differing opinions presented at the hearing regarding whether or not temporary price relief was warranted, and if so, what level of price relief was appropriate.

There were six proposals presented at the hearing that followed the format outlined in the hearing notice. The specific details of these proposals and their estimated impacts on class and Pool prices can be found in Table 1: *"Summary of Proposals"* and Table 2: *"Estimated Impacts"* of this Panel Report. All six proposed changes to the pricing formulas would yield higher class prices that would lead to higher Pool prices, thus providing temporary price relief to dairy farmers. All proposals from producer trade associations or producer cooperative organizations suggested six months of price relief, while the single proposal by an organization representing processors suggested three months of price relief. When reviewing the six proposals, the magnitude of the increases and the distribution of the increases across the five classes of milk varied greatly.

Four of the six proposals would lead to increases in all five classes of milk, with the WUD proposal leaving the Class 4a pricing formula unchanged and the DI proposal leaving the Class 1, 2, and 3 pricing formulas unchanged. While all of the proposals that would increase Class 1, 2, and 3 prices suggested the same increase to Classes 2 and 3, the proposals presented by DFA, CDI, and LOL would increase the Class 1 price in a different magnitude than Class 2 and 3 prices. The WUD and CDC proposals were intended to increase the Class 1 price to the same level as the Class 2 and 3 prices. Four out of the five proposals that proposed increases to both Class 4a and 4b prices would lead to higher increases in the Class 4b price compared to the Class 4a price, with the exception of the DI proposal that would increase both of these classes by the same amount.

Impact of Proposals

To estimate the impact to the current class and Pool prices, the Department analyzed the six proposals assuming the proposals had been in effect from November 2007 through October 2012. The proposals would have resulted in five-year monthly average increases from $0.10/cwt. to $1.90/cwt. in the class prices and from $0.08/cwt. to $1.00/cwt. in the Pool price. The ranges of the estimated class and Pool price increases were broad. The largest increases were proposed by representatives of producer interests, while the proposal presented by a representative of processor interests was comparatively more modest in comparison.

Discussion

The hearing record showed that 18 interested parties testified at the hearing and eight others submitted written correspondence. The majority of the interested parties that testified (13) and all those that submitted written correspondence advocated for increased prices to provide some level of financial relief to dairies. For the most part, those parties that advocated for price relief were individual dairy producers, representatives of producer cooperative organizations, representatives of producer trade organizations, or representatives of industries that provided services to dairies. One organization representing processor interests, DI, proposed a modest level of price relief compared to the other proposals. Conversely, there were five witnesses that argued for no change in any class pricing formulas (no price relief), four of them representing proprietary processors and one representing a consultant in the whey processing industry.

In general, testimony supporting price relief focused on the financial challenges facing dairies. It is clear that the extended period of negative margins on California dairies from 2008 to 2010 weakened their financial positions. Many of the dairies that survived that episode were forced to use much of the equity that had been built up prior to those years. The resulting draw down in equity has left dairies vulnerable to episodes of negative margins, such as those that have been experienced throughout 2012. The hearing record is clear that feed costs in 2012, especially since the summer’s drought have been historically high. It has been noted by many analysts that the drought of 2012 was the worst on record since the 1930’s having impacted the entire U.S. and not specific regions as seen in prior years. The high feed costs, combined with other costs such as increasing environmental costs, have resulted in negative margins that have caused some dairies to go out of business. Testimony indicated that there have been dairies exiting the industry at a greater rate than past trends and there are currently dairies that are vulnerable to bankruptcy in the near future. Ultimately, price relief may temporarily help the struggling dairies that are confronted by grim financial circumstances.

On the other hand, testimony opposing any price relief focused on the marketing conditions of dairy products and the connection that milk prices should have to these marketing conditions. Those witnesses opposing price relief argued that milk prices should be determined by the marketing conditions of the dairy products made from milk. The supply and demand movements in these markets establish the prices or value of the goods made from milk and send price signals to producers to expand or contract the milk supply accordingly. Witnesses cited factors such as milk supplies, competition from international dairy producers, and international demand for dairy products as important drivers of milk prices. These drivers of milk prices, in conjunction with factors influencing cost of production, determine the margins facing dairies. However, these factors may not be corrected by the regulated milk price, suggesting the regulated price of milk could not be the correct method of addressing the negative margins facing California dairies.

TEMPORARY PRICE RELIEF

The hearing record shows that representatives from both producer and processor organizations supported some level of temporary price relief, although the support from the processor side of the industry was limited to one organization. Representatives of producer trade, producer cooperative, and processor organizations all testified that any price relief would not serve to recoup the losses from the negative margins experienced from 2008 to 2010 and then again in 2012, but would help to offer some level of price relief until milk prices and the cost of production equalize for a time period long enough to restore profitability on the dairy.

Although financial conditions on the dairy tend to exhibit fluctuations as they cycle through periods of positive and negative margins, feed cost increases in the latter part of 2012, specifically corn feeds, caused by drought have been unique. Corn feed is an integral part of the California dairy feed ration, is difficult to replace due to its properties, and is primarily purchased from Midwest grain markets. The hearing record shows that the price of corn spiked in the summer of 2012 as it became apparent the severity of the drought would exert significant upward pressure on corn prices moving into the second half of 2012 and into 2013. Because of the severity and wide reaching effects of the drought, the Panel believes that this event has caused extraordinary financial stress to dairies to the point of warranting some level of temporary price relief.

In general, the drought has affected California dairies through the increased price of corn feeds. Although the drought has affected soybeans in some magnitude as well, soybean meal is not a significant part of the typical California feed ration. The prices of other important feed categories of California dairies, such as wet and dry roughage, are set through more local and regional supply and demand phenomenon that are not as directly tied to the 2012 drought conditions. Therefore, the most attributable component of the feed cost increase to California dairies from the second to the third quarter of 2012, resulting from the drought, is the cost of corn feeds. Data from CDFA's cost of production survey comparing the second to the third quarter of 2012 shows that, on average, the total cost of feed increased $1.17/ cwt., from $10.91/cwt. to $12.09/cwt. The corn feed price increases from this data ranged from approximately 20 to 40 percent of the total feed cost increase for the majority of California dairies in the survey. As a result, one economic factor in determining the temporary price relief should be the corn feed price contribution to the feed cost increases experienced as a result of the drought.

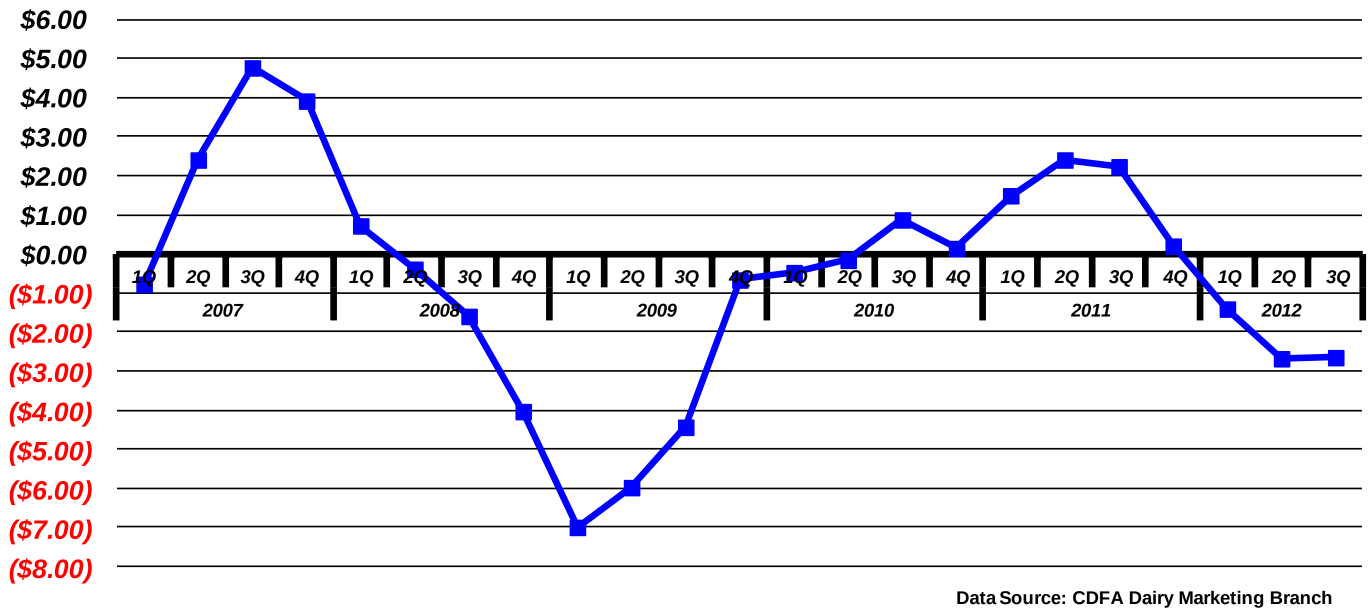
While temporary price relief can help to soften the affect of increased corn feed prices on dairies, the Panel acknowledges price relief can only serve as a temporary financial boost designed to help dairies "weather" the financial conditions facing them. Any price relief would not be sufficient for dairies to recoup lost equity due to past periods of negative margins, on average. Dairies, like most businesses, are confronted with periods of both prosperity and difficulty.

A key indicator of the state of milk production is the cost of producing milk in relation to the income or price received for milk. *Figure 1* utilizes the Department's Cost of Production Survey to estimate the difference between mailbox prices received for milk and the cost of producing milk, which is a measurement of margins on the dairy, for each quarter beginning with the first quarter of 2007 to the third quarter of 2012. The mailbox price consists of quality payments, component and yield premiums, bonuses, and monthly distribution of cooperative earnings. It is a measurement of the actual income received by producers participating in the Cost of Production Survey. It has been adjusted to account for marketing costs, which are included in the estimated cost of production. The cost of production estimate takes into account allowances for return on investment and return for management.

The following figure, based on CDFA's cost of production survey, estimates the margins observed on California dairies by showing the difference between mailbox prices and the total cost of production, which includes allowances for return on investment and return for management *(see Figure 1).* The figure confirms the cyclical nature of financial conditions on the dairy and the average negative margins confronting dairies in 2012.

Figure 1:

Difference Between California Mailbox Milk Price Less California Cost of Production
Based on the California Production Cost Survey, with Allowances
January 2007 through September 2012
(In Dollars per Hundredweight)



Additionally, temporary price relief cannot counteract the influences of key determinants of milk prices and costs of production that contribute to dairy producer margins. Revenue from the sale of farm milk and farm milk prices are affected by supply and demand conditions influencing the markets for farm milk and dairy products. Factors including, but not limited to, milk supplies relative to demand for farm milk, domestic and international demand levels for finished dairy products, movements in milk supplies of major dairy product exporting countries, inventory levels of storable dairy products, and availability of substitute goods all contribute to milk prices. Movements in these factors all contribute to the economic conditions in the marketplace and transpire often independent of milk pricing regulations and are not conditions that can be completely controlled by milk pricing regulations. Like milk prices, key determinants of cost of production on the dairy cannot be controlled or remedied through temporary price relief. Feed costs, which are the largest category of the cost of production on the dairy, have remained above pre-2007 levels and appear likely to continue at these levels into the foreseeable future. The Panel is aware that this elevated feed cost trend is affecting farm profitability not just in California, but throughout various sections of the U.S., particularly the western region of the country. Many dairies throughout these regions of the U.S. are confronted with feed cost circumstances that may require adjustments in their business models to specifically address how this issue could be managed in the future. Ultimately, temporary price relief cannot counter or remedy the changing realities of the conditions driving the fluctuations in the markets for farm milk, finished dairy products, or feeds.

In order to determine the appropriate level of price relief, a number of different economic factors affecting the various dairy industry stakeholders must be considered. Besides the impact of increased corn feed prices confronting dairies, other factors such as current marketing conditions of California dairy products, farm milk supplies in relation to demand, and potential future impacts to these and other factors need to be considered. These factors will be discussed in the following sections that focus on the duration of price relief, which class prices to increase to provide price relief, and the magnitude of class price changes.

Duration of Price Relief

The hearing record shows that all witnesses that testified at the hearing and those that sent in written correspondence were divided between providing three months of price relief or the maximum amount possible, which was six months based on the call of the hearing contained in the hearing notice. Representatives of producer trade associations, producer cooperatives, and industries that provide services to dairies all suggested providing six months of price relief, while the DI proposed three months of price relief. While there were various processor representatives that argued for no price relief at all, two of these representatives did testify in favor of three-month price relief if the Secretary were to choose to provide it.

The Panel is cognizant that the dynamic nature of dairy markets requires caution when making such a decision. Historic data shows that dairy markets are cyclical in nature and the market prices for dairy products can move rapidly in a matter of days or weeks. Additionally, the markets for finished dairy products, such as fluid milk, can require processors to make bids for sales contracts on a monthly basis. If dairy markets were to move dramatically during the time when the price relief was in effect, unintended marketing consequences could arise, which may cause disruptions in the marketplace.

California monthly milk production, when compared to the same month last year, has declined every month since July 2012 due in part to the financial circumstances of dairies. Although there was some evidence that declining milk production had reduced the milk available to some proprietary and producer cooperative plants below ideal levels in certain circumstances, there was little evidence indicating the declines in milk production had caused wide-spread instability in the production of market milk or unsatisfactory marketing conditions. Testimony reflected that some proprietary cheese plants have increased premiums paid to dairy producers for milk out of concern for their financial stress and some level of renegotiation of premiums in the marketplace has begun. However, it does not appear the decline in milk production had caused broad concern that could initiate either wide-spread renegotiation of premiums or increased premium payments by a large section of the processing sector. This suggests there is still an adequate and continuous supply of milk for all purposes and that the relative balance of milk supplies in relation to demand is not currently problematic.

Although the milk supply appears to be adequate relative to current demand, it is unclear how the milk supply or demand may change in 2013. Milk production is cyclical and reaches its peak during the spring flush period which can cause issues of plant capacity, as was the case in 2012. Department data and anecdotal evidence indicate that milk supplies could continue at sufficient levels heading into the spring flush. There appears to be available replacement heifers and freshening dry cows that could contribute to sufficient milk supplies to start 2013.

On the other hand, feed costs are expected to remain at elevated levels during the first part of 2013 and could continue to put financial stress on dairies. Some analysts predict that in the first part of 2013, milk supplies in the U.S. and in other key dairy exporting countries may be below 2012 levels and that dairy product demand may be sufficiently strong enough to create milk price recovery in the beginning of 2013. This price recovery could lead to milk prices high enough to allow dairies to return to profitability. However, if milk prices do not reach levels sufficient to create dairy profitability, the continuing financial stress could lead to further milk production declines in a magnitude great enough to compromise the balance of milk supplies relative to demand.

When considering the proposals presented at the hearing and the hearing record, the Panel is concerned that providing price relief could disrupt the normal marketing conditions of the state's milk supplies or finished dairy products if the price relief continues for numerous months after the point of any potentially significant improvement in the financial condition of dairies. This concern is intensified by the timing of the price relief, which will be during the spring flush period, when milk supplies tend to be at their highest levels and plant capacity issues tend to occur. As a result, some level of caution must be exercised when determining how long to provide price relief.

Panel Recommendation

The Panel recommends a temporary price increase for the four-month pricing period February 2013 to May 2013.

<u>Determining Which Class Prices to Increase</u>

There were some differences in the proposals presented at the hearing regarding how price relief should be generated across the five classes of milk. Four of the six proposals, which included the proposals from the three major processing cooperatives in the state and one producer trade association, applied temporary increases across all classes of milk. WUD proposed increases on all classes except for Class 4a, and DI proposed increases only on the manufacturing classes of 4a and 4b. The hearing record shows that many of the witnesses that provided testimony and the interested parties that submitted written correspondence, either supported increases on all classes of milk or supported the WUD proposal that increases most of the classes. Although the DI is an organization that represents processors of all classes (primarily Classes 1, 2, 3, and 4b), there were no witnesses or written correspondence from processors of Class 1, 2, or 3 finished products in the hearing record. Representatives from Class 4a processors (processing cooperatives) and Class 4b processors (proprietary cheese manufacturers) were well represented at the hearing.

Although DI excluded Classes 1, 2, and 3 increases from its proposal, their testimony cites their intention to allow the pass-through effects of a Class 4a price increase to Classes 2 and 3, which occurs due to the Class 2 and 3 formulas being tied to the Class 4a formula. Therefore, the intention of the DI proposal is to exclude only the Class 1 price from any price increases. The reasons cited for excluding the Class 1 price from any increases are based on the decreasing sales trend of Class 1 products over the last few years, current Class 1 prices are at relatively high levels, and the fact that the Class 1 price is the highest regulated price compared to all the other class prices. The Panel agrees that Class 1 product sales have been steadily decreasing in California (and the U.S.) over the course of the last few years and further price increases could potentially worsen this trend. Because the current Class 1 price is towards the upper end of its normal range of fluctuation, further increases could also dampen sales as price sensitive consumers may move away from California fluid milk to fluid milk from out-of-state sources, or even non-dairy substitutes. However, testimony from fluid milk processors as part of the November 2009 hearing suggested moderate price increases for a short period of time would not disrupt marketing conditions too greatly and would be less likely to cause negative sales impacts that are unforeseen or unintended.

In addition to the competition observed in the markets for Class 1 products, the competition in the markets for finished dairy products in the other classes also must be considered. The Panel is aware that California Class 2 manufacturers face competition from out-of-state manufacturers, particularly with regards to sour cream and cottage cheese, and class price increases could worsen their competitive position. CDFA data shows the production of Class 3 products has decreased in 2012 and it is possible a class price increase may contribute to this downward production trend. Although it may be possible to pass along some of the increased costs of Class 2 and 3 price increases to consumers, some of these increased costs may need to be absorbed due to the competitive nature of these markets.

The WUD proposal excludes Class 4a increases because of the difficulty of passing on the increased cost to buyers of manufacturing products and because the Class 4a price has recently been higher than the blended Pool price, indicating that Class 4a processors have effectively been "paying into" the Pool. Class 4a products tend to be commodities with little to no differentiation making these markets highly competitive. Due to this and because Class 4a is a market-clearing class, there is risk associated with increased prices as passing on those increased costs to buyers of these products is difficult. The Panel recognizes the validity of this argument but also believes that processors of all classes could be confronted with the issue of passing on additional costs to the buyers of their dairy products. For example, Class 4b commodity cheeses face the same issues as commodity Class 4a products. Other types of cheeses, like Hispanic cheeses, are purchased by consumers sensitive to price changes, which makes passing increased costs along difficult as well. Furthermore, the state's processing cooperatives that manufacture and market almost all of the state's Class 4a products all proposed some level of Class 4a price increases. This all indicates that excluding a Class 4a increase in not warranted.

Although Class 4a prices recently may have been higher than Pool prices for parts of the last few years, this is not out of the ordinary when comparing Class 4a prices with overbase Pool prices since 2007. There have been months when Class 4a prices have been above the overbase price and months when it has been below the overbase price. This is true of 2012, when Class 4a prices were above the overbase price during months in the first half of the year, but under overbase prices in the latter part of the year. By the nature of how Pool prices are calculated, there may be occasions when Class 4a prices will be higher than Pool prices. This is also the same for Class 4b prices, which is the other market-clearing class price.

Some witnesses argued that increasing Class 4a and Class 4b prices would redistribute revenue from certain dairy producers to others through the Pool. Testimony shows that two large cheese processors have been paying increased premiums to dairy producers or dairy producer cooperatives that provide these cheese processors with milk. They indicated increasing Class 4b prices would cause them to reduce the premiums paid directly to the dairy producers shipping milk to them because these premium dollars would need to be applied to the increased Class 4b price. This would essentially transfer these premium dollars from those dairy producers that ship to them to all dairy producers that are paid Pool prices. Furthermore, testimony shows increased Class 4a prices will essentially redistribute some revenue from dairy producers who are members of processing cooperatives to those dairy producers that are not. By increasing the Class 4a price, processing cooperatives that own most of the Class 4a manufacturing capacity would in essence pay higher prices for milk, and the extra revenue from the higher price would be shared with all dairy producers paid from the Pool. However, the increased Class 4a price would be a detriment to the dairy producer members of processing cooperatives if the class price increase cannot be passed on to customers of their finished dairy products. In the end, increases in the Class 4a and 4b prices could lead to redistributions of revenue because of pooling, instead of affecting all dairy producers equally.

The Panel is aware that due to the structural nature of the revenue sharing concept of pooling, dairy producers paid the Pool price receive the benefit of the revenue from the sale of farm milk to all manufacturers, regardless of where a dairy producer ships his or her milk. One processing cooperative organization acknowledged increases in the Class 4a price would reduce the overall benefit to their producers, but was necessary to help all dairy producers that were experiencing financial difficulties. The Panel agrees that in order to provide price relief to dairy producers that receive blended Pool prices, class price increases need to extend across all classes of milk.

Panel Recommendation

The Panel recommends a temporary price increase across all classes of milk.

<u>Magnitude of Class Price Changes</u>

The proposed increases presented at the hearing varied greatly *(see Table 1)*. Proposed class price increases ranged from no change to $1.90/cwt. As demonstrated in *Table 1*, the proposals differed greatly with regards to the magnitudes of each class price increase and the uniformity of increases across the classes. When setting the magnitudes of the class price increases proposed at the hearing, testimony shows that some of the factors considered were the competitive position of California manufacturers to out-of-state manufacturers and the level of temporary price increases that resulted from the November 2009 hearing.

When establishing a price increase to provide price relief for dairy producers, one important consideration is the delicate balance of the marketing conditions of finished dairy products. California manufacturers compete with out-of-state manufacturers of dairy products and non-dairy substitute goods. If price increases are set too high, even on a temporary basis, it is possible to place California manufacturers in a competitive disadvantage with out-of-state manufacturers of dairy products. This disadvantage could lead to lost sales and market share. In the long-run, lost market share may decrease the quantity of milk procured by manufacturers, which could be detrimental to dairy producers. Even though dairy products of the different classes have slightly different marketing conditions with regards to consumer sensitivity to price changes, ability to pass on increased raw product costs resulting from class price increases, and marketing pressures from both domestic and international competitors, all manufacturers may be ultimately affected by class price increases.

In addition to out-of-state manufacturers of dairy products, California manufacturers must also compete with non-dairy substitute goods. The Panel is aware that consumer behavior has been evolving over the last number of years with regards to dairy products, especially fluid milk. It appears that changes in tastes and preferences may indicate that some consumers are willing to either buy non-dairy substitutes for dairy products or products made from non-dairy ingredients resembling dairy products. When consumers move away from dairy products for either of these reasons, it is not clear if they return to buying dairy products when the relative price of these dairy products decreases. The resulting lost sales, as mentioned previously, could be detrimental to both manufacturers and dairy producers.

The Panel considered and analyzed various temporary price increase scenarios across all classes. For the four months that the temporary price adjustment would be in effect, various scenarios were examined to balance the differing impacts to dairy producers, both members and non-members of processing cooperatives, proprietary manufacturers of all classes of milk, processing cooperative plants, and consumers. Competing economic factors were weighed in order to recommend an appropriate level of price relief. Using data from CDFA's cost of production survey; the Panel examined the corn feed price contribution to the total feed cost increases in the third quarter of 2012, which could be attributed to the 2012 drought. The increased corn feed costs for typical California dairies were correlated to different class price increases and their corresponding Pool price increases. Different scenarios were examined with the purpose of maximizing total revenues to producers by spreading the added revenues across all class prices, while minimizing the frequency of occurrences that California dairy products were uncompetitive in price with competing products from outside California.

The Panel analyzed the estimated impact of each classified price increase on both a hundredweight basis and on the raw product cost of various finished dairy products in order to balance the need to provide price relief without disadvantaging proprietary processors or processing cooperative members who have invested in manufacturing facilities. The different class price increase scenarios were compared to the levels of current class prices in relation to historic levels and the normal range of historic class price fluctuation. This was performed with the intention to limit market disruptions for finished products and maintain a reasonable relationship of the various classes to each other and to the price of milk used for similar purposes in contiguous states and other parts of the U.S. In the end, the scenarios considered the different competing economic factors that were available in the hearing record in order to not upset the stability in the production of market milk to ensure an adequate balance of milk supplies in relation to demand.

Panel Recommendation

The Panel recommends a temporary price increase of \$0.05/cwt. on Class 1; \$0.10/cwt. on Classes 2 and 3; and \$0.30/cwt. on Classes 4a and 4b for the four-month pricing period February 2013 through May 2013. Analyzing the 12-month period ending with October 2012, the effect of these changes would have increased monthly Pool prices, on average, by approximately \$0.251/cwt.

The temporary formula changes will be implemented as follows:

Class 1:	Fat:	\$0.0006 per pound
	SNF:	\$0.0045 per pound
	Fluid:	\$0.0001 per pound
Class 2, 3:	Fat:	\$0.0082 per pound
	SNF:	\$0.0082 per pound
Class 4a, 4b:	Fat:	\$0.0246 per pound
	SNF:	\$0.0246 per pound

This Hearing Panel Report has been prepared and submitted by:

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Original Signed by

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Appendix A

SUMMARY OF TESTIMONY

DAIRY FARMERS OF AMERICA, INC., Gary Stueve and Perry Tjaarda
<u>Testimony</u>

- DFA's monthly marketing's represent approximately 20 percent of the state's milk production.
- Proposal follows 2009 hearing format: does not alter underlying formulas, offers temporary adjustments to existing component and carrier values, takes into consideration comparative prices for each class price.
- Feed costs have been and are likely to stay well above historical norms.
- Dairy farm margins have been under extreme stress for many months.
- Lack of farm profitability is primary reason for reduced milk production.
- Data from Frazer LLP shows net income losses per cwt. for first six months at $0.92/cwt. in Kern County, $1.75/cwt. in San Joaquin area, and $2.24/cwt. in Southern California area.
- Have seen abnormal exodus in farm counts within DFA membership in 2011 (20 farms went out of business) and 2012 (34 farms have failed or exited).
- CDFA cost of production data for the third quarter 2012 shows total income against total costs and allowances at a $4.50/cwt. negative turn from 2011.
- How could any business make adjustments to operations to account for the $4.50/cwt. negative change in comparison to third quarter 2011.
- For 2012: Southern California Class 1 price vs. Phoenix Class I price showed Phoenix price $0.48/cwt. higher for the period. Northern California Class 1 price vs. Southern Oregon Class I price showed Southern Oregon was $0.30/cwt. higher.
- For 2012: California Class 2 prices vs. Federal Order Class II price showed Federal Order prices $0.45/cwt. higher, Class 3 prices vs. Federal Order II price showed Federal Order prices were $0.57/cwt. higher.
- For 2012: California Class 4a prices vs. Federal Order Class IV price showed Federal Order prices $0.39/cwt. higher, Class 4b prices vs. Federal Order IV price showed Federal Order prices $1.93/cwt. higher.
- For DFA proposed Class 1 changes, used same level of Class 1 markets as in 2010 hearing decision. Changes would yield approximately $0.35/cwt. increase in class prices, $0.05/cwt. increase to the Pool.
- For DFA proposed Class 2 and 3 prices would yield approximately $0.48/cwt. increase in class prices, $0.02/cwt. increase to the Pool.
- For DFA proposed Class 4a prices would yield approximately $0.25/cwt. increase in class prices, $0.08/cwt. increase to the Pool.
- For DFA proposed Class 4b prices would yield approximately $1.54/cwt. increase in class prices, $0.69/cwt. increase to the Pool.
- There is substantial competitive room for a price change in the Class 4b price.
- All DFA changes are for February-July 2013 (six months).
- Proposed per pound changes: Class 1 fat $0.0035, SNF $0.0298, fluid carrier $0.0009; Class 2 and 3 fat and SNF $0.0390; Class 4a fat and SNF $0.0205; Class 4b fat $0.0205 and SNF $0.1689.
- Mr. Tjaarda testified that his family's dairy has showed a loss for the last four years.

- Additional processing capacity will create more competition for milk and raise prices to producers – but only if it is market driven, value added, and allows for significant pass through of dollars to dairy producers.
- Charts and figures: California milk production 2000-2012; Statement of Dairy Farm Income and Costs, by Area, June 30, 2012 and annually 2006-2012; CDFA Third Quarter 2012 Statewide Cost Comparison Summary; Comparison of Class Prices, CDFA and Federal Order Nearby Markets, 2010-2012.

WESTERN UNITED DAIRYMEN, Annie AcMoody and Michael Marsh
<u>Testimony</u>

- Economic and regulatory pressures are escalating in the state and the cost of production has increased significantly.
- Price relief is needed for producers to make it through these tough times.
- It will take a prolonged period of improved margin for dairy producers to recover the immense losses and eroded equity from the economic disaster of 2008-2010.
- Just within WUD, 50 dairy sell outs occurred in the last eight months.
- Court records show that farmers, several that have multiple dairies, owe more than $100 million to lenders, feed companies, and other dairy suppliers.
- For the first six months of 2012, dairies in Southern California, Kern County and the San Joaquin Valley have lost a significant amount of money with average net incomes of -$2.24/cwt., -$0.92/cwt., and -$1.75/cwt., respectively.
- According to CDFA data, feed costs rose from just over 51 percent of total cost of production in 2003 to 60 percent of total costs by the third quarter of 2008.
- For 2012, third quarter, feed costs represented 65.4 percent of the total cost of production.
- Combined impact of our proposed change would result in an approximate 80 percent increase in the overbase price.
- California has a competitive edge in Classes 1, 2, and 3. Completely losing this edge would cause sales to decrease, which could cause California producer revenues from these classes to shrink.
- Changes that are temporary in nature will not have an adverse long-term effect on dairy producers that could be caused by a potential loss of higher valued classes.
- Similarity between 2009 dairy industry conditions and now is striking.
- The state currently has processing capacity not being fully utilized and processors have recently had difficulties securing sufficient milk supplies to meet their business needs.
- The 2009 Hearing Panel concern about the loss of Class 1 sales to the Nevada fluid milk processing plant has disappeared since it is no longer in business.
- Six months seems to be an appropriate time period to implement a temporary price increase.
- The six-month time period will assist producers in weathering the current financial crisis and provide an opportunity for the Secretary to work with the industry task force on longer term solutions.
- Class 1, 2, and 3 processors should be able to pass along the price increase more readily to the marketplace.
- The presence of the Real California Milk seal on Class 1, 2, and 3 products makes it more difficult for processors and retailers to change their suppliers.
- Class 4a and 4b tend to be market-clearing classes and impacting these plants with higher minimum prices could pose added risk. It is difficult to pass on increased raw product costs to buyers of manufactured products.

- The temporary increase for Class 4b is to get the producer side a fair Pool value from cheese making revenues.
- The May 31-June 1, 2012 hearing decision to raise the whey value to $0.75 fell short of a fair value for whey in the Class 4b formula.
- The whey factor should more closely reflect the whey value generated by the current Class III formula.
- For the last 12 months, Federal Order Class III has averaged $2.00/cwt. higher than Class 4b, 80 percent of the difference can be attributed to the whey value.
- The Class 4b plants are not sharing into the Pool like other classes. Producers shipping to cheese plants benefit from higher-blended prices from Class 1, 2, 3, and 4a when the Class 4b price is lower than the overbase, but the Class 4b plant does not share the full value of what it processes into the Pool.
- WUD proposed per pound changes: Class 1 fat $0.0105, SNF $0.0893, fluid carrier $0.0026; Class 2 and 3 fat and SNF $0.0820; Class 4b SNF $0.1150.
- Tables and Charts: Condensed Statement of Dairy Farm Income and Costs; California Seal examples; Letters from Consumers; Price Comparison, Federal Orders vs. California; December 2012 Corn Futures; Year-to-Date Temperature Anomalies for Contiguous U.S.; California Feed Costs; California Dairy Profit Margin; California Overbase minus California Cost of Production.

CALIFORNIA DAIRIES, INC., Eric Erba

Testimony

- CDI producer-members produce almost 43 percent of the milk produced in California.
- California dairy producers under great deal of financial stress, some unable to achieve a margin substantial enough to remain in business.
- Some of the financial pressure experienced in California can be attributed to drought in significant growing regions of the U.S., leading to escalating feed costs.
- The cost of feed makes up nearly 70 percent of the cost of producing milk.
- California witnessing an unprecedented drop off in milk production: September 2012 was the lowest month of milk production since 2005, about 13 percent lower than the peak month.
- CDI is questioning how they will be able to follow milk and dairy product marketing plans if milk production continues to fall below projections.
- CDI is proposing providing dairy producers with a higher milk price temporarily and one that is justified based on the market conditions facing the industry.
- CDI proposed per pound changes: Class 1 fat $0.0035, SNF $0.0298, fluid carrier $0.0009; Class 2 and 3 fat and SNF $0.0205; Class 4a fat and SNF $0.0082; Class 4b fat $0.0082, SNF $0.0542.
- CDI proposal's projected effect would be to increase Class 1 by $0.35/cwt., Class and 3 by $0.25/cwt., Class 4a by $0.10/cwt., and Class 4b by $0.50/cwt.
- CDI proposed changes to fat and SNF are nearly identical to those prescribed for the three-month period January 1 to March 31, 2010 – prices already endured temporarily.
- Class 4b bears a larger increase: current sliding scale for value of whey to Class 4b formula does not come close to matching the value placed on whey in Federal Order Milk Marketing areas; two large cheese plants, representing approximately 20 percent of the milk produced in California and 40 percent of the milk processed as Class 4b have been voluntarily paying $0.50-$0.60/cwt. to producers since September; over the last two years, all California class prices have been within the range of $0.25-$0.50/cwt. lower than their federal counterparts except Class 4b which is closer to $1.80/cwt. lower than Federal Order Class III price.

- Nearly all butter and powder processing facilities are owned by producers and not proprietary companies, increasing the Class 4a price only distributes the money from producers who have made investments in the plants to producers who have not.
- CDI proposed increase to Class 4a price will have direct negative financial impact on each CDI member.

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

- Dairy Institute of California represents 30 dairy companies which process approximately 75 percent of the fluid milk, culture, and frozen dairy products, over 85 percent of the cheese products, and a small percentage of the butter produced in California.
- Secretary must consider how to set prices and pricing formulas such that all of the declared intentions of the legislature are met as closely as possible.
- Producers facing extreme volatility of both milk revenues and input costs.
- Producer financial struggles are undeniable, however there is tremendous diversity with respect to the financial position of individual dairymen as evidenced by the Department's cost of production feedback data.
- 2012 follows what was a very profitable year, 2011, for many dairymen.
- Financial pressures facing dairymen are not unique to California, but are playing out wherever grain concentrates are fed.
- Only grazing production systems seem exempt from the current dairy financial crunch.
- High feed costs from increased demand and new uses for feed crops both domestically and globally are behind the financial difficulties.
- The severity and extent of the drought also helped corn prices move upward.
- The most recent reduction in milk supply was needed to restore orderly conditions to the market, but the painful way it came about was not desirable.
- Negative on-farm finances also contributed to the production decrease.
- Production data, bankruptcy and herd sales reports, dairy cow slaughter information all suggest industry is undergoing another round of consolidation, moving milk production onto fewer, but larger, farms.
- Contractions in the global market supply growth are expected to move dairy commodity prices higher by the second quarter of 2013.
- Processors and manufacturers do not have the margins to support large unilateral revenue transfers to producers, nor are they able to get such revenues from the market in today's competitive environment.
- Milk prices are not to be determined by milk production costs alone, but by supply and demand in the marketplace.
- There is no way for a state to increase its regulated prices without making the state's processing industry less competitive.
- California processors will lose sales and overall demand for California milk will fall if California increases its regulated prices and other states do not.
- Regulated prices should be minimum prices that serve to stabilize and underlay the market.
- Regulated prices set too high interfere with market signals.
- Reportedly, market-based, over-order premiums have been increasing to ensure that milk moves to where it is needed.
- It will be difficult to remain profitable with a production model that relies exclusively on purchased feed.

- Taking advantage of rising global demand means we must have an industry and policy environment that encourages investment needed to access, serve, and thrive in global marketplace.
- Simply raising regulated prices to improve incomes for dairymen is a policy that will fail.
- Best to attract and encourage investments that yield higher returns so increased demand for California dairy products will lead to higher demand and greater competition for milk and higher prices.
- DI supports the CDFA Dairy Task Force and its effort toward reforms.
- Urge Secretary to consider impact of proposed pricing changes on the ability of California processors to compete and sell product both nationally and globally.
- Tightening milk supplies leads to increased premiums paid to milk suppliers.
- Anticipate a brief period of lower prices in 2013 – these could be bridged by a modest and temporary increase to the state's regulated prices without too much market disruption and would be acceptable in light of the financial difficulties California dairymen have faced this year.
- DI proposed to increase the Class 4a and 4b price by $0.10/cwt. for three-month period, February through April 2013. Any increase to Class 4a price will pass through to Classes 2 and 3.
- DI does not propose any increase to Class 1.
- USDA currently has no plans to provide emergency relief through amendments to Federal Order price formulas.
- Tables/charts provided: California Milk Production 2009-2012; California Milk Cow Numbers, 2009-2012; California Blend Price as Reported by CDFA; Rabobank article Weaker Global Dairy Demand Won't Prevent Price Recovery; Pool Impact of Dairy Institute Proposal.

BESTWHEY, LLC, Barry Murphy
<u>Testimony</u>

- Must move toward free market milk pricing to capitalize on current and long-term global opportunities open to California's dairy industry.
- California's minimum price system works if milk premiums are used effectively to balance supply and demand dynamics in normal markets.
- California's large cooperatives, DFA, CDI, and LOL are not using the milk premium above minimum pricing effectively and are directly responsible for lower incomes to the dairies.
- Larger cooperatives focus clearing milk rather than creating markets for milk use.
- Support no change to the Class 4b pricing formula.
- Small and medium-sized cheese plants are already paying $0.75/cwt. for whey factor for milk.
- With a whey protein plant, more than 50 percent of the total SNF in milk is disposed to animal feed at a financial loss.
- Small cheese plant with 25 truckloads of milk per day, economies of scale will work to invest in whey protein plant, but at a minimum investment of $25 million.
- California's specialty cheese industry has seen little growth relative to Wisconsin, California has less than 10 percent of this market.
- Federal Order pricing mechanisms are broken and profitability in those large cheese plants is marginal on cheese and zero on whey protein.

- Last major investment in California cheese industry was over 10 years ago, LOL in Tulare. This investment resulted in several years of losses and eventual sale of plant was not profitable.
- F&A Cheese sold out after a few years on financial losses as a direct result of the Class 4b whey factor, which at the time was similar to the Federal Orders.
- Lactalis USA is closing its specialty cheese plant in Tipton next year to move operations to unregulated Idaho.
- Gossner Cheese specialty plant in Imperial Valley is in jeopardy of closing but is not closing its unregulated Utah plant.
- Cantare Cheese in San Diego when bankrupt a little over a year ago.
- Without a stable milk pricing policy environment, investors cannot move forward with cheese and whey expansion.

CALIFORNIA DAIRY CAMPAIGN, Lynne McBride
Testimony

- All evidence points to urgent need for CDFA to act to increase producer prices to provide much-needed relief to dairy producers.
- Estimated that more than 100 dairies will close their doors in 2012, more than in the devastating year 2009.
- Quoted numerous media sources describing the California dairy industry as crippled and likely to get worse and may never recover.
- Closure of dairy operations has a ripple effect on local, regional, and state economy and social fabric of affected communities.
- CDC has joined other organizations to call for reforms to state dairy pricing systems so that prices paid to producers are more equitable compared to prices in Federal Orders.
- Lack of response by CDFA, despite unified call for reform has caused members to look toward joining the federal milk marketing order system in order to receive a fair price for their milk, in line with the rest of the country.
- CDC proposes increases to all class prices – believe it should be a permanent change, but for this hearing we are calling for six months.
- Increase Class 1, 2, and 3 by $0.40/cwt., Class 4a by $0.30/cwt., and Class 4b by $1.90/cwt.
- CDC proposed increases based on average difference between the California class prices and the equivalent Federal Order class prices over the last 24 months.
- Proposed per pound changes: Class 1 fat $0.035, SNF $0.0247, fluid carrier $0.0007; Class 2 and 3 fat and SNF $0.0327; Class 4a fat and SNF $0.0246; Class 4b fat and SNF $0.1557.
- CDFA data shows cost of producing milk at $18.46/cwt. and $19.94/cwt. including management and return on investment.
- Provided graph showing 80 percent of dairies in California operating at a loss in the third quarter (70 percent in the first quarter, 90 percent in the second quarter).
- In order to keep 50 percent of producers at breakeven levels, estimate the overbase price must be no less than 87 percent of cost of production.
- Many of the dairies that remain in operation exhausted their equity during the crisis of 2009.
- California dairy producers facing bleak economic situation yet reports show Kraft Foods posted a third quarter net income of approximately $470 million (13 percent more than previous quarter); Dean Foods posted net income of $36 million (83 percent increase over previous year); and James Leprino of Leprino Foods shows a net worth of 2.6 billion.

Dairy producers deserve to profit as well given the fact that the milk they produce is the foundation on which the dairy sector is built.
- Record feed prices and historic drought led to rise in input costs that is pushing dairies across the state near the brink of ruin.
- CDFA can provide some relief by restoring equity in the dairy pricing system to be more aligned with prices paid in the Federal Orders.
- CDC proposal would increase the overbase price by $1.00/cwt., however this still will not bridge the gap between the cost of producing milk and producer income.
- CDFA third quarter reports show that California producers are losing $3.19/cwt.
- Tables and Charts: North Valley Cost Survey – Percent of Dairies with a Net Loss.

FARMDALE CREAMERY, INC., Scott Hofferber
<u>Testimony</u>
- Farmdale has 80 employees and processes an average 24.2 million pounds of milk and cream per month (100 loads per week) into cheese, sour cream and buttermilk.
- Farmdale supports no change to the pricing formulas.
- Farmdale had substantial investment and improvement of facilities earlier in the year and current climate of petitions and legal and legislative actions are undermining stability and creating a negative environment. This may inhibit the future and other processing growth.
- See no affirmative progress toward reforming most pressing internal industry issues appear to be forthcoming.
- Farmdale's cheese business was "in crisis" in 2007 under the variable whey factor.
- Recent meetings and hearing have stated that feed costs are putting certain California producers into an unsustainable business state.
- Are hopeful that our producer-partners will continue to change their dairy farming models to allow for continued mutually beneficial business ventures.
- Some sort of short-term blanket relief appears inevitable at this point.
- If there is a temporary price adjustment enacted, it should include all classes of milk.
- Support no more than three months for any emergency relief program.

LAND O'LAKES, INC., Thomas Wegner
<u>Testimony</u>
- LOL is a dairy cooperative with 3,000 dairy farmer member-owners, California and five different federal orders.
- LOL owns and operates cheese, butter/powder and value-added plants in the Upper Midwest, East, and California. California member-owners supply over 16 million pounds of milk per day primarily processed at the Tulare and Orland plants.
- Proposes that all classes of milk be increased for no less than six months.
- Proposed per pound changes: Class 1 fat $0.004, SNF $0.034, fluid carrier $0.001; Class 2 and 3 fat and SNF $0.369; Class 4a fat and SNF $0.0082; Class 4b fat $0.0082, SNF $0.1864.
- Increase Class 1 by $0.40/cwt., 2, and 3 by $0.45/cwt., Class 4a by $0.10/cwt., and Class 4b by $1.65/cwt.
- Proposed Class 1 increase is modest and the Southern California Class 1 price has averaged $0.48/cwt. less than Arizona Federal Order Class I price for 12 months of 2012.
- Through November 2012, Class 2 price has average $0.51/cwt. less than Federal Order Class II price and Class 3 price has averaged $0.80/cwt. less than Federal Order Class II price.
- Proposing a temporary $0.10/cwt. increase in Class 4a price despite current California manufacturing allowances being below 2011 average (CDFA data).

- Since last Class 4a pricing formula amendment, Federal Order Class IV price has exceeded Class 4a price by average of $0.33/cwt.
- Federal Order Class III price has exceeded Class 4b price by average of $2.07/cwt. over last 15 months. Since August 2012 and most recent change to Class 4b formula, Class III price has average $1.65/cwt. more than Class 4b.
- California cheese plants have benefitted from whey factor adopted by CDFA in 2007 and again in 2011 and 2012.
- Western dry whey price continues to show significant market strength.
- LOL proposal would increase overbase price by $0.82/cwt.
- California milk production has slowed from growth rate of early 2012.
- High temperatures in August, fewer cows, and less milk per cow have led to production decrease.
- In 2012, 43 LOL member farmers have discontinued milking.
- California dairy farmers have received far less for their milk in 2012 than in 2011, adding to the severe financial hardship.
- Drought in Corn Belt has impacted California producers, especially those who cannot grow their own feed but must purchase feed.
- LOL specialists estimate that for every $1.00 increase in corn, a California dairy farmer's feed costs increase by $0.30/cwt., depending on rations.
- Change of feed rations in an attempt to minimize costs may have led to the decrease in milk per cow.
- Management strategy of purchasing or renting additional land to better control feed cost has been and will continue to be expensive option for California dairymen.
- Farmers who grow almonds, walnuts, or pistachios typically can outbid dairy farmers for land purchases.
- CDFA data shows third quarter 2012 costs to produce milk increased 10 percent from second quarter 2012.
- Feed costs in third quarter 2012 average 11 percent more than second quarter 2012. In the third quarter 2012, feed costs represented 65.4 percent of total costs.
- Income over feed costs has fallen to $4.46/cwt., a decrease of 49 percent from third quarter 2011.
- Unless drought conditions improve in the Corn Belt, feed prices look to stay at levels that will continue to challenge California dairy farmers.

MILK PRODUCERS COUNCIL, Rob Vandenheuvel
<u>Testimony</u>

- Cites Code Sections 61805(d); 62062; 62062(a); 62062(b); stressing the intent to bring about a reasonable amount of stability and prosperity in the production of market milk.
- The balance of also looking at the economic needs of California dairy families is missing.
- Dairies and cooperatives rely on CDFA to follow Food and Agricultural Code when they establish contracts to sell their milk to manufacturers.
- Class 4b pricing formula dry whey factor limited when compared to Federal Order Class III formula.
- California dairy farmers subjected to financial losses in five out of past seven years.
- Dairy farmers are selling milk at prices well below cost of producing milk.
- Hard to negotiate better prices for milk because milk often sold under long-term contracts for economic stability.
- CDFA needs to make upward adjustment of minimum prices, even if only for the short time being allowed by the call of this hearing.
- MPC supports the WUD proposal.

- Over the past two years dairy producers have been in desperate need of increase in the pay price for milk, while cheese manufacturers have said minimum prices are fine where they are – saying premiums should be the only tool to increase pay price.
- Through California's regulated Pooling system, butter/powder plants have been heavily subsidizing the cheese plants over past three years.
- Tables and charts: California Cost of Production, Blend Price, Difference.

LEPRINO FOODS COMPANY, Sue M. Taylor
<u>Testimony</u>

- Leprino operates three mozzarella plants in California, two in Lemoore and one in Tracy. Process whey into sweet whey or whey protein concentrate or lactose.
- All whey from Leprino California plants is processed into protein concentrates and lactose.
- Regulated minimum milk prices are only one of several factors that drive level of net returns and should not be viewed as sole solution for farm financial stress.
- National supply and demand balance drives the finished product values that determine overall market value of milk through regulated price.
- Local supply and demand balance impacts market premiums that are paid in excess of the regulated minimums.
- Producers across the country have experienced similar patterns of stress and profitability at varying levels over the last several years.
- November overbase price of $18.49/cwt. was $4.84/cwt. above May price and slightly above the CDFA third quarter estimate of cost of production.
- Value we paid in excess of the minimum regulated price in November was more than 2.5 times the level that we were paying in the Spring. Competitive issues will drive other manufacturers to similarly increase payments as milk shifts to higher paying markets.
- Marketplace is better venue for price relief.
- If the Department determines that regulated price relief is warranted, we urge the Department to apply it across all manufacturing classes as proposed by Dairy Institute – and no longer than a three-month timeframe to minimum disruption to marketplace responses.

HILMAR CHEESE COMPANY, INC., David Ahlem
<u>Testimony</u>

- In California, Hilmar processes over 12 million pounds of milk per day (more than 10 percent of the milk produced in California) and purchases milk from over 200 dairies.
- Hilmar supports low regulated minimum prices that allow the market to set high market driven prices.
- Hilmar is supportive of the Institute's proposal, but don't believe price increases should come through increases in the regulated price, but should come through the marketplace.
- High feed prices have changed the competitive position of producers throughout the western U.S.
- The purchased feed model is now a detriment to some and the industry is undergoing a painful adjustment to this changing dynamic.
- Market demand and competition drive value, not regulated prices.
- Regulated price increases are artificial and the benefits to producers will be short lived – they are simply income/revenue redistribution.
- Many California processors pay premiums to producers above the Class 4b price.
- In October 2012, Hilmar made significant proactive increases in pay prices above and beyond the premiums that had been paid for years.

- California cooperatives that control 80-85 percent of the milk in California have the ability to increase the price for milk to all their customers tomorrow.
- Regulated minimum price should be a market clearing price, not a market making price.
- Any increase in Class 4b minimum price will take money away from those premium-earning producers who supply Hilmar; simply erode their mailbox pay price as premiums get redistributed to others via the Pool.
- In first eleven months of 2012, nearly $6 million of Hilmar premiums were redistributed through the Pool as a result of the past two Class 4b hearings.
- Need to move toward a system that forces all market participants to compete for milk and create value.
- Out-of-state competitors have the ability to choose whether or not to participate in the regulated system – this is not an option in California.
- Minimum price increases put California cheese processors at further disadvantage to primary competitors in unregulated markets, both domestically and abroad.
- If Secretary increases the regulated minimum price above market price to pursue parity with pricing of another region, run the risk of being uncompetitive in the marketplace we currently compete.
- Frequently changing regulatory environment creates uncertainty and discourages long-term, capital investments (26 milk pricing hearings in the last 10 years).
- Hilmar urges the state not to increase the minimum price.

LOREN LOPES, Dairy Producer
Testimony

- Have been in the dairy business since 1968 and am an activist for fair dairy pricing that allows average producer to receive the cost of production and return on investment for their milk.
- The Young Act and Gonsalves Milk Pooling Act adopted because of the inequities of the milk pricing system.
- In early years, there was a support price based on parity and set for five years at a time through the farm bill. Now the support price only serves as a floor for basic commodity prices.
- The Class 4b formula is very lucrative designed to keep cheese processors competitive with the rest of the U.S., guaranteeing tremendous profitability.
- Feed costs have had the biggest effect on cost of production because of the ethanol mandate and the drought.
- The California third quarter shows an average loss of $2.55/cwt. with return on investment and return for management.
- The September mailbox price for California was $3.12/cwt. below that of Wisconsin. This shows that there is room for increase in manufactured price of milk and still be competitive with other states.
- Majority of California dairy producers need a $2.00/cwt. emergency price increase to survive the next six months.
- With a cost-based pricing system the milk price is stable and producers cover his/her costs and more of the marketing premiums stay with the processor or cooperative.
- History tells us that dairy cannot function without sanction of government regulation because we have a perishable product produced every twelve hours and that makes the producer vulnerable to establishing a fair price for his/her labor.

CALIFORNIA DAIRY WOMEN ASSOCIATION, Linda Lopes
<u>Testimony</u>

- CDWA represents 180 dairy producers from Sonoma to Tehachapi.
- At today's prices, per every 500 cows, dairies are losing $22,000 per month.
- Dairies need $18.00-$20.00/cwt. to catch up.
- Feed costs have increased dramatically and environmental regulations have increased costs.
- Not right that CDFA covers costs of the processing side but not producer side.
- Many support businesses both small and large depend on the dairy industry to survive.
- California dairy producers are number one nationally for production and quality and have invested millions of dollars to do this.

MARQUEZ BROTHERS INTERNATIONAL, INC., Jose. T. Maldonado
<u>Testimony</u>

- Previous two hearings have resulted in price increases that presented challenges to our company, specifically the limit we can derive from both cheese and the by-products side of the business.
- Marquez supports no change in the milk pricing formulas.
- Dairymen are caught in feed price crunch, a national problem and raising milk prices will do little to help farmers with that – and will put plants at risk and remove markets from California's milk.
- Marquez decision to invest in whey processing plant was driven by rising environmental concerns with whey disposal and cost of whey disposal, not projected financial return.
- Increase in Class 4b milk price will result in small/medium size cheese manufacturers unable to recoup their investment and extinction.
- Presented a chart outlining the process of making cheese and whey extraction.
- In California, out of the 57 plants making cheese, only 11 plants have whey concentration facilities and less than a handful of those process dry permeate/lactose.
- To capture maximum value of whey stream, important to have ability to take it all the way to a dry state. Small/medium cheese processors don't dry permeate/lactose fraction and don't have funds for $35 million permeate drying facility.
- Included CDFA table "Pounds of Milk Processed into Cheese" and outlined number of cheese plants producing cheese and whey products.
- All 57 cheese plants would be severely financially impacted by increase in milk price, 33 cheese plants will never recover their investment and 6 other plants will break even.
- There is no milk allowance in the Class 4b formula to cover whey disposal costs.
- Marquez is years away from a return on investment on their whey plant, simply do not have enough volume.
- Waste water treatment plant has an operating cost of $200,000/month.
- Quotes an article by John Umhoefer, 2012, stating one third of Wisconsin's cheese plants are swimming in red ink on the other solids price – the only hope for changing this nine-year-old mistake is recognition of this problem in the 2012 farm bill.
- Leaving Class 4b prices as is will provide margins for cheese makers to invest in new technology and invest funds in research and development.
- California cheese plants are still struggling to adapt to the change implemented in 2011 and 2012 which to date added $0.50/cwt. to the cost of milk.
- Processors are confronted with higher energy, labor, resin, petroleum based packaging materials and workers compensation costs to operate in California.

TONY MARTIN DAIRY & DAIRY GODDESS FARMSTEAD CHEESE and MILK & DAIRY GODDESS PORK, Barbara Martin

Testimony

- Supports raising the California milk price to dairy farmers.
- Have been receiving nearly $2.00/cwt. less than the rest of the U.S. for too long.
- California has the highest cost, highest regulations and highest quality of milk.
- I believe the task force to fix the long-term issues needs to happen.
- My farm's future depends on the adjustment as we are continuing to have record high alfalfa and grain prices.

STEIFEL DAIRY, Marcia Crouse

Testimony

- Supports raising the prices for all classes of milk.
- Charts included showed California mailbox price lagged behind USDA milk mailbox prices for all of 2012.
- Cost of production figures show California dairy producers producing milk for much less than mailbox milk price.
- Dairy producers are not guaranteed a profit, need milk prices to be fair.
- Raise California milk prices so that they are aligned with USDA milk prices.

LORI BYLSMA, Dairy Producer

Testimony

- Family run dairy for last 60 years, barely making it and need milk prices raised.
- People need dairy products in their diet and dairy producers need to make a living.
- Not fair that California dairy producers getting $2.00/cwt. less that other states.

ALFRED SOARES DAIRY, Alfred and Reis Soares

Testimony

- Amending class prices for six months is not sufficient given the losses California dairy producers have sustained.
- If increase is granted and is similar to the last increase which amounted to approximately $500.00/month on a 1,000 cow dairy, let's not waste anyone's time. That increase was an insult to the dairy industry.
- We support current legislation introduced by California Assemblyman Richard Pan.

WALTER & WILHELM, Riley C. Walter

Testimony

- I am a bankruptcy attorney based in Fresno specializing in agricultural insolvencies.
- Over last two years have worked with 60 dairymen and their families who have experienced extreme financial pressure due, in part, to low milk prices.
- Have worked with dairymen in Iowa, Kentucky, Texas and Arizona, they receive more for their milk and have lower costs than California dairymen.
- Support increase to all classes and believe the six month extension is too short.
- Many dairymen have depleted their equity in their assets and are on the verge of bankruptcy or liquidation.
- Absent a meaningful and immediate price increase, there are at least six clients who will almost certainly have to file bankruptcies in the first quarter 2013.
- Each failed dairy inflicts a very large damage on the dairy supply chain.

WESTERN DAIRY ADVISORS, George Salsa
<u>Testimony</u>

- I am an independent financial consultant in Tulare, specializing in dairy finance.
- Historically, milk prices in other states exceed that received by California dairies.
- Increases are warranted and should be implemented immediately. Increases should be considered on a permanent basis and not a six-month extension.
- Increased feed costs and volatile milk prices have caused depressed industry conditions.
- Sample of feed costs of my clients shows 2008-2012 feed costs are 45 percent higher than 2005-2007.
- Feed costs make up approximately 70 percent of total operating costs. Fuel and energy have also been significantly higher.
- Many dairies are in a situation where their lender has requested they seek alternate financing and prospective banks are not taking new dairy customers. Lack of credit in marketplace is resulting in a record number of dairy bankruptcies in California.
- Lenders have a common theme that there isn’t enough demonstrated profitability over the past 2-3 years.
- Dairy producers want a fair pay price that will allow them to remain profitable and keep their business viable.
- Obvious discrepancy in Class 4b price and balance needs to be leveled between producers and manufacturers.
- As dairy economy suffers, all associated with it are directly impacted such as feed vendors, supply companies, veterinarians, nutritionists, equipment companies, etc.

CALIFORNIA STATE GRANGE, El Paso de Robles Grange #555
<u>Testimony</u>

- Set forth a proclamation with the resolve that it supports efforts for California dairies to join the Federal Milk Marketing Order System and supports an increase to the price paid for whey for California dairy farmers.

MOSS TUCKER, ATTORNEYS AT LAW, Douglas Tucker and Amanda G. Hebesha
<u>Testimony</u>

- Represent multi-generational family owned dairies in the Central Valley.
- Support price increases for Class 1, 2, 3, 4a, and 4b.
- Dairies have been operating under harsh market conditions stemming from lack of ability to obtain financing for operating loans, cost of feed which has increased dramatically, and relatively low milk price in California.
- Due to lack of financing, many dairies have been forced to cash flow their operations without the use of borrowed funds and are almost totally reliant on the milk price to fund their operations.
- Strongly believe amendments should be enacted and more permanent and stronger actions be considered and implemented in the future.

Dana Koetsier
<u>Testimony</u>

- California dairies for over the past two years have received much less, close to $2.00/cwt. per month for their milk compared to the surrounding states.
- Expenses to run a dairy in California are much higher than other states.
- Personally lost our family dairy in 2009 and am seeing the closure of dairies going on.
- Support immediate price increase while long-term solution is being discussed.

R. DOORNENBAL RANCHES, Rien Doornenbal
<u>Testimony</u>

- Operate three dairy farms, speaking only on my own behalf and for neighbors and friends.
- Any money added to my milk check would definitely help, but the elephant in the room is Class 4b pricing.
- Proposed to increase Class 4b price by $1.75/cwt.
- Would like to ask the Department why they are so concerned about plant capacity - it is the dairy producers' responsibility.
- Would like to ask the Department if they are concerned that the Class 4b price has averaged $1.50/cwt. lower than Class III for last three years.
- When cost of production is higher than revenue, producers have to get out of the business or produce as much milk on a per cow basis as possible. Most attempts to reduce inputs on dairy farms during times of low milk prices succeed in lowering milk production, but the net effect to the dairymen is to lose even more money.
- High feed costs affect dairymen all across the U.S.
- In California, dairymen are also operating with high feed costs and lower milk prices than the rest of the country.
- CDFA needs to bring Class 4b into alignment with the Class III.

DUARTE DAIRY, INC., Antoinette Duarte
<u>Testimony</u>

- Ten months ago we reported to the Department that we were losing equity due to the low milk prices and in particular the Class 4b.
- We have been receiving $2.00/cwt. less than anyone in the surrounding states and this has caused a collapse to the dairy producers in California.
- Supports the CDC proposal.
- The Department needs to recognize the hard work, sacrifices and investments that we have put into our dairies for years.

GEOFFREY VANDEN HEUVEL, Dairy Producer
<u>Testimony</u>

- The days of cheap feed are over, about 40 percent of this year's corn crop is dedicated to ethanol.
- We are discovering that we cannot get milk prices high enough to cover those feed costs. As seen recently, as soon as we get that milk price up to $20.00 or so there is just a resistance in the marketplace and it will not sustain that.
- Market is telling me I need to get out of the business, we need to reduce the supply of milk in California because we are not competitive.
- If I was getting something close to within $0.30 or $0.40 of the Federal Order prices, I have a chance to make it.
- A lot of dairy producers have had their loans expire. There were two dispersals in Chino in the last six days, selling 9,000 cows.
- It's not just dairy farmers, but employees, hoof trimmers, soap people, grain dealers, hay dealers, all are impacted.
- It is different today, dairy farmers are out of equity and the banking industry is executing plans to liquidate. They don't want all these cows rushing to the border at the same time because it's too disruptive.
- The Department's actions show market clearing and protecting processors is more important than protecting producers.
- Ask the Department to do the most you can.