

STATE OF CALIFORNIA
DEPARTMENT OF FOOD AND AGRICULTURE
DAIRY MARKETING BRANCH

CONSOLIDATED PUBLIC HEARING TO
CONSIDER AMENDMENTS TO THE STABILIZATION
AND MARKETING PLANS FOR MARKET MILK FOR THE
NORTHERN AND SOUTHERN CALIFORNIA MARKETING AREAS

CALIFORNIA DEPARTMENT OF FOOD & AGRICULTURE
DEPARTMENT AUDITORIUM
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SACRAMENTO, CALIFORNIA

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9:00 A.M.

ACCELERATED BUSINESS GROUP

(916) 851-5976

A P P E A R A N C E SCDFA Panel

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Petitioners

Tom Barcellos
Western United Dairymen

Donna Melby, Attorney
Paul Hastings
representing The Coalition

Alternative Proposals

Scott Hofferber
Farmdale Creamery, Inc.

Also Testifying

Michael McCully
On behalf of Kraft Foods

Greg Dryer
Saputo Cheese USA Inc.

Corey Travis
Caseus Energy

Elvin Hollon
Dairy Farmers of America, Inc.

Arie de Jong
Milky Way Dairy

Stephen Mancebo
Mancebo Dairy

William C. Van Dam
Alliance of Western Milk Producers

Rien Doornenbal
R. Doornenbal Dairy

Edwin Rizo
Rizo Lopez Foods, Inc.

Sue M. Taylor
Leprino Foods Company

Jared Fernandes
Fernoak Farms

Patricia Van Dam
Two B Dairy

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P R O C E E D I N G S

9:00 a.m.

1 HEARING OFFICER ROWDEN: Okay, I am going to open
2 the hearing again. And first of all to remind everybody,
3 restrooms are through the double doors, out and to the left
4 and down the hall. Exits again in case there's any kind of
5 emergency is either through the double doors or through one
6 of these two doors. And then if you go through these two
7 doors, left and out to the alley and then out to the park.

8 Okay, our first witness today is Mike McCully.
9 Please state your full name, spell your last name and state
10 your affiliation for the record.

11 MR. McCULLY: My name is Mike McCully, M-C-C-U-L-
12 L-Y. I'm with the McCully Group, representing Kraft Foods
13 here today.

14 Whereupon,

15 MICHAEL McCULLY

16 Was duly sworn.

17 HEARING OFFICER ROWDEN: And your testimony is
18 Exhibit 59. Please.

19 (Exhibit 59 was received into evidence.)

20 MR. McCULLY: Thank you. Good morning,
21 Mr. Hearing Officer and members of the Hearing Panel. My
22 name is Mike McCully of the McCully Group and I am
23 representing Kraft Foods at this hearing. Kraft operates a
24
25

1 multi-product dairy plant in Tulare, California. This plant
2 produces Parmesan and other hard Italian cheeses along with
3 dry whey powder. It also produces Knudsen brand cottage
4 cheese and sour cream. In addition, Kraft purchases cheese
5 and other dairy ingredients from several companies located
6 in California. Consistent with prior testimony on this
7 subject, Kraft opposes the petitions from Western United
8 Dairymen and the coalition of dairy producer organizations.

9 The question of how to value whey in regulated
10 milk prices is not a new one nor is unique to the California
11 system. Indeed, the debate surrounding valuing whey in the
12 4b formula dates back over a decade. In late 2007, the
13 California Department of Food and Agriculture sanctioned an
14 industry work group, the Whey Committee, to explore possible
15 solutions to this puzzle. While numerous options were
16 presented, there was no consensus reached and the decision
17 from the December 2007 hearing remained in place. This 25
18 cent per hundredweight fixed whey factor benefitted dairymen
19 for several years and provided stability in the regulated
20 price formula for processors. However, as whey prices moved
21 higher in 2011, the gap widened between the California 4b
22 milk price and the Federal order Class III milk price. Once
23 again, the valuation of whey in the 4b formula is being
24 questioned. However, California is not alone. In fact,
25 there have been numerous discussions over the last few years

1 on reforming the federal order milk pricing system to make
2 it more modern and market oriented. This seems to be a
3 central question in both California and the federal orders,
4 how should milk be priced and what role does the regulatory
5 system play in setting prices? So while whey is the focus
6 at this hearing, it is a small part of a bigger issue and
7 one the industry needs to resolve sooner rather than later.

8 In response to very high milk prices in 2011 and
9 mild winter weather conditions, milk production has been
10 strong across the country in 2012. For the first four
11 months of the year US milk production is up 3.9 percent
12 compared to 2011, which California milk supplies are 5.7
13 percent higher than last year. Put another way, while
14 California's share of US milk production is 21.5 percent,
15 the 2012 increase in California is nearly 31 percent of the
16 total growth in the US. To accommodate the continued growth
17 of California milk supplies it is imperative for the success
18 of the California dairy industry that the state fosters and
19 builds additional manufacturing capacity.

20 Until the last six years or so, California's
21 regulated pricing environment encouraged dairy industry
22 growth and provided an advantage over other areas of the
23 country. Now that advantage is gone and other areas are
24 taking market share from California, illustrated by new
25 plants being located in various states but little to no

1 activity in California. During this time there have been
2 several years, including 2012, where milk produced in
3 California was shipped out of the state to find a
4 manufacturing home, usually at a significant loss, or worse
5 yet, dumped on farms. A logical conclusion to this
6 situation is the state has inadequate capacity to process
7 growing milk supplies into products demanded by the
8 marketplace. If California's dairy industry is to remain
9 competitive in a domestic as well as a growing global market
10 it is imperative the regulated pricing system foster, not
11 impede, the development of new processing capacity.

12 An important difference between the regulated
13 pricing systems in the Federal Orders and California is the
14 ability for processors to depool milk in the Federal Orders.

15 This depooling function allows processors to clear milk
16 from the market and handle it in an orderly fashion. In
17 contrast, California does not have such a mechanism to act
18 as a relief valve for milk supplies. Instead, when milk
19 supply exceeds manufacturing demand in California milk
20 leaves the state to find an manufacturing outlet. This milk
21 usually incurs a severe loss due to transportation costs and
22 a discounted sales price. Furthermore, plants that compete
23 with California buy the discounted milk, providing them a
24 competitive advantage in raw product costs. Therefore,
25 California loses out twice, in the form of losses in surplus

1 milk sales and then again when competing against lower cost
2 finished goods. Appendix 1 contains excerpts from USDA's
3 Dairy Market News from January to May 2012. On a regular
4 basis, milk was being discounted \$2 to \$5 per hundredweight
5 under class in the Midwest in order to clear the market. In
6 contrast, base plans were implemented in California and some
7 milk left the state due to inadequate manufacturing
8 capacity. From a broader policy perspective there has been
9 discussion for several years about allowing manufacturing
10 plants in California to depool milk in order to clear the
11 market. Given the lack of new manufacturing capacity coming
12 on-line in the next few years, this should be given serious
13 consideration.

14 Some have pointed to the whey factor as a major
15 cause of milk price's variability, thereby negatively
16 impacting the ability of California producers to hedge their
17 milk prices. However, this is only part of the story. The
18 analysis has been between the California 4b price and the
19 Federal Order Class III price. The variability in these two
20 price series results from the use of NASS/AMS block and
21 barrel cheese prices versus Chicago Mercantile Exchange
22 block cheese prices as well as the difference in whey
23 valuation. But a broader analysis of the California all-
24 milk price versus Federal Order Class III prices shows
25 California milk price variability is less than other states

1 over the last five years. And I have a table shown in the
2 middle of the page that I'll just illustrate and talk about
3 for the crowd's -- they don't have it in front of them.

4 On the far left hand of the graph it has the first
5 states of Minnesota and Wisconsin. They have the lowest
6 basis variability. And this is measured from 2007 through
7 2011 and variability is the range of the basis throughout
8 the year. So it would be -- the high and the low is what
9 the variability is. Minnesota and Wisconsin are both the
10 same at \$1.75 and \$1.78 per hundredweight, whereas on the
11 opposite -- and this is the top ten milk producing states.
12 The opposite side is Pennsylvania, is \$3.26 per
13 hundredweight, New York at \$3.12 a hundredweight. And in
14 that -- go back to the left hand side. Minnesota and
15 Wisconsin at \$1.75 and \$1.78, Idaho is \$2.25, California is
16 \$2.43, Texas is \$2.57, New Mexico at \$2.71, Washington at
17 \$2.73, Michigan at \$2.84 and then New York and Pennsylvania.
18 This doesn't include states in the Southeast or Florida
19 where the basis variability is even greater.

20 As you would expect, the states -- Minnesota and
21 Wisconsin have an 80 to 90 percent Class III utilization, so
22 their all-milk highest price or paid-price to farmers would
23 be highly correlated to what the Class III milk futures
24 price is, yet there still is a lot of variability throughout
25 the year. Going back to the text.

1 Of the top ten milk producing states, California
2 basis variability ranks the fourth least out of ten. Other
3 areas with high Class I utilization like the Southeast or
4 Florida orders have even higher basis variability. It is
5 good that basis variability and hedging is being discussed.
6 Again, a policy solution could improve the situation by
7 allowing cooperatives or producers to forward contract with
8 processors. This would remove a lot of the basis
9 variability as California prices would be used for
10 contracting.

11 On to whey issues. The addition of a whey factor
12 to the 4b price formula has a long and contentious history.
13 The problem is complex and solutions have been elusive.
14 Before 2003, whey was not included in the price formula for
15 4b milk. In early 2003 in a period of low milk prices, the
16 whey factor was added to the formula, breaking from
17 longstanding Department position on this issue. The Hearing
18 Panel report noted:

19 "For years, the Department has made policy
20 decisions not to include an explicit pricing
21 component for whey in the Class 4b formula. Based
22 on testimony and relevant data this position has
23 been reaffirmed at each of the hearings that have
24 been open to recommendations for including a whey
25 pricing component."

1 Since it was added, numerous problems have arisen.
2 The hearings in 2005, 2006 and 2007 went into detail on the
3 whey manufacturing allowance, CDFA's manufacturing cost
4 survey data and other whey issues. At each hearing, the
5 Panel's recommendation was the same, remove the whey
6 component from the 4b formula.

7 The Hearing Panel's report from February 2005
8 detailed the problem.

9 "As was reported in the January 2003 hearing
10 determinations, the incorporation of a pricing
11 component to the Class 4b pricing formula to
12 reflect the value that cheese operations earn from
13 their skim whey stream, the residual of cheese
14 production, has not been easy or straightforward.

15 The skim waste stream has historically been a
16 waste byproduct of the cheese making processing.
17 As the cheese industry has matured and the
18 environmental regulations have become more
19 stringent, the development of whey byproducts have
20 become more commonplace by necessity. Still the
21 investments required to process skim whey stream
22 into value-added products are significant and the
23 financial risk for processing the whey stream into
24 a value-added product are considerable."

25 The Panel's recommendation was to remove the whey

1 factor in the 4b pricing formula and was concisely
2 summarized as follows:

3 "The Panel is mindful of using a manageable
4 pricing formula. It seems clear from the
5 positions taken by the producer/processor
6 witnesses that incorporating a factor for the
7 value of the whey stream appears to be
8 intractable. Given the testimony and evidence
9 before the panel it would be far wiser to simply
10 remove the skim whey factor from the Class 4b
11 pricing formula than to continue to expand this
12 factor in an inconsistent manner with the butter
13 and nonfat dry milk and Cheddar cheese pricing
14 formulas."

15 The problem of the whey component was back again
16 at the June 2006 hearing. And once again the Panel's
17 recommendation was to remove the whey factor from the
18 formula for the same reasoning as the prior hearing.

19 "As a result of reviewing the testimony and
20 for the reasons outlined above, the Panel
21 continues to support the removal of the whey
22 factor in the 4b pricing formula as it did in the
23 2005 hearing determinations."

24 Proposals have also been made regarding the
25 addition of Whey Protein Concentrate or other whey proteins

1 into the formula. Unlike cheese, butter and nonfat dry
2 milk, there is not one standard whey product that is
3 appropriate to use in pricing formulas. The Panel's reports
4 from both 2005 and 2006 hearings detailed this problem.

5 "Whey is one of the biggest reservoirs of
6 food protein and can be made into a wide variety
7 of both food and non-food products. In the food
8 category it can be used in baby food, diet
9 supplements, bakery products salad dressing,
10 beverages and confections. It can be made into
11 pharmaceutical products, yeast products and
12 industrial products. Unlike Cheddar cheese,
13 butter and nonfat dry milk, which have defined
14 standards of identity and fairly uniform
15 processes, each of these whey usages require their
16 own unique processing equipment, processing
17 procedures, with vastly different associated
18 costs. While economies of scale are critical in
19 successful whey operations, the Panel is mindful
20 that an inappropriate decision on this factor can
21 inadvertently make previously profitable whey
22 enterprises a losing proposition should it over-
23 stimulate the production of a particular whey
24 product."

25 An editorial by John Umhoefer from the Wisconsin

1 Cheese Makers Association in the August 3, 2007 Cheese
2 Market News, I've attached that as Appendix 2, provides
3 additional documentation of the problem of attempting to
4 value the whey stream.

5 Of the 90 plants that replied to the WCMA survey,
6 91 percent did not produce dry whey.

7 About 42 percent of the plants performed minimal
8 processing and received minimal payment for their product.

9 Those plants that sold wet, skimmed whey earned
10 between 10 to 20 per pound in June 2007, compared to the
11 NASS price of 72 cents per pound price for dry whey powder.

12 Most of the remaining plants, and there were 42 of
13 them, performed various combinations of ultrafiltration,
14 reverse osmosis, and/or evaporation to separate whey
15 components and condense whey.

16 In response to the strain put on cheese plants by
17 record-high whey prices in 2007, the hearing in October 2007
18 resulted in a move to a fixed factor of 25 cents per
19 hundredweight for whey. That solution worked for several
20 years and provided producers a higher milk price compared to
21 the prior formula for over three years. However, by mid-
22 2011 yet another hearing was held and a new sliding scale
23 was adopted for whey pricing. Within seven months of
24 implementing this new formula producers have petitioned for
25 another hearing two separate times. Their proposals would

1 return 4b milk pricing to where it was in 2007 and generate
2 the same problems as it did then.

3 Whey pricing is also causing issues in the Federal
4 Orders. John Umhoefer wrote another editorial on whey
5 pricing in the January 6, 2012 Cheese Market News; I have
6 attached that as Appendix 3. The article highlights the
7 challenges faced by small and medium sized cheese plants in
8 Wisconsin due to the impact from whey on the other solids
9 pricing in Federal Order Class III milk prices. He again
10 argues the base component for other solids pricing should be
11 wet skimmed whey, not sweet dry whey powder. He also calls
12 the Federal Order other solids pricing "logically flawed" as
13 regulated prices should establish a base or minimum price
14 with premiums and bonuses added to it.

15 It is evident that the addition of the whey
16 component to the 4b price formula has introduced a multitude
17 of problems. This is true not only in the California
18 pricing system but also in the Federal Order system. Prior
19 hearing panels have recommended the removal of the whey
20 factor altogether. The decision from last June's hearing
21 was a compromise, that by definition means everyone dislikes
22 some part of it. It attempts to strike a balance between
23 the needs of dairymen and the competitiveness of cheese
24 makers in the state. A central tenet of regulated pricing
25 is that the system establishes a regulated minimum price

1 that allows the market to clear. If there were additional
2 revenue generated from the milk then it would be returned in
3 the form of premiums, cooperative earnings or other
4 payments. Milk production in California continues to grow
5 while in-state processing capacity has not kept up with this
6 growth. For the industry to prosper in the future, it needs
7 to look beyond the current whey issue and consider broader
8 regulatory and policy reforms.

9 While the regulated pricing system in California
10 served the industry well for years, it is becoming more
11 apparent it is time for a change. Regulated pricing systems
12 in California and the Federal Orders were established many
13 years ago with vastly different market dynamics than exist
14 today. The dairy markets have evolved from local to
15 regional to national to global in nature. Dairy farmers,
16 through the California Milk Advisory Board, commissioned a
17 study by McKinsey and Company on the future of the
18 California dairy industry. The strategic consulting firm
19 Bain conducted an extensive review of the US dairy industry.

20 Their recommendation was for the US to become a consistent
21 exporter and highlighted the need to update dairy policy to
22 accommodate that vision. We should use those studies as a
23 basis for developing a regulatory system that best serves
24 the needs of today's dairy industry. I believe the US dairy
25 industry has the potential to fill the growing world demand

1 for dairy products. With 95 percent of the world's food
2 consumers outside the US, the potential market is enormous.
3 Unfortunately, outdated regulated systems are holding back
4 the US dairy industry from realizing the full potential of
5 this opportunity. Other countries will eventually grab it
6 if we don't. Kraft has long believed in transitioning to a
7 free market environment and feels the US dairy industry
8 would benefit greatly from this change. The industry needs
9 to work together to develop a long-term policy approach for
10 the California dairy industry. Until the California dairy
11 industry embraces more market-oriented policies, dairy
12 producers will lose out on the opportunities in both the
13 domestic and export markets. The competitive advantage
14 enjoyed by the California dairy industry over the last 25
15 years is gone. To compete in the marketplace of the future
16 the California dairy industry needs to adapt to these new
17 realities or get left behind.

18 In summary, Kraft encourages the Department to
19 reject the proposal from Western United Dairymen and the
20 coalition of dairy producer organizations. I thank you for
21 the opportunity to testify here today and would like to file
22 a post-hearing brief if necessary. I welcome any questions
23 at this time.

24 HEARING OFFICER ROWDEN: Your request for a post-
25 hearing brief is granted. Panel questions?

1 MR. EASTMAN: Yes, I have a couple of questions
2 about the one graph that you had that showed the basis
3 variability.

4 MR. McCULLY: Okay.

5 MR. EASTMAN: The first question I had is, when
6 you are looking at the all-milk price, I assume the all-milk
7 price for the other states outside of California, which is
8 the all-milk price as released by the USDA.

9 MR. McCULLY: Correct.

10 MR. EASTMAN: When it came to the California all-
11 milk price which one did you use?

12 MR. McCULLY: The one that is consistent with the
13 same data set that is released by USDA.

14 MR. EASTMAN: Okay.

15 MR. McCULLY: And if you would like me to I could
16 actually send you the data file or the spread sheet with the
17 numbers.

18 MR. EASTMAN: Sure, that would be great.

19 MR. McCULLY: Okay.

20 MR. EASTMAN: If you want to send that in your
21 post-hearing brief.

22 And then another question I have. So in essence
23 when you're looking at the variability you were looking at
24 just the range from the highest to the lowest number,
25 correct?

1 MR. McCULLY: Correct.

2 MR. EASTMAN: Is there any reason why you chose
3 that measure of variability compared to something else, like
4 maybe a standard deviation or some other statistical
5 measure? Was there an advantage or disadvantage?

6 MR. McCULLY: I think it probably gives -- you
7 could go and do a standard deviation to do something more
8 sophisticated. I was in the keep it simple mode so this is
9 just an easy way of measuring it. The numbers probably
10 could come out differently, a bit differently, but I think
11 the overall story is about the same.

12 And logically you would think Minnesota,
13 Wisconsin, areas with high Class III utilization, Idaho,
14 that are based more off of a -- they're pretty close to
15 Class III milk pricing with their all-milk pricing, would
16 have the lesser basis variability versus areas, say a New
17 York or Pennsylvania that have a high Class II utilization,
18 high Class I utilization, less Class III utilization, that
19 would have more variability than in basis.

20 And this isn't even including, say, Florida or the
21 Southeast orders where you'd have a lot of variability due
22 to the Class I influence.

23 MR. EASTMAN: And then another question I had was
24 regarding your plant. How has your milk procurement gone
25 over the last number of months, so to speak? Are you

1 running at full capacity or do you have the ability to take
2 more milk? Are you -- I'm sort of curious to see how the
3 plant is running in response to the milk supplies in the
4 state. Do you have a sense of what premiums the plant's
5 been paying? Have those been decreasing over time or how is
6 that going?

7 MR. McCULLY: Okay, there's a number of questions
8 there. The first one I'll address is on the sour cream and
9 cottage cheese side of the plant. That is made to order,
10 that's a demand pull. So that isn't something you would
11 take in. There's extra milk and you would take in and build
12 more finished goods inventory on cottage cheese and sour
13 cream because of the perishability. So the supply doesn't
14 impact the production of those products, that is a demand
15 pull, not a supply push.

16 However, on the cheese side, the hard cheese side,
17 on the Parmesan side, is more of a -- you know, obviously
18 it's a historical product so there is more flexibility in
19 terms of usage. Typically that plant is run seven days a
20 week on Parmesan if there is demand for it. But then it
21 also bumps up against demand at some point as well as long
22 as inventories would be under control. If the inventory is
23 going to get too high they would continue on a seven day
24 plan.

25 I believe there were certain months earlier this

1 year where finished goods inventory was relatively high and
2 they backed to six days a week. So at certain times there
3 was a day available for manufacturing capacity but it didn't
4 have the demand for the Parmesan.

5 MR. EASTMAN: So in essence it seems like Kraft
6 with that plant will manage its production based on sales
7 volume and orders they have.

8 MR. McCULLY: Correct. It's not set up to be a
9 balancing plant for milk.

10 MR. EASTMAN: And then since -- Kraft does have
11 plants outside of California that it operates in Federal
12 Orders, correct?

13 MR. McCULLY: Um-hmm.

14 MR. EASTMAN: Some people could argue that by
15 having that plant in California with a lower 4b price you
16 could, as a multinational company you could leverage, say a
17 lower milk price at that plant and use that to gain some
18 sort of competitive advantage against your competitors --
19 other competitors making the same product, so to speak.

20 MR. McCULLY: Um-hmm.

21 MR. EASTMAN: How would you respond to an argument
22 like that? Does Kraft -- are they able to leverage their
23 plant there to getting sales over competitors that maybe
24 don't have a plant in California and solely operate in
25 Federal Orders or outside of California?

1 MR. McCULLY: Sure, that's a good question. I'm
2 going to get back -- also before I answer that I'll address
3 the premiums. The premiums have not changed that we have
4 seen in the state in terms of the milk contracted so there
5 hasn't been any change to that. I didn't address that --
6 didn't get that in the last question.

7 In terms of competitive advantage. the Kraft
8 plant in Tulare is essentially a carbon copy of a Parmesan
9 cheese plant that Kraft used to own in Minnesota and
10 actually Kraft still buys product from that plant in
11 Minnesota. And sometimes the same product will come from
12 both plants, between the Minnesota plant, which is now an
13 outside supplier, as well as the internally produced. So
14 there is a make-versus-buy analysis that happens on a
15 continual basis of where production should occur, whether
16 it's internally produced or whether it's purchased from that
17 supplier in Minnesota. So that's a continual process. And
18 that's not just unique to this year, that's happened over
19 the years.

20 And if there is a time where the cost structure,
21 delivered cost structure looks like it's a competitive
22 advantage in California, there could be some production
23 shift to California. And consequently there's also times
24 where if the delivered cost model shows that there is a
25 better value from a Midwest product or a Minnesota product

1 then that production will shift to that plant.

2 And you go back, there was some testimony
3 yesterday that talked about -- and historically there was,
4 you know, at that time it was probably four to five cents a
5 pound for cheese and the \$1.50 to \$2 diesel fuel range.
6 That four to five cents would be about the difference or
7 cost to get cheese from California back in the Midwest.
8 Unfortunately, diesel fuel prices aren't \$1.50 to \$2 a
9 gallon anymore and as you double that now the cost is
10 roughly a dime or so. I think that was referenced
11 yesterday, a little over a dime for a pound of cheese to
12 move back into the Midwest.

13 So that dynamic has changed quite a bit, it's
14 changed the competitiveness. So it's kind of maybe a long
15 way of answering your question in terms of the
16 competitiveness. It's not just milk price. We actually
17 look at or Kraft looks at it, as well as other companies
18 look at it, on a delivered cost basis to their plants
19 depending on where that's at, whether it's in the Midwest or
20 in the East. At one time Kraft had a processing facility
21 out in Pennsylvania. And as you can imagine, going from
22 California to Pennsylvania is even greater freight cost.
23 And that's when Midwest cheese or East Coast cheese would
24 get into the equation and be a lower delivered cost.

25 MR. EASTMAN: So just to clarify. So you

1 mentioned that your California plant was a carbon copy of a
2 plant in the Midwest that --

3 MR. McCULLY: Right.

4 MR. EASTMAN: -- you no longer own but you still
5 will procure Parmesan.

6 MR. McCULLY: Right.

7 MR. EASTMAN: Does Kraft not have any other plants
8 outside of California that are making Parmesan and hard
9 cheeses anymore?

10 MR. McCULLY: No. No. The plant is in Melrose,
11 Minnesota. It was sold -- well, the whole time line. In
12 the early 1990s Parmesan demand was growing and at that time
13 the Louis Rich plant had shut down and there was a great big
14 empty building in Tulare that Kraft owned. The decision was
15 made to -- they decided to essentially carbon copy or copy
16 the plant in Minnesota and build a new Parmesan plant in
17 Tulare. And that was '93-94 when that -- the spring of '94
18 when that opened. It produces Parmesan cheese.

19 When the Visalia plant closed in 2005 the Knudsen
20 products moved over to the Tulare plant as well. the plant
21 that's in Melrose, Minnesota was sold, I believe, in 1999 or
22 2000 to a couple of the co-ops in the upper Midwest and they
23 continue to operate that today. So that went from an
24 internally-produced product to then a third-party or a
25 supplier-owned plant. That's the only two facilities that

1 make those products.

2 MR. EASTMAN: Thanks. I may have another
3 question, we'll see.

4 MS. GATES: Could you share with us, as a maker of
5 dry whey products in California, how the sliding scale would
6 impact the competitiveness that you guys have --

7 MR. McCULLY: Sure.

8 MS. GATES: -- off of a fixed factor.

9 MR. McCULLY: Sure. I believe of the 57 cheese
10 plants left in the state I think the Kraft Tulare Plant is
11 one of two left in the state that actually makes sweet dry
12 whey powder. And a little -- since I talked about the
13 history of the plant, a quick history on that is, when the
14 plant was built the Melrose plant -- I don't even know when
15 it was put in but they actually had -- the waste stream went
16 into an ethanol facility that was there so part of that was
17 ethanol. I think they had a dryer there as well.

18 Kraft looked at what was essentially the cheapest
19 way of handling the waste stream and that was to put in a
20 sweet dry whey operation. And there's been times that
21 they've looked at going to a higher grade, a 34-80, but it
22 continues to be sweet dry whey.

23 As far as the impact from last year, there was --
24 again, the cost structure changed as we went to a sliding
25 scale from what it was before, so that would have

1 directionally resulted in a less-profitable enterprise than
2 what it was before. But again, I know that product is
3 handled by a third party and that product goes into both
4 export and domestic markets. So Kraft doesn't have
5 visibility on what the sales prices are, they just have --
6 they have a sales price to a broker and then the broker
7 handles the sale of that.

8 MS. GATES: Thank you.

9 HEARING OFFICER ROWDEN: Thank you very much.

10 MR. McCULLY: Thank you.

11 HEARING OFFICER ROWDEN: Greg Dryer. Please state
12 your full name, spell your last name and state your
13 affiliation, please.

14 MR. DRYER: My name is Greg Dryer, D-R-Y-E-R, and
15 I'm representing Saputo Cheese USA.

16 Whereupon,

17 GREG DRYER

18 Was duly sworn.

19 HEARING OFFICER ROWDEN: And your testimony that
20 you submitted is Exhibit 60.

21 (Exhibit 60 was received into evidence.)

22 MR. DRYER: I wish I was 60.

23 (Laughter.)

24 MR. DRYER: I was, once. Good morning,
25 Mr. Hearing Officer and members of the Hearing Panel. My

1 name is Greg Dryer. I am Executive Vice President of
2 Industry and Government Relations for Saputo Cheese USA.
3 Our company has 16 facilities across the United States, five
4 of which are located here in California. Four of the five
5 California plants purchase milk for the manufacture of
6 cheese. The fifth plant utilizes cheese from our own plants
7 and that of other companies for further processing and
8 packaging. We employ over 1,000 people in the state and
9 purchase a substantial portion of the state's milk
10 production both directly from farmers and from farmer
11 cooperatives.

12 I am here to testify in opposition to the Western
13 United Dairymen and Coalition petitions filed with the
14 Department in March 2012.

15 The state has the authority and the obligation to
16 establish minimum prices to be paid by handlers to producers
17 for market milk. It does not have the authority to oblige
18 handlers to purchase milk that is uneconomic. Nor can it
19 prevent handlers from shunning the state when pricing
20 mechanisms become unpredictable or when minimum prices are
21 set so high as to make it unfeasible to earn a reasonable
22 return on investment. It is not incumbent upon the state to
23 be the arbiter of market equilibrium.

24 There is nothing today to prevent the state's
25 farmer cooperatives from raising the price of milk they

1 charge their customers. After all, they control the vast
2 majority of milk produced in the state and enjoy federal
3 antitrust exemptions. The fact is that no one enterprise or
4 group is so skillful or powerful as to overcome the
5 unimpeded functioning of the marketplace. Cooperative
6 leaders know that in a surplus production environment,
7 raising prices would cripple their ability to market all of
8 their milk. Other manufacturers with available capacity
9 would lure away their direct ship producers simply by
10 offering a guaranteed home for their output.

11 Dairy producers are presently faced with falling
12 milk prices and high feed costs, conditions similar to those
13 existing in 2009. Now, however, California producers are
14 better positioned to overcome these challenges given the
15 September 1, 2011 adjustment to the whey factor along with
16 the cost advantage they currently enjoy.

17 An average California dairy farm produces more
18 than 11 times the milk of an average Wisconsin farm and six-
19 and-a-half times the national average. According to
20 published reports, their cost advantage, due largely to
21 scale, vastly outweighs their price disadvantage relative to
22 Wisconsin or other regions. If the state arbitrarily shifts
23 the burden of mitigating low prices, which have largely
24 resulted from over-production, away from producers and on to
25 processors, it obscures the message that the marketplace is

1 trying to send. Punishing those that have no influence over
2 supply is both inequitable and ineffective and simply
3 prolongs the duration of the required correction.

4 Regarding price comparisons with other regions or
5 systems, they are simply not relevant. Milk, due to its
6 nature, is a local product. Its value is established by
7 local economic conditions. It cannot be transported cost-
8 effectively to take advantage of distant markets which over
9 higher returns unless capacity exists to convert it into a
10 concentrated, storable product. The cost to ship milk from
11 California to the higher-priced Midwest region exceeds \$10
12 per hundredweight, which makes it uncompetitive.

13 There are many stark contrasts between the dairy
14 industries in California and the Upper Midwest. California
15 has over time generally enjoyed a milk surplus. On the
16 other hand, the Upper Midwest is deficit in milk and surplus
17 in manufacturing capacity. This deficit has been pegged at
18 10 to 15 percent.

19 Plants must compete to obtain an adequate supply,
20 which has resulted in higher milk costs. Cheese plants by
21 necessity have migrated toward smaller batch, higher value
22 specialty products as opposed to the high-volume, high-
23 efficiency commodity orientation of California plants.

24 Similar to cheese manufacturing, there is no
25 shortage of whey processing capacity in the Upper Midwest.

1 There is fierce competition to procure additional whey
2 solids based on its incremental value. Whey processing
3 plants will compete up to the level where the cost does not
4 exceed the marginal contribution. Therefore, small Midwest
5 cheese operations can earn a reasonable return on their whey
6 stream without having the scale or capital required for a
7 whey processing venture. Like most cheese plants they will
8 and do struggle mightily when the whey market rises to the
9 level that they are unable to return as much as the USDA
10 Class III formula presumes they can.

11 If the price of milk in California is too low,
12 shouldn't manufacturers be investing in the state to take
13 advantage of this opportunity for windfall profits? Not
14 only are those investments not forthcoming, but in recent
15 years cooperatives have generally downsized or abandoned
16 their involvement in the cheese business in California.
17 Instead they have pursued a strategy of seeking higher
18 prices for sales of cheese milk while seeking lower prices
19 for milk in those products they continue to manufacture.

20 One solution for California to increase milk
21 prices would be to stimulate increased demand by encouraging
22 expansion of existing plants or of constructing new plants.

23 Those activities might be taking place even now if not for
24 fear that regulatory changes could dramatically discount or
25 make worthless investments in California's cheese industry.

1 Cheese manufacturing is traditionally a low margin
2 business. Milk typically comprises 80 to 90 percent of the
3 cost. Therefore, a small percentage change to the cost of
4 milk translates to a very large percentage impact on a
5 typical cheese maker's bottom line. There is simply not
6 enough margin in cheese to insulate producers from price
7 swings resulting from supply and demand imbalances. While
8 the state has historically exercised prudence in
9 implementing changes to milk prices, given the unpredictable
10 political environment, there is no guarantee to potential
11 investors that such a practice will continue into the
12 future. And there have been examples in the past where
13 significant price changes were implemented shortly after
14 companies made investments amounting to tens or even
15 hundreds of millions of dollars. The September 1st, 2011
16 adjustment of the whey factor alone has increased cheese
17 milk costs to date by almost 40 cents per hundredweight.

18 The appropriate value attributed to whey and
19 arguably transferred from processors to producers has been
20 debated ad infinitum. The industry's stakeholders should
21 instead focus on fundamental change, which will allow the
22 market to work and lay the groundwork on which to build the
23 kind of industry that will lead the world for the years to
24 come. Done right, it can form the template to be emulated
25 by federal dairy policy. The Secretary has already

1 initiated that process with the establishment of the CDFA
2 Dairy Advisory Committee. We believe that process should be
3 fully vetted before any further changes are considered to
4 existing formulas. It has been our position that the 25
5 cent fixed whey factor established in December 2007 was a
6 reasonable compromise. But rather than submitting an
7 alternative proposal to return to that factor we have
8 elected to align with the majority of our counterpart
9 members of the Dairy Institute of California and request the
10 Department to make no further change until a viable long-
11 term solution can be identified.

12 And with your permission I -- after listening to
13 the testimony yesterday I drafted a little addendum to my
14 testimony that I would like to add if you don't mind.

15 This entire controversy seems to be revolving
16 around misalignment with Federal Orders. I'd like to remind
17 everyone, we didn't get here by accident. In 2007 we had a
18 hearing to address a crisis that threatened the viability of
19 the state's cheese industry. The solution was to
20 intentionally break from USDA by replacing the whey factor
21 in the 4b formula with a fixed factor. Problem solved.

22 It seems we now have developed selective amnesia,
23 or rather California producers are seeking a recall election
24 to undo the 2007 decision. It would be beneficial for all
25 to go back and review the hearing record and panel report

1 from the 2007 decision.

2 Regarding Federal Orders, they are a mess.
3 Archaic, broken, outdated, unresponsive, counter-productive.

4 Even the national producer organizations acknowledge it.
5 The National Milk Producers Federation, of whom most
6 producer organizations represented here are members,
7 recognizes its failure and have included a provision to
8 deregulate Class III in the original Foundation for the
9 Future Program. To survive and flourish California's
10 industry should not be looking at emulating a dinosaur well
11 on its way to extinction.

12 And that concludes my testimony and I would
13 request the opportunity to file a post-hearing brief if
14 warranted. And happy to answer any questions.

15 HEARING OFFICER ROWDEN: All right, thank you,
16 your request is granted. And questions from the panel?

17 MS. RANKIN: I have a question. How has the
18 recent scale impacted Saputo?

19 MR. DRYER: Well, you know, the market for whey is
20 well-established so if the cost of raw materials goes up it
21 decreases your margin, basically.

22 MS. RANKIN: So, I guess, in terms of making any
23 adjustments within the company or anything, if the cost
24 structure is changed.

25 MR. DRYER: Well, if we see costs go up we look

1 for ways to try to mitigate, you know, however you can.

2 MS. RANKIN: And then my other question would be,
3 how has capacity and procurement issues been recently?

4 MR. DRYER: Capacity and procurement?

5 MS. RANKIN: Just in terms of the increased supply
6 of milk. How has that affected Saputo?

7 MR. DRYER: There's abundant milk. I mean, the
8 fact is we could look to expand our operations in California
9 to take advantage of the supply of milk. But given fears as
10 to what the rules of the game will be going forward, it
11 doesn't make sense to make further investments.

12 MR. EASTMAN: I have a couple questions. Halfway
13 through your testimony you mentioned that it cost about \$10
14 a hundredweight to ship milk to -- where was that? Was that
15 to the Upper Midwest?

16 MR. DRYER: That would be to Wisconsin.

17 MR. EASTMAN: Wisconsin. And you're just talking
18 about bulk farm milk, I take it?

19 MR. DRYER: Right. I'm saying if we -- if we have
20 already exceeded the capacity to process the milk -- if you
21 ship raw milk from California to Wisconsin, based on today's
22 freight costs, it would amount to more than \$10 a
23 hundredweight. We heard yesterday testimony that there was
24 a \$4 disparity in the price of milk in Wisconsin. But to
25 take advantage of that price it would cost you \$10 to get it

1 there, basically.

2 MR. EASTMAN: And is that based on sort of data or
3 any sort of actual experience or information you have of
4 milk that's actually been shipped that far?

5 MR. DRYER: We don't -- we don't ship milk,
6 obviously, that distance but we ship other liquid products.
7 We are aware of what transportation costs are.

8 MR. EASTMAN: And then in your testimony you
9 mentioned that one difference between California and
10 Wisconsin is -- whether it be over the last number of years
11 -- cheese makers have begun -- or they started shifting to
12 more specialty-type cheese products. Has Saputo ever
13 considered that or have they started implementing any
14 similar strategy there and here in California to take
15 advantage of the pluses of having that type of operation
16 compared to more of a commodity cheese operation?

17 MR. DRYER: We definitely have over the years.
18 Most of our more commodity-oriented products we ship out of
19 the Midwest, either to the East or West Coast and more
20 orientation towards specialty products in Wisconsin to be
21 able to afford the higher cost of milk there.

22 MR. EASTMAN: And so here in California then you
23 focus more on commodity cheese.

24 MR. DRYER: Right, because we have large plants in
25 California. We are processing big volumes of milk on a

1 daily basis, so we are oriented towards efficiency.

2 MR. EASTMAN: What would keep Saputo from trying
3 to do the same thing in California? Start production of
4 some sort of specialty cheese-type plant or go in that
5 direction away from commodity cheese.

6 MR. DRYER: You know, I suppose that opportunity
7 is there but much of the market is on the eastern part of
8 the country so there is an advantage in terms of -- you
9 know, each region has its own benefits and disadvantages.
10 Wisconsin, because of the size of the plants, they're
11 smaller plants. You can't mix the culture of high-volume/
12 high-efficiency with small, batch-oriented specialty.
13 Different markets, different structures, they're different
14 cultures basically.

15 So kind of concentrate -- I mean, there is no
16 reason California can't develop a specialty cheese industry.
17 Wisconsin has really pushed for that and I think we're up
18 to about 20 -- 20 percent of the total cheese production is
19 considered specialty in Wisconsin.

20 MR. EASTMAN: Do you have any sense of the
21 differences in the marketing? So you mentioned that the
22 markets -- some of the markets for specialty cheese are more
23 East Coast or on the other side of the country from
24 California. Do they just buy more specialty cheese than say
25 the Western region of the United States or is that --

1 MR. DRYER: There's just more people there. Just
2 more people, more population.

3 MR. EASTMAN: That's all I have.

4 HEARING OFFICER ROWDEN: Thank you.

5 MR. DRYER: Thank you.

6 HEARING OFFICER ROWDEN: Corey Travis.

7 MR. TRAVIS: Good morning and thank you for the
8 opportunity to speak here.

9 HEARING OFFICER ROWDEN: Sorry.

10 MR. TRAVIS: Sure.

11 HEARING OFFICER ROWDEN: Yes. Please provide us
12 your full name, spell your last name and tell us who you
13 represent.

14 MR. TRAVIS: Corey Travis, and it's T-R-A-V-I-S.
15 I'm here with Caseus Energy.

16 Whereupon,

17 COREY TRAVIS

18 Was duly sworn.

19 HEARING OFFICER ROWDEN: And your testimony that
20 you submitted is Exhibit 61. Please.

21 (Exhibit 61 was received into evidence.)

22 MR. TRAVIS: I am a representative for Caseus
23 Energy and we are an advanced bio-products company whose
24 low-cost platform technology allows for the production of
25 value-added products that target the agricultural and energy

1 markets. Caseus utilizes a variety of sugar-rich waste
2 streams such as whey and whey permeate, which has dominated
3 the discussion here. And as we know, these are low-value
4 byproducts of the cheese production process.

5 With a proprietary catalyst and a patent pending
6 process we create an economically sustainable outlet for the
7 value-added processing of waste permeate.

8 In essence, we aggregate waste streams from the
9 cheese, food and beverage industries and process these
10 streams into higher value products such as biofuel, human
11 food products and animal feed supplements. And I am
12 responsible for government affairs as it relates to
13 navigating governmental grant opportunities, researching the
14 regulatory landscape and supporting governmental efforts
15 that will grow Caseus Energy in target areas such as
16 California.

17 We have a full scale demonstration plant in
18 Wisconsin which produces fuel grade ethanol and dry yeast, a
19 direct feed microbial designed to be mixed or top-dressed
20 with nutritionally balanced diets for all classes of
21 livestock, equine and pets, with a specific emphasis on
22 dairy cattle.

23 We are currently scaling up our facility in
24 Wisconsin to a full scale commercial production and are in
25 the process of securing additional sites elsewhere,

1 including several in California, which is our home base.
2 Now each plant will generate around 20 direct jobs and over
3 100 indirect jobs in hard hit rural areas.

4 Due to the fact that our primary feedstock is
5 intertwined with both the milk and cheese production, our
6 business model rests on the health and vibrancy of both the
7 CA dairy industry as well as the California cheese industry.

8 Now Caseus Energy produces high -- or we process
9 high BOD whey and whey permeate streams from those cheese
10 producers that do not individually have the financial or
11 operational resources to adequately process or convert these
12 streams into value-added products.

13 Furthermore, since one of our key products dry
14 yeast, is specifically intended to be used in California
15 dairy farms, it is equally important for us that the
16 California dairy industry continues to thrive and flourish.

17 Now our business model rests on building
18 sustainable partnerships with our feedstock suppliers,
19 whereby we are procuring either fluid whey with proteins,
20 lactose and various salts and minerals, or whey permeate,
21 after proteins have been removed from fluid whey,
22 essentially converting this cost center into an ancillary
23 revenue stream.

24 Now obviously our financial model is very
25 sensitive to the cost of our inputs, which in turn are

1 directly impacted by the cost of milk. In Wisconsin, for
2 instance, we found that the financial and operational
3 situations in the cheese companies is very diverse and most
4 small to medium sized companies either lack whey processing
5 capabilities or have limited whey capabilities. Processing
6 whey into animal feed grade proteins, which is a low-margin
7 item, as opposed to human food grade proteins, a higher-
8 margin item, such as WPC 80 or WPI. Some of these limited
9 resources cheese producers sell their whey streams to
10 aggregators. But they do not fully realize the whey value
11 as an aggregator must burden processing costs to realize a
12 certain margin. Hence, small to medium sized cheese
13 companies in Wisconsin that lack economies of scale are
14 definitely feeling the pressure of current price escalation
15 in the regulated cost of milk due to high whey markets.

16 Now a similar situation exists in California. A
17 small to medium size cheese producer, without access to
18 funding and a healthy balance sheet, will be hard pressed to
19 immediately absorb the full implied value of the whey
20 stream. At best it will take some time to secure financing,
21 build a WPC plant, and only then potentially be able to
22 recoup its investment. The entire process may take years
23 with no certainty of success.

24 Now having said that, we are keenly aware of the
25 pressing need and urgency to keep the California dairy farms

1 vibrant and ensure that pricing will not be detrimental to
2 its survival. After all, our business model starts with a
3 cow, with milk sourced from the dairy farms, and ends with a
4 cow with the sale of our dry yeast products.

5 I do appreciate the opportunity to share our views
6 regarding the current whey landscape in California. I would
7 like to answer any questions you may have at this time and I
8 would also request the opportunity to file a post-hearing
9 brief if needed.

10 HEARING OFFICER ROWDEN: And your request is
11 granted. Questions?

12 MR. EASTMAN: I have a few questions. So you
13 mentioned that Caseus Energy is based in California.

14 MR. TRAVIS: That's correct.

15 MR. EASTMAN: In terms of you have a corporate
16 office or --

17 MR. TRAVIS: Our corporate office is in Los
18 Angeles. The technology that we are bringing here to our
19 home base was refined and developed in Wisconsin to solve
20 the whey permeate problem.

21 MR. EASTMAN: How many facilities do you have in
22 Wisconsin?

23 MR. TRAVIS: We have had an R&D facility that has
24 been a full-scale production facility since 2004 and we are
25 currently in the processing of scaling that to a commercial

1 facility.

2 MR. EASTMAN: And so besides the R&D facility do
3 you have other commercial facilities?

4 MR. TRAVIS: That is -- that transition would be
5 our first commercial facility. Simultaneous to that we are
6 looking at the California market for potential investment
7 for solely commercial facilities here.

8 MR. EASTMAN: Since you are based in California is
9 there a reason why you have that one facility in Wisconsin?
10 Is there a reason why you started there?

11 MR. TRAVIS: We started there because the
12 technology was initially pioneered and developed by veterans
13 of the cheese industry in Wisconsin. So rather than move
14 that facility and continue R&D here in California we wanted
15 to keep it in Wisconsin and further refine it.

16 MR. EASTMAN: So the question I have is, based on
17 your business plan and based on whatever analysis you have
18 done on the Wisconsin area, that state and California and
19 the cheese industries in both areas, do you see that your
20 operation, that you could build one in California, that it
21 would be viable? Do you feel that there's any strengths or
22 weaknesses to building a plant or facility here in
23 California?

24 MR. TRAVIS: Well looking at, looking at the
25 nation, California and Wisconsin are both strong cheese

1 producing states. You know, part of our decision to move
2 into California would depend on the regulatory landscape and
3 what future -- the future of the whey markets and our cost
4 of our inputs would be in the state.

5 MR. EASTMAN: Besides milk costs or input costs
6 are there any other considerations that are bearing heavily
7 on your expansion plans?

8 MR. TRAVIS: That's a primary driver. There are
9 other considerations but it would be outside the scope of
10 this particular forum here.

11 MS. GATES: We heard testimony yesterday that the
12 difference between Wisconsin and California were the small
13 cheese makers are in proximity to themselves. How do you
14 see that working in California? Do you see that as viable
15 with the long distances, maybe just depending on where you
16 would centralize?

17 MR. TRAVIS: It is and that's a great question.
18 Wisconsin, as most of us know, does have a higher
19 proliferation of the smaller and medium size cheese
20 companies that are within closer proximity to each other
21 where California does have larger producers and a much
22 larger state. So yes, freight does play a role in the
23 development and our process. Again, which is why we are
24 closely looking at the cost of our inputs to make this
25 decision to come to California.

1 MS. GATES: Thank you.

2 MS. RANKIN: Just to piggyback off of Candace's
3 question. Is there a certain distance or does it depend on
4 volume in terms of what's been viable in Wisconsin for
5 shipping the whey product?

6 MR. TRAVIS: Distance is definitely a
7 consideration. We have an ideal range that generally we'd
8 like to see 50 to 75 miles radius from where we're actually
9 procuring our waste whey permeate. However, again, based on
10 the inputs and the cost of freight there may be some play
11 there. Closer is always better though.

12 HEARING OFFICER ROWDEN: Thank you.

13 MR. TRAVIS: Thank you.

14 HEARING OFFICER ROWDEN: May I have the list, the
15 witness list. And the next witness is Elvin Hollon, please.

16 MR. HOLLON: The copies at the front table are
17 available if somebody wants to follow along. Sometimes it's
18 easier to sleep when you have something in your hand.

19 HEARING OFFICER ROWDEN: We'll start your
20 testimony when everybody is settled.

21 MR. HOLLON: There will be four things. First
22 there's the testimony of Elvin Hollon, you said that was
23 Exhibit number?

24 HEARING OFFICER ROWDEN: I didn't, I haven't --

25 MR. HOLLON: Oh, I'm sorry.

1 HEARING OFFICER ROWDEN: I'm not starting the
2 testimony until we have everybody seated.

3 MR. HOLLON: Okay.

4 HEARING OFFICER ROWDEN: Will you please state
5 your name, spell your last name and who you are affiliated
6 with.

7 MR. HOLLON: Elvin Hollon, H-O-L-L-O-N, and I am
8 affiliated with Dairy Farmers of America, Inc.

9 Whereupon,

10 ELVIN HOLLON

11 Was duly sworn.

12 HEARING OFFICER ROWDEN: Okay. Your testimony
13 that you submitted is Exhibit 62a. The letter from
14 Mr. Masuhara --

15 MR. HOLLON: To Mr. Masuhara from Mr. Gallagher.

16 HEARING OFFICER ROWDEN: Okay, to Mr. Masuhara, is
17 62b. Your Annual Milk Production United States Federal
18 Orders is 62c. And the large, whatever the spreadsheet is,
19 is 62d. Please.

20 (Exhibits 62a through 62d were
21 received into evidence.)

22 MR. HOLLON: In my testimony I will, from time to
23 time, omit some paragraphs because I think that material has
24 been covered a couple of times so I'll try to call that to
25 your attention.

1 Mr. Hearing Officer and Members of the Hearing
2 Panel, good morning, or perhaps afternoon or evening. I
3 didn't quite know when I would be up. I am Elvin Hollon,
4 Director of Fluid Marketing and Economic Analysis for Dairy
5 Farmers of America, Inc., DFA. On May 22, 2012 the DFA
6 Western Area Council, whom I am representing, unanimously
7 approved the position that I will be presenting today.

8 I want to thank the Department for calling this
9 hearing and allowing me the opportunity to voice our concern
10 about whey valuation in the California milk pricing system.
11 We appear at the hearing as a participant of what the
12 hearing notice has termed the Coalition. Our testimony is
13 in collaboration with the Coalition. We offer testimony in
14 support of Proposal 1 and we fully support the position and
15 testimony of Donna Melby, representing the producer
16 coalition. We also support the proposal made by the Western
17 United Dairymen.

18 Dairy Farmers of America is a Capper Volstead
19 cooperative, a marketing cooperative. We are a national
20 cooperative of more than 1500 members representing
21 approximately 320 farms that market milk in California. Our
22 members produce approximately 20 percent of the state's milk
23 supply. We market milk to 30 buyers in the state and
24 operate two plants. Our facility at Hughson, California is
25 primarily a Class 4a facility and our plant in Turlock,

1 California is primarily a 4b facility. Several of our
2 members operate dairies in California and in states where
3 the Federal Milk Marketing Order system administers prices.
4 Several of our customers operate plants in California and in
5 regions of the country within the Federal Order system. as
6 a cooperative with members and customers and manufacturing
7 plants operating within California and also throughout the
8 country, DFA is well-qualified to submit testimony and
9 evidence to the Secretary on the matter of the appropriate
10 contribution of whey value to the Class 4b price.

11 Our members support the regulated system and
12 clearly believe that the regulated system provides the best
13 framework to support their farm operations, the customers to
14 whom they market milk and the plants they have invested in,
15 own and operate.

16 The California Department of Food and
17 Agriculture's state milk marketing order system operates a
18 regulated and transparent end product pricing formula system
19 for establishing milk prices for the benefit of consumers,
20 processors and dairy farmers. Milk buying decisions are the
21 result of some type of end product price formula calculation
22 that compares the selling price with the revenues from the
23 sale. A regulated system makes that process transparent,
24 provides consistent terms of trade to all in the industry
25 and generally provides for minimum prices to be paid for

1 milk.

2 Skip the next three paragraphs. Step into the
3 last paragraph from the bottom.

4 Producers who compare milk checks from their farms
5 in California to their farms or other farms located in
6 federal markets, even while selling to the same company.
7 But one plant located in California and the other plant in a
8 state covered by Federal Order regulation, do not conclude
9 that the requirements of the California 4b price bear a
10 "reasonable and sound economic relationship with the
11 national value of manufactured milk products." There's a
12 Code site. And I would draw attention to Mr. Kasbergen's
13 statement yesterday. He had some data in his statement that
14 was a direct comparison.

15 Our testimony relates primarily to the differences
16 between the California CDFA 4b price and the Federal Order
17 Class III price. We will demonstrate why the Class III is
18 the appropriate benchmark for comparison to the 4b price and
19 to some operational issues within the Federal Order system,
20 focusing specifically on the practice of depooling.
21 Additionally we will comment on dealing with temporary over
22 supplies of milk, the small plant/whey processing situation
23 and the recruitment of California dairy farms by outside
24 state firms.

25 The Federal Order Class III is the appropriate

1 benchmark for California 4b prices. While the Secretary is
2 required to make sure the 4b price "bear a reasonable and
3 sound economic relationship to the national value of
4 manufactured milk products" there is no list of appropriate
5 market prices with which to compare, firmly established in
6 the statute. However, it seems reasonable and appropriate
7 that the Federal Order Milk Marketing Order price for Class
8 III milk be that benchmark for comparison.

9 It is well established that the Federal Orders
10 operate a nationwide coordinated system of prices. Prices
11 are announced monthly for similar products and in both cases
12 the product mix for each class is much the same. The Class
13 III milk price is only a minimum price and is the benchmark
14 in the Orders for negotiated base premiums.

15 I'm going to skip the language. This is simply
16 language out of the two orders that directly defines what
17 the classes are. If you'd like to discuss them you can but
18 I will move on to the top of page four.

19 The process for determining those prices, as is
20 the practice in California, is the result of many public
21 hearings and extensive industry input. The orders use a
22 product price formula system -- which I would add at this
23 point, includes data from the California system in the
24 product price formulas for the Class V prices in Federal
25 Orders. And I'll be glad to discuss that with you if it

1 needs to be.

2 The orders use a product formula system, as is the
3 practice in California, that requires the use of market-
4 determined benchmark commodity prices and hearing-determined
5 make allowances and yield factors to establish prices. The
6 Federal Order system administered prices for 65 percent of
7 the nation's milk supply in 2011. That percentage has been
8 reasonably consistent for many years. Table 1. We'll go
9 over the tables at the end of my testimony.

10 Within that system, 38 percent of the milk supply
11 was Class III in 2011 and again reasonably consistent over
12 many years. Within the order system the Upper Midwest Order
13 accounts for 49.2 of the Order system's total Class III
14 pounds. Between 2007 and 2011 the percentages fluctuated
15 between 46.1 and 51.4 percent and totaled 29.92 billion
16 pounds in 2011. Likely Class III and 4b represent the
17 largest classified use for milk in the country. Table 2.

18 The National Agricultural Statistics Service's
19 Dairy Products Report, published monthly, and recaps the
20 production of manufactured dairy products. The report
21 publishes production pounds in total for the United States
22 as well as for individual states where possible. Table 3
23 recaps total cheese production for the US and for states
24 available over the past five years.

25 Several observations can be made from Table 3.

1 First, cheese production is growing across the US as total
2 production increased each year. California is the second
3 largest state in terms of total cheese production accounting
4 for 21.5 percent of the nation's output over the five year
5 period. Wisconsin is the largest cheese producing state
6 with 25.2 percent of the national supply.

7 Categorizing each area's cheese output by
8 regulatory oversight from CDFA, the Federal Order or as
9 unregulated pricing geographies, the breakdown would be as
10 follows: California and CDFA, 21.5 percent; unregulated Utah
11 and Idaho account for 8.8 percent of production; plants
12 located in the Southwest Order, 6.5 percent; plants located
13 primarily in the Mideast Order, 1.9 percent; primarily in
14 the Northeast Order, 12.6 percent; primarily in the Central
15 Order, 2.7 percent; primarily in the Upper Midwest Order,
16 33.7 percent; plants located in all other states and
17 primarily within a Federal Order, 12.6 percent.

18 Additionally, much if not all of the milk in Idaho and Utah
19 is priced in terms and values that are driven by Federal
20 Order pricing. DFA and the other cooperatives who market
21 milk there compete with prices based on Class III values or
22 are Class III directly. The large privately owned cheese
23 plants do also. One of those companies just recently
24 converted their milk procurement pricing system from a
25 privately calculated end product pricing formula that had

1 been in place for more than nine years directly to a Class
2 III-based price. Another large private company modified its
3 end product pricing formula significantly. Our internal
4 analysis of how the new formula would have worked, if in
5 place since calendar year 2000, shows a greater than 95
6 percent correlation with the Class III price.

7 This would mean conservatively 75 (sic) percent or
8 more of the nation's cheese production has a base price that
9 is or tracks closely with the Class III price. There is no
10 other milk price that would represent a better benchmark for
11 the CDFA 4b price than the Federal Order Class III price.

12 Depooling in the Federal Order System. A frequent
13 reason given for allowing the 4b price to significantly fall
14 below the Class III price is that Federal Order plants are
15 either non-pool plants or are allowed at times to depool
16 from the Order. Depooling is a term describing the action
17 of removing milk from an Order's pricing pool and not paying
18 in any value nor collecting any from the month's pooled
19 returns. It occurs in the system for several reasons. And
20 I want to add at this point, I am not aware of any depooling
21 decisions that were made to clear the market. They were
22 made for income enhancing reasons but not to -- not to clear
23 a market of distressed milk.

24 Four primary reasons. Number one: Producer
25 quality. If a producer loses Grade A quality standards the

1 milk is removed from the pool. No big surprise.

2 Failure to meet producer touch base standards.

3 All Orders require individual producer performance standards
4 to be met. That is, a producer must indicate the ability to
5 serve the Grade A market by delivering some quantity of milk
6 directly to an Order pool plant, pool distributing plant.
7 Generally a fluid processing plant. In some cases the
8 producer may deliver to a nearby manufacturing plant if that
9 plant delivers a prescribed quantity to pool distributing
10 plants. This allows the performance to be demonstrated but
11 not force uneconomic transportation. This performance
12 standard is termed "touch-base." And if a producer does not
13 meet the touch-base rules his milk would not be allowed to
14 be pooled. Touch-base standards range from a single day to
15 multiple days per month.

16 Number three, failure to meet handler performance
17 standards. In addition to touch base standards, all Orders
18 require handler level performance standards also. These
19 standards require the pooling entity, the handler of the
20 milk, to deliver a percentage of its total supply to pool
21 distributing plants. Over the course of a month the handler
22 delivers milk to the plant for processing and diverts away
23 from the plant to a balancing location when the milk is not
24 needed for processing. The diversion percentage regulates
25 the maximum amount of milk that can be delivered to a

1 balancing location and still be pooled on the Order. In
2 areas with a large supply of milk relative to distributing
3 plant needs this percentage is large and in areas with a
4 smaller supplies of milk relative to distributing plant
5 needs the percentage is small. A handler may not have
6 enough shipments to pool distributing plants to qualify
7 their entire milk supply. If this occurs, milk diverted to
8 balancing locations in excess of the diversion percentage
9 cannot be pooled.

10 Number four, reason of price. There are times
11 when milk is depooled for price reasons. That is, the class
12 price charged for milk is higher than the blend price
13 received from the pool. In this case the handler, the
14 seller, charges their buyer the class price but does not
15 pool the sales price. For example, if the Class III price
16 is \$15 and the Order blend is \$14.50 a handler may choose
17 not to pool milk delivered to a Class III buyer, charge the
18 buyer the Class III price of \$15 but not put the pounds or
19 the dollars into the pool. In every case that we have
20 observed, the seller retains the higher value and does not
21 share the added value with the milk buyer. Since the Orders
22 only require Class I milk sales to be pooled, sales to Class
23 II, Class III or Class IV may be depooled.

24 Reasons 1 and 2 account for a minuscule portion of
25 milk pooled on the Order system. Reason 3 may account for

1 more pounds but is only a fraction of a percent of the total
2 milk pooled. Reason 4 represents the largest volume of
3 depooled milk, but its volume was only 4.3 percent of
4 calendar year 2011's total Federal Order pooled milk volume.

5 Add here that Reasons 1, 2 and 3, to my knowledge
6 there is no recap, there is no pound figures maintained.
7 Reason 4 they do make an attempt to report those and in one
8 of my tables I've got a ten year history of that.

9 Calendar year 2011 statistics from the Agriculture
10 Marketing Service, AMS, indicate 126.9 billion pounds of
11 milk were pooled on Federal Orders, Table 4. Of this total,
12 AMS reported 5.4 billion pounds was not pooled, or depooled,
13 due to a disadvantageous price relationship. Table 4 also
14 indicated a large reduction in the pounds of depooled milk
15 in the Orders since peaking out at 16.86 in 2004. Also note
16 that this percentage is not broken out by class. A
17 significant portion of the depooled milk represents Class II
18 and IV, comparable to CDFA Classes 2, 3 and 4a, volume.
19 Table 5 compares, for example, the relationships in Federal
20 Order 30 in 2011. Order 30 with its very high Class III
21 utilization and low Class I differential would be the most
22 likely place to measure impact of depooling. It is the
23 location where the incidents would be most often
24 economically feasible. Mr. Schiek pointed that out
25 yesterday in his statement, that exact logic. The table

1 presents the monthly announced blend price for Order 30 at
2 the base zone and the month's Class II, III and IV price.
3 It indicates which months of depooling in each class might
4 occur. Depooling of Class II pounds would be economically
5 beneficial in eight months, Class IV pounds five months and
6 Class III pounds only one month. So in all likelihood more
7 of the depooled pounds in Order 30 in 2011 represent Class
8 II and IV utilization than Class III. The competitive
9 relationship between 4b and Class II and IV is not the
10 question in this hearing.

11 When the Orders were reformed in 2000 the pooling
12 provisions were liberalized. It was easier to add milk to
13 many of the pools. The touch base and diversion limits were
14 low relative to historical standards. For example, a
15 standard that allowed a single delivery forever unless milk
16 was delivered to another Order's pool distributing plant,
17 coupled with a low diversion percentage, allowed millions of
18 pounds of California milk to be pooled on the Upper Midwest
19 and Central Orders at the same time it was pooled on the
20 California State Order, for well over two years. In
21 addition to it being much easier to add milk to the pools,
22 it was much easier to depool milk. As price volatility
23 increased the incidence of depooling increased. Both the
24 ease of pooling milk on the Orders and the increased
25 occurrence of depooling created disorderly marketing

1 conditions that even those who took advantage of the
2 situation realized it should be changed if the integrity of
3 the Federal Order system was to be maintained.

4 Between 2000 and 2005, hearings were held in the
5 Pacific Northwest, Central, Upper Midwest and Mideast Orders
6 to tighten performance standards and make it much more
7 difficult to depool milk. By modifying the touch base
8 rules, decreasing diversion percentages and in some cases
9 more strictly defining what constituted a qualifying
10 delivery the performance standards of these orders were
11 tightened up. And attaching milk to markets to collect
12 monies but shipping only minimal volumes of milk to pool
13 distributing plants was virtually eliminated. Equally
14 important, limitations were placed on pooling that greatly
15 decreased depooling opportunities. In brief, the volume of
16 milk pooled in the current month is closely related to the
17 volume of milk pooled in the prior month, so removing
18 volumes from the pool in the current month carries potential
19 liabilities for future months as it may take several months
20 to get one's entire volume back on the pool once removed. A
21 calculation of financial benefit becomes a multi-month
22 decision rather than a single month decision. One's ability
23 to re-qualify milk for the pool plus one's ability to
24 correctly forecast prices and price relationships and the
25 pooling activities of others must be accurate if the

1 decision to depool is ultimately successful. The
2 combination of all these activities is difficult to
3 accomplish.

4 I would add at this point, we regularly have staff
5 meeting with the folks in each of our operational areas who
6 make pooling decisions and we sit down and estimate prices,
7 we estimate blend prices. We look at these calculations and
8 we also try to think, well, if we do this and Hyrum's co-op
9 does that and Candace's co-op does that, what would be the
10 resulting price? And it gets a pretty intense conversation
11 to try to make that decision.

12 I wanted to point out to you the language in the
13 Orders that govern this so this is a cite from Federal Order
14 30. 7 CFR. PART 1030 - Milk in the Upper Midwest Marketing
15 Area, 1030.13. That is the Producer Milk section, Section
16 -- paragraph (f) reads:

17 "The quantity of milk reported by a handler
18 pursuant to either 1030.30(a)(a) or 1030.30(c)(1)
19 for April through February may not exceed 125
20 percent, and March may not exceed 135 percent of
21 the producer milk receipts pooled by the handler
22 during the prior month. Milk diverted to non-pool
23 plants reported in excess of this limit shall be
24 removed from the pool."

25 So in practicality, if I have 100 pounds of milk,

1 next month I could only pool 125 under this scenario, and in
2 any month except March. So I have to decide if I am going
3 to take milk off the pool this month to gain this price
4 advantage I better make sure that the next month I can pool
5 all my milk if the price advantage isn't there. And if it's
6 not I have to say, okay, well over two months do I come out
7 ahead? So it's not as simple and it's not as easy to do and
8 there is an economic decision to it.

9 This language would be repeated if you were to
10 look in the Central Federal Order and the Mideast Federal
11 Order only the percentages would be different. And those
12 were developed in hearings to reflect the conditions in
13 those Orders.

14 I would close this section by saying the
15 implications of the impact of depooling drawn from reading
16 the dairy press from the middle part of the 2000 decade are
17 simply not relevant to today's market landscape.

18 Price comparisons in the month that milk is
19 depooled. The exhibit from the hearing workshop detailed
20 depooling for Order 30 demonstrates the success of these
21 types of provision changes. The percentage of milk depooled
22 there has declined markedly since peaking at 14.1 percent in
23 2007. And this is referring to the Federal Order 30 data
24 that was in the hearing workshop. There was the graph, a
25 chart and a copy of the monthly market report and examples

1 of where the data came from. Trends in the other Midwest
2 Orders would show similar results. However, critics would
3 say there continues to be depooling and thus the wide level
4 of disparity between Class 4b and Class III is still
5 warranted as depooling somehow gives the Federal Order
6 handler or manufacturer a competitive advantage. That
7 response is based on incomplete logic and incomplete facts.

8 In Federal Order 30, the single largest collective body of
9 milk competing with California cheese plant operators,
10 handlers continue to pay mailbox prices in excess of the
11 Class III price, even in months when they depooled milk,
12 hardly a competitive advantage. And despite paying a higher
13 price for milk processors there, as shown by the extensive
14 table of plant expansions in Land O'Lakes' testimony, plants
15 continue to invest and expand their asset base while the
16 California processing sector appears to lag due to non-milk
17 pricing issues.

18 Table 6 describes the calculation that reaches
19 this conclusion. For each month in 2007 through October
20 2011 the total pounds in the pool, the Class III pounds, the
21 Class III price, the pounds of butterfat, protein and other
22 solids, the test percentage of each component, and the price
23 per pound of each component is listed for Order 30. The
24 dollar value of the components over the standard test, 3.5
25 percent for butterfat, 2.9915 for protein and 5.6935 for

1 other solids -- and I obtained those standards from the
2 Order 30 Market Administrator, is calculated. The Mailbox
3 Milk Price as published for Wisconsin by the Agriculture
4 Marketing Service, the largest geographical portion reported
5 within Order 30, was chosen to represent the comparison.
6 The mailbox price was adjusted to the standard price by
7 recognizing the value of components that varied from the
8 standard. One additional adjustment needs to be made, the
9 producer price differential, termed PPD, needs to be
10 subtracted from the mailbox price. The PPD generally
11 represents the added value from the Class I and Class II
12 sales in the Order. The remainder of the mailbox price
13 would then represent the value paid to dairy producers at
14 standard test and reduced by an premium valued derived from
15 the operations of the Order. In every month but one the
16 value is in excess of Class III, including five months where
17 milk was depooled. Chart 1 depicts these values
18 graphically. The minimum value over 58 observations is at
19 -20 cents per hundredweight; the maximum value at \$2.65 per
20 hundredweight, the average 90 cents and the median 56.

21 HEARING OFFICER ROWDEN: Excuse me.

22 MR. HOLLON: Yes, sir.

23 HEARING OFFICER ROWDEN: You are over time.

24 MR. HOLLON: Okay. I am perfectly willing to step
25 aside and sign up again and pick up here.

1 HEARING OFFICER ROWDEN: Okay, yes, to be fair
2 with everybody.

3 MR. HOLLON: That's fair, I understand.

4 MS. GATES: We'll keep you where you're at.

5 MR. HOLLON: You'll keep me where I'm at? Okay.

6 HEARING OFFICER ROWDEN: Arie de Jong. Please
7 state your name, spell your last name and who you are
8 affiliated with, please.

9 MR. DE JONG: Arie de Jong, A-R-I-E; the last name
10 is D-E, J-O-N-G.

11 Whereupon,

12 ARIE DE JONG

13 Was duly sworn.

14 MR. DE JONG: And I am representing myself here.

15 HEARING OFFICER ROWDEN: Thank you. And this is
16 your testimony?

17 MR. DE JONG: Yeah, yes it is.

18 HEARING OFFICER ROWDEN: Okay.

19 MR. DE JONG: I would like to start by thanking
20 you for the opportunity to speak to you at this time.

21 HEARING OFFICER ROWDEN: One second. That's
22 Exhibit 63. Please.

23 (Exhibit 63 was received into evidence.)

24 MR. DE JONG: I am a producer of milk in both
25 California and Arizona. I am the owner of the Milky Way

1 Dairy in Visalia, California, milking 4,200 cows with 12,000
2 head of young stock. We also farm about 5,000 acres of
3 ground in Visalia.

4 I am also the owner and Acting President of
5 Hollandia Dairy, a producer distributor in San Marcos,
6 California, where we process, sell and deliver milk to over
7 1400 schools, numerous hospitals, the Navy, Marine Corps
8 bases and many stores in the area. We operate that company
9 in San Diego, Riverside, Los Angeles and San Bernardino
10 Counties.

11 That company also operates Hollandia Farms in
12 Riverside County where we milk 2,400 cows and ship the milk
13 directly to our plant in San Marcos.

14 My son Joshua milks 4,100 cows on the Ramona Dairy
15 in San Jacinto, California and ships milk to Security Milk
16 Producers Association in Southern California, which supplies
17 the non-producer distributor milk to our plant in San
18 Marcos.

19 We own and operate a 5,000 acre farm in Imperial
20 County to feed the cows in Riverside County.

21 I also milk 18,000 cows on five different dairies
22 in Arizona and ship that milk to United Dairymen of Arizona,
23 which is a cooperative, which markets the milk in the
24 Federal Order system.

25 United Dairymen I might add, makes 25 different

1 products, including dry whey, and exports to 28 different
2 countries in the world.

3 My dairies ship over 11 percent of Arizona's milk.

4 I have served on the board of directors of United
5 Dairymen for over 24 years and have been vice president
6 there several times. I am currently serving, I think, my
7 12th year on the executive committee of that board.

8 I am also, oddly enough, a board member of
9 Security Milk Producers Association in Southern California.

10 I have served on that board many years also, I don't know
11 how many.

12 I am the son of a Dutch immigrant who came here in
13 1949.

14 I was born in California, grade school educated in
15 California, high school educated in the Netherlands by the
16 same teachers that taught my father and his siblings.

17 Our family now milks over 250,000 cows in
18 California, Arizona, Michigan, Indiana, Illinois, Ohio,
19 Oregon and Wisconsin.

20 I am thoroughly familiar with all aspects of both
21 producing milk and marketing milk in the Federal Order
22 system and the state of California. Though there are more
23 qualified people in the audience to answer questions on
24 Federal Orders I can answer questions on the costs of
25 production in most of those other states.

1 There are some facts I would like to bring out in
2 my testimony here that I don't think have been emphasized.

3 Number one. There seems to be some feeling that
4 cooperatives don't want to build cheese plants in
5 California. Let me expound on that a little. If a
6 cooperative owns and operates a cheese plant and also sells
7 to other cheese plants they would often be competing with
8 their customers for the same outlet for their product. This
9 is very unpopular with our cheese producer customers. We
10 chose instead to endow them with full supply contracts,
11 often selling them our cheese plants and giving them our
12 finished product customers, so as not to compete with them.

13 It makes for a better relationship with our customers.

14 Number two. I have heard a lot of testimony here
15 from cheese producers how they would like to buy milk at
16 clearing prices. I have been party to negotiations of
17 numerous contracts with end users of milk and cooperatives
18 over the years. I am not totally positive but I am almost
19 certain that with the exception of Hilmar Cheese, all of the
20 cheese manufacturers are in full supply contracts with the
21 local cooperatives.

22 These cooperatives provide a valuable service to
23 their customers. They provide them with full loads of the
24 best quality milk available. They make sure that the
25 highest protein milk the co-op produces goes to these cheese

1 producers. They deliver the milk in the exact amount they
2 want, when they want it, free of freight, free of fuel
3 surcharges, three, four, five, six or seven days a week. If
4 they don't have enough tank capacity at their cheese plants
5 we are standing by with tankers full of milk in their
6 parking lot to ensure them that they can run at maximum
7 efficiency.

8 They are free from negotiating separate contracts
9 with producers who might not be in close proximity to their
10 cheese plants and who might not ship high protein milk.
11 They are disconnected from the responsibility of picking up
12 the milk on the dairy seven days a week, 365 days a year,
13 Christmas, New Year or any other holiday that they might not
14 be running their plants. Their employees can have those
15 days off. They would not be able to make more cheese when
16 the milk is cheap or less cheese when the milk is expensive,
17 like they can do now.

18 They would not have the opportunity to shut down
19 for maintenance the last several days of one month and empty
20 their supply lines because they know they can buy the milk
21 cheaper the following month. This is what happened in 2008
22 when several cheese producers at the same time shut down for
23 several days in a row because they knew they could buy the
24 milk cheaper the next month. This caused mass dumping of
25 expensive milk in California.

1 When they enter a full agreement with a
2 cooperative they pay a negotiated premium for the services
3 that they receive. It's not a tax.

4 How many cows I choose to milk on my farm is none
5 of their business.

6 When I have too much milk, as I have had in the
7 past, they never ponied up for the expenses incurred to move
8 that milk to other plants outside of California.

9 It is simply not the job of either the cheese
10 manufacturers or of CDFA to manage my supply of milk. That
11 is my job, either on the farm or at the co-op level, both of
12 which I can control.

13 For us to let our customer, the cheese
14 manufacturer, out of contract when there is too much milk so
15 that they can buy that milk at clearing or depressed prices
16 simply does not get rid of the problem, there is still too
17 much milk. They are all running at capacity when there is
18 too much milk, making hay when the sun shines, so to speak.

19 If we already have a negotiated price for milk and
20 services provided to them, why would we as co-ops let them
21 out of these agreements just to give them the milk cheaper,
22 the same milk cheaper?

23 The cooperatives in not only this state but all
24 over the world have to own and operate large clearing plants
25 for the volume of milk that at times has no homes. And let

1 me reiterate, at times. Because at United Dairymen
2 sometimes our plant is empty. It's parked all summer long.
3 And in the wintertime we process milk for other states and
4 we help each other out that way. All these co-ops are
5 working together to try to not dump milk.

6 When there is too much milk on the horizon
7 everybody at the co-op level gets nervous.

8 We are the ones who make and store product when
9 the market is declining, not the cheese producers.

10 We are the ones milking the cows, who have to make
11 the hard decisions to either cull or sell or powder to the
12 international markets. That decision can never be managed
13 by a customer who only takes 40 percent of our milk five
14 days a week. Certainly not DFA also. I have to look the
15 cow in the eye and say "honey, it didn't rain in December or
16 January and now you have to go."

17 Another thing, I had number three. We got to hear
18 from a controller of a cheese plant in San Bernardino, how
19 he would like to add ten percent capacity to a one million
20 pound plant a day -- or a day plant, but just can't justify
21 the investment given the marginal return.

22 I don't mean to sound callous but don't you think
23 it's kind of extreme to expect all the dairy families in
24 California to give up over a million dollars a day to try to
25 increase the state's capacity by just two loads of milk?

1 That plant is in an area where the dairymen are
2 suffering the most. Frazer and Torbet's numbers for 2011
3 show that the dairymen in Southern California made zero
4 money in 2011. No return on investment. No money for
5 management. As a matter of fact they had to borrow other
6 money to make principal payments on their dairies. And I
7 can forward that information to you. I got it via email.
8 And we could print that out and I could give that to you
9 later on if you want.

10 This cheese producer got his milk in 2011, when we
11 didn't make any money. He'll get his milk in 2012 when
12 we're losing money. He'll get his milk when we don't have
13 any more milk in Southern California because we as co-ops
14 will deliver it to him at the negotiated contract price,
15 whether his cheese plant is in the right location or not.

16 Number four. We also got to hear from another
17 cheese manufacturer in Hanford about how he only wants to
18 make cheese, not whey protein concentrate.

19 I own a milk plant in San Marcos and I only want
20 to bottle milk, not run a waste water treatment plant, which
21 costs millions of dollars.

22 I own a dairy and I only want to milk cows, I
23 don't want to scrape and haul manure all day.

24 Ripping and disking fields is not as fun as
25 harvesting feed but it's all part of the game. As far as

1 that goes we are all on the same playing field.

2 Number five. We also heard a choking testimony of
3 how it costs up to \$8 more to make milk in Wisconsin than in
4 California.

5 Let me assure you that that is wrong. Why would
6 dairymen hedge their milk at a Federal Order Class III on
7 the CME at around \$16 if their production costs were upwards
8 of \$23. The actual production cost on a western style dairy
9 in Wisconsin was just over \$16. Of course, when asked where
10 these numbers came from, he had to admit they were
11 anecdotal. I had to ask SIRI what that word meant.

12 In conclusion, when I listen to all the
13 testimonies of these cheese producers I get the feeling that
14 they feel entitled, so to speak, to make more than the usual
15 money, as they obviously have been lately.

16 The cheese, I want to add in here, the cheese
17 makers in Wisconsin -- and I read that same article that
18 they read. The cheese makers in Wisconsin are simply
19 jealous of the low milk price that our cheese makers here in
20 California are enjoying.

21 I for one would like to see CDFA go through their
22 books to see if there maybe is some room for more
23 reasonableness on their part to pay a competitive price for
24 our milk. Wouldn't that be nice? They see all our costs.

25 After listening to only yesterday's testimonies I

1 woke up at 2:45 a.m. and felt compelled to write my feelings
2 down in an organized way so as to not give an answer in
3 anger, but to appeal to this Committee to support the
4 Coalition's proposal and to level the playing field. Not
5 only for dairymen in this state but also for cheese
6 producers in other states where our money is going. Putting
7 a lot of smaller cheese producers at risk for non-survival
8 because our money is going there to build very competitive
9 cheese plants in those areas.

10 This is my first visit to CDFA here in Sacramento.

11 I have listened to hours of well-written, rehearsed
12 testimony prepared by people who got paid to write and/or
13 deliver their testimony to you. Let me assure that I didn't
14 get paid for my time away from my farm and family to present
15 these facts to you. As a matter of fact, I am apolitical,
16 so that what you hear from me, though it might be unpopular,
17 is nevertheless the truth.

18 Thank you. I would like to ask for the
19 opportunity for a post-hearing brief.

20 HEARING OFFICER ROWDEN: That's accepted.
21 Questions from the panel?

22 MR. EASTMAN: You mentioned that you would be
23 willing to submit some of the -- actually --

24 MR. DE JONG: From Frazer and Torbet, the cost of
25 production?

1 MR. EASTMAN: Yes, from Frazer and Torbet. Would
2 you mind just sending that in --

3 MR. DE JONG: No.

4 MR. EASTMAN: -- in the form of a post-hearing
5 brief. That can just be an attachment and usually that
6 comes in via email.

7 MR. DE JONG: Yes.

8 MR. EASTMAN: It could just be --

9 MR. DE JONG: We're always the first to get those.
10 We get them via email before they come into a printed form
11 because we like to see where we compare with everybody else
12 because I milk cows in Southern California, Central
13 California and Arizona. They do -- they do accounting for
14 pretty much all dairies that I know of in our area and in
15 California. The western style dairies.

16 I don't think that they're involved -- and I also
17 don't think -- because Genske and Mulder's name was
18 mentioned too. I don't think they're involved in real small
19 dairies in the Midwest either.

20 So most of the accounting firms follow their
21 clients to other states. If I started a dairy in Wisconsin
22 Frazer and Torbet would, would be my, my accountant because
23 they do it here too. And I think that's the same with those
24 western-style dairies in those areas too.

25 MR. EASTMAN: Well, that's great. So if you could

1 submit that or what other information that compares the cost
2 of production across various states that would be most
3 helpful.

4 MR. DE JONG: Yeah.

5 MR. EASTMAN: And if you want to just stipulate,
6 just sort of confirm the style of dairies, how big they are,
7 so we have a sense of what type of dairies would be included
8 in the sampling. That would be great.

9 MR. DE JONG: Okay, we can do that. And you also
10 have, of course, CDFA's, your own information. We
11 participate in those studies too. You have an economist
12 here that meets with my son here regularly and they know the
13 costs on our dairies here. And they also have all the sizes
14 of the dairies.

15 MR. EASTMAN: Yeah, we're aware of that and we
16 know that guy.

17 (Laughter.)

18 MS. GATES: I have a clarification question for
19 you. At the bottom of page one when you're talking about
20 producer-distributor in San Marcos and you're supplying all
21 of the schools, hospitals and everything. Is that
22 California milk?

23 MR. DE JONG: Yes, yes ma'am, that is all
24 California milk.

25 MS. GATES: I was getting a little confused with

1 the Arizona, the this, the that.

2 MR. DE JONG: No, that is all California milk.
3 It's all produced in Southern California.

4 MS. GATES: Okay.

5 MR. DE JONG: Because we were hauling that milk
6 from Hanford down there.

7 MS. GATES: Okay.

8 MR. DE JONG: Later we started a dairy in Southern
9 California so we wouldn't have to -- because we didn't get
10 the hauling credits for hauling PD milk south over the ridge
11 route. So we started a dairy in Southern California and
12 milked those cows in Southern California for Southern
13 California with feed from Southern California.

14 MS. GATES: So everything is kind of separate with
15 Arizona and Southern California?

16 MR. DE JONG: Yes, ma'am, it is, it is. I wanted
17 to dairy in California all my life. I was born and raised
18 here. I spent four years in Holland. I wanted to live in
19 California. But I couldn't afford a dairy in California
20 because in those days if you didn't have shipping rights to
21 either Safeway or some creamery or some co-op you couldn't
22 get in. You could not dairy here, it was closed. It was a
23 closed market.

24 And being born and raised here I had to wait for
25 an opportunity to come back here. When I came back here I

1 came back to Visalia, California. I wanted to live here but
2 my wife didn't like it. I have too many relatives. My
3 relatives are a little bit overwhelming.

4 (Laughter.)

5 MS. GATES: Thank you.

6 MR. DE JONG: So I chose to not divorce and live
7 in Arizona.

8 MS. GATES: You did what you needed to do.

9 MR. DE JONG: But my kids love it here, they're
10 back here.

11 MS. GATES: Thank you.

12 HEARING OFFICER ROWDEN: Thank you.

13 MR. DE JONG: You're welcome.

14 HEARING OFFICER ROWDEN: Scott Hofferber. Wait,
15 excuse me. Before you get back up I want to make sure --
16 I'm sorry -- to make sure that everybody that has not had a
17 chance yet we'll call them. All right then. And what we
18 would like to do is make sure everybody gets at least one
19 shot at this and then if you want to sign up again you can
20 do that.

21 And just to let you know, in terms of thinking
22 about your testimony if you are going to stand up again, we
23 are not looking for rebuttals, we look for new information.

24 This is not a debate forum. So just remember that if you
25 plan to get up again.

1 The next witness is Stephen Mancebo, Mancebo.

2 MR. MANCEBO: Hello. My name is Stephen Mancebo,
3 it's M-A-N-C-E-B-O.

4 HEARING OFFICER ROWDEN: And you are representing?

5 MR. MANCEBO: Mancebo Dairy.

6 Whereupon,

7 STEPHEN MANCEBO

8 Was duly sworn.

9 HEARING OFFICER ROWDEN: Okay, please.

10 MR. MANCEBO: Again, my name is Stephen Mancebo.
11 My family and I dairy in Tulare, California. I have been a
12 dairyman most of my life. I am not a polished speaker so
13 I'll apologize in advance. I follow a lot of Arie de Jong's
14 sentiments as to what he said on the dairy side.

15 As a producer things have always been up and down
16 in the dairy business. The last three to four years have
17 been an extreme struggle. Prices are down, feed input costs
18 have been up, amazingly up. We have no control over input
19 costs on what the fuel market, corn market and different
20 things do. I can make contracts, lock in feed costs, all of
21 a sudden fuel goes up, they can then put on a surcharge for
22 the fuel to deliver it to me.

23 I have no opportunities whatsoever to add any kind
24 of a surcharge to any product I make. The only input -- the
25 only thing I am paid for in this business is my milk. As

1 that is my only product to sell I also have no control over
2 the price. I am totally set to what CDFA sets as the
3 California standard fair minimum price that is paid to
4 dairymen, a month after I produce it. A pretty bad business
5 model on my sense but that's what we have to work with.

6 We work with a pooling system that puts the milk,
7 the money in there off of the end product pricing so that I
8 can get a fair minimum price established for milk.

9 As I have sat here for a day and listened to this,
10 I am only here trying to find out more information as to why
11 my business neighbors and friends are going out of business
12 at an extremely alarming rate. I can look in the history
13 and see we lose 50, 70 dairymen a year. Twenty years ago
14 there were 5,000 dairymen, today there are around 1,500.
15 You take that same 50, 70, 100 dairymen a year, the
16 percentage of dairymen that we are losing is at an alarming
17 rate.

18 I have heard testimony that the production is
19 still here. Well yes it's still here. I have had to get as
20 efficient as possible as a dairymen. I have to squeeze
21 every last drop of milk out of every cow I have, I have to
22 find every little bit of room that I have to squeeze another
23 cow in, for the fact my fixed costs are the same. If my
24 facility has room to somehow squeeze another 10, 20 cows in
25 I have to do that. I'm making less and less, if anything,

1 per cow. And over the last couple of years it has not been
2 anything. And I still try to push more milk for the fact
3 the day I do make a few cents per cow, once again I can
4 become profitable.

5 I have heard some testimony here where it is very
6 hard to get more money for cheese out of the market. Add
7 anything to the whey. I as a dairymen have no one to even
8 try to get another cent out of. I am stuck with the set
9 price from California that is established as a fair minimum
10 price for all products made out of my milk product when it
11 is sold.

12 Well now I no longer feel we are fair. You take a
13 cheese plant, from my understanding. Before they processed
14 whey they had to dispose of it. California doesn't want it
15 in the water systems. You can't dispose of it. It was a
16 full cost.

17 I understand now they have come up with
18 technology, different styles of whey and there's a product
19 price for it. Over the last two years that price has become
20 a very valuable product. The rest of the nation is getting
21 paid for that product. The Federal Order has a price in for
22 whey. You can look at the CME, you can see whey has a
23 value. Ten, 15 years ago there was no value, it was an
24 expense to a cheese processor. They are capitalizing on
25 that product. If they're small, large, indifferent and

1 there is a product there they need to make the adjustments
2 to do it.

3 Me as a dairymen, whether I'm small, large,
4 whatever, I'm getting the same exact price as the guy that
5 isn't small or large or different from me. So to hear a
6 cheese processor say small or large -- they are all whey
7 manufacturers, there are ways of dealing with it, they have
8 to get more efficient.

9 If I as a dairymen decided ten years ago, I'm not
10 going to put misters, soakers, to figure out a way to hold
11 my production through the summer, I would be out of
12 business. I have to take every avenue, every new
13 technology, every new product that's made, and try to
14 benefit from it. It's the only way to stay in business.

15 It's the same with these cheese processors. So if
16 the Federal Order can pay a Class IIIb price with a whey
17 factor in it, and our whey factor adjustment is so much
18 lower, I am no longer competitive with any of my neighbors
19 in other states. I would definitely like to keep my
20 business right here in California. That is a fact.

21 You talk about the production. We weren't paying
22 much for whey seven years ago. I've heard that there was
23 different things. I know that Hilmar Cheese started here in
24 California, made a cheese plant. It still looks like it's
25 doing very well to me. Yet they go out of the state to

1 build more processing capacity. That's not on the price of
2 the milk that's here in California, that's California's
3 rules, regulations, water, air board. The same things I
4 fight as a dairy producer. We have to adjust to all of
5 those things.

6 So to pay me less to think that we are going to
7 get more capacity built. I find that really hard to
8 believe. We as dairymen and the co-ops that we belong to
9 can control that production and processing -- we can control
10 that production. Because the production is not here year
11 round. Spring it hits very hard. This spring especially.
12 Spring this year started last year in August. We have had
13 unbelievable weather. I have pulled more milk without
14 changing a thing on my place at this time, at this point in
15 time. I'm up five pounds per cow.

16 I also have neighbors going out of business and I
17 don't know when I am going to be next. But I feel really
18 bad that I have taken advantage of that. When they do sell
19 their cattle it is under market value because there's a lot
20 of milk. So if I've got 20 -- room for 20 cows I have
21 bought them in an undervalued market. It has actually
22 benefitted me for the fact that the bank puts a value on
23 cows and I am able to buy them under. It's a step that I am
24 taking to try to stay in business for at least another day
25 or two until we can get a price established that pays a fair

1 price for milk.

2 I know I am not as smart as a lot of people in
3 this room on the whey processing process, on the cheese
4 process. But what I do know is we are no longer being paid
5 a fair price here in California for this whey factor. And
6 it's not the only problem we have but it is a problem. And
7 each piece needs to be fixed so the producers have a chance
8 of staying in the state and producing milk.

9 Like I said, I am not very polished so I apologize
10 for this but this is the end of my testimony. Thank you
11 very much.

12 HEARING OFFICER ROWDEN: Questions? Questions?
13 All right, thank you very much.

14 William Van Dam.

15 MR. VAN DAM: I'm not a polished speaker either.
16 (Laughter.)

17 HEARING OFFICER ROWDEN: Please state your name,
18 spell your last name and let me know who you are affiliated
19 with.

20 MR. VAN DAM: My name is William Van Dam, V-A-N,
21 separate word, D-A-M; I'm with the Alliance of Western Milk
22 Producers.
23 Whereupon,

24 WILLIAM C. VAN DAM

25 Was duly sworn.

1 HEARING OFFICER ROWDEN: And your testimony is
2 Exhibit 64. Please.

3 (Exhibit 64 was received into evidence.)

4 MR. VAN DAM: Okay. Good morning, Mr. Hearing
5 Officer and Hearing Panel. My name is William C. Van Dam.
6 I am the CEO of the Alliance of Western Milk Producers. Our
7 organization is made up of two cooperatives, California
8 Dairies Inc. and Dairy Farmers of America - Western Council.

9 The two cooperatives currently market and process 63
10 percent of the milk produced in California.

11 The Alliance of Western Milk producers is a member
12 of and supports the proposals put forth by the Coalition.
13 The use of a coalition of this sort is a departure from the
14 practices of the past and came about because of producer
15 frustration with a pricing system that they feel has left
16 them with a price that is, for no apparent reason, far below
17 the price levels paid to producers in other parts of the
18 country. California producers have long ago come to grips
19 with the fact that there are good and adequate reasons why
20 California producer milk cannot be as -- milk prices cannot
21 be as high as those in the Midwest. The reasons fall into
22 two general categories: First, the Midwest is over 1,000
23 miles closer to the customers on the East Coast. Second,
24 the cost of doing business in California are higher than
25 other areas. However, whey values generated by the

1 California formula have, in times of high dry whey prices,
2 have been below the Federal Order Class III price by amounts
3 several multiples of the biggest values the traditional
4 factors could possibly explain. This is a price difference
5 without a clear and easily understood explanation. It has
6 been shown by prior witnesses, the high whey values are
7 being paid by nearly all milk used to make cheese in other
8 parts of this country.

9 An additional factor is that price volatility is
10 here to stay. This means that producers cannot afford the
11 "luxury" -- luxury in quotes because it's an ironic
12 statement -- of foregoing participation in price peaks in
13 good times because they will not be able to avoid the price
14 valleys in the bad times. There is an old saying in the
15 farming business that goes: "If you want to be there when it
16 is good, you have to be there when it is bad." But for that
17 to work the good times cannot be artificially reduced by
18 pricing policies that trim the top off the peak of the
19 pricing.

20 Those of us that have been through the now nearly
21 a decade old California whey wars know how complex and
22 difficult this topic has been, and continues to be. The
23 tremendous amount of effort that went into the whey
24 committee effort in 2007/2008 -- of which I was part and
25 many people in the room were. It is discouraging to

1 remember the whole effort ended in "unchanged" and the 25
2 cent fixed factor installed "temporarily" in December '07
3 stayed put until September 2011, a period of nearly four
4 years. In the light of that background, the producer side
5 very much appreciates the adjustments made to the whey value
6 formula last year. It was, in historical terms, a very
7 significant improvement in the recognized value of whey, and
8 even more important, in terms of providing a framework for
9 establishing a formula that can be adjusted to give a
10 workable and fair alternative estimate of the proper whey
11 value since the traditional factors, such as make
12 allowances, are not available.

13 It is significant that the proposed pricing by the
14 Coalition follows, and thus endorses, the sliding scale
15 concept adopted last year. The Alliance opposes the
16 alternative proposal suggested by Farmdale Cheese because it
17 would undo all the progress made at the previous hearing on
18 this topic.

19 It is very important to stress that this hearing
20 narrowly limited to discussing the value of whey in the
21 Class 4b formula. This hearing should not be seen as an
22 attack on the California milk pricing system or an attempt
23 to undermine it.

24 Thank you very much for holding this hearing and
25 allowing us to testify on this very important topic. The

1 end. An all-time record, short testimony.

2 HEARING OFFICER ROWDEN: Questions?

3 MR. EASTMAN: I do have a couple of questions.
4 Were you going to want the right to file a post-hearing
5 brief if necessary?

6 MR. VAN DAM: Don't plan to.

7 MR. EASTMAN: Okay. So that's a no?

8 MR. VAN DAM: If you give it automatically, fine;
9 I'm still not going to. (Laughter.)

10 MR. EASTMAN: I'm glad someone here is able to
11 predict the future. (Laughter.)

12 You mentioned that California Dairies Inc. and
13 Dairy Farmers of America are the two cooperatives that are
14 members of the Alliance of Western Milk Producers. We have
15 seen graphs and information and then we'll have to see even
16 more extensive testimony from Dairy Farmers of America. I
17 assume that the Alliance supports their testimony. Is one
18 of the reasons why your testimony is so short is because
19 those other two representatives have provided more
20 information and more graphs?

21 MR. VAN DAM: Yes indeed. That was very detailed
22 testimony, especially by DFA and by CDI. You end up with
23 almost triple memberships with a coalition of those two. So
24 it is short for that reason.

25 MR. EASTMAN: And then I have one more question.

1 We have heard testimony during this hearing about it seems
2 some of the factors that -- for milk production there's
3 obviously different factors such as nutrition, feed rations,
4 cow comfort, weather, et cetera.

5 And I'm curious, do you have an understanding or
6 knowledge of how do you view milk production going into the
7 future in light of some of the things that have been
8 mentioned? For example, there's sex semen, we have had good
9 weather for quite a while now, things of that nature. Do
10 you view milk production as going to change coming into the
11 future? Is that going to get off of the upward trend? Is
12 that new technology just going to keep milk production
13 always there? I know that's a lot. That's a pretty long,
14 winding question. I'm just sort of curious as to your
15 thoughts on how that milk production is going to react.

16 MR. VAN DAM: So you set me up to give you a long,
17 winding answer.

18 MR. EASTMAN: That is great.

19 MR. VAN DAM: It's very interesting that you bring
20 it up and when you try and think through this. However,
21 you've got to look at the history. And I have now -- I came
22 to California, once I got out of school and went to work
23 here, in 1970. And since that time there has literally been
24 one year that milk production in California went downward.
25 There was a couple others that it was flat. That is part of

1 the DNA of a producer in California.

2 As it is going on right now there is a significant
3 shift going on in California to the much larger places where
4 they raise nearly all their own feed. That seems to be the
5 new key to dairying and it's working here in California.
6 They've got water all the time as long as they're in the
7 right places that it's in the ground. But water is not
8 typically an issue here in California. They get their crop,
9 the water is applied at their time, the crops are big. So
10 this is a good place to dairy and that's the model that
11 seems to be taking over.

12 Unfortunately, a lot of smaller dairies that are
13 in place or that happen to be surrounded by almond trees and
14 sometimes by grapes can't get access to the kind of land and
15 they are at a disadvantage and those are the ones that are
16 at the biggest risk. So the simple answer is I do see
17 production continuing to increase. The production plans
18 seem to be working reasonably well to contain that within
19 the size of the plant capacities and I think that's an issue
20 we'll see for awhile.

21 MR. EASTMAN: Thank you.

22 MR. VAN DAM: You're welcome.

23 HEARING OFFICER ROWDEN: Thank you.

24 MR. VAN DAM: Thank you.

25 HEARING OFFICER ROWDEN: Rien Doornenal (sic).

1 Doornenbal, excuse me. Please state your name, spell your
2 last name and let us know who you are affiliated with.

3 MR. DOORNENBAL: My name is Rien Doornenbal, the
4 last name is spelled D-O-O-R-N-E-N-B-A-L, and I represent R.
5 Doornenbal Dairy.

6 Whereupon,

7 RIEN DOORNENBAL

8 Was duly sworn.

9 HEARING OFFICER ROWDEN: Okay, please continue.

10 MR. DOORNENBAL: I am here to let the panel know
11 that I agree with the proposal coming from the Coalition and
12 Western United Dairymen and I have some of my own points
13 that I would like to share with you.

14 The Department continually refers to market
15 signals. And as they have -- it seems by the questions that
16 the Department asked they seem to feel they have some
17 responsibility on how milk is priced having to do with the
18 market signals.

19 The dairy producers have historically responded
20 very well when the market signals indicate that it is a good
21 time to expand. For example, we all know the phenomenal
22 success story of Hilmar Cheese Company. They sent a lot of
23 signals to the market that they were ready to accept more
24 product. And I think that they have done a terrific job.
25 It's almost unbelievable the success story that goes along

1 with Hilmar Cheese.

2 The same thing goes for Leprino Cheese. They came
3 out here years ago, started and bought a plant that, what is
4 now Dairy Farmers of America, was not able to operate. It
5 worked better to have Leprino operate it. They increased
6 the production there. And of course as you know, they have
7 a plant in Lemoore that several years ago doubled their
8 production and the dairymen in the state responded. They
9 brought the extra milk that was required.

10 What we all have to understand is that once we
11 have expanded as dairymen, we are committed. Once we borrow
12 the money, build the facility, buy the cows, we as
13 individual dairy businessmen cannot reverse that process.
14 If the market signals are such that we are long in milk in
15 California, there is nothing that the individual dairymen
16 can do by himself, regardless of the milk price or
17 regardless of any decision that the Department can make
18 affecting the milk price.

19 Case in point. For the year of 2009 -- and the
20 year 2009 has often been referred to because it was
21 absolutely a bloodbath for the dairymen in California, as it
22 was for the dairymen all over the United States. Many of us
23 spent time with our consultants to determine if we could
24 lower our production. We're getting so little for our milk,
25 maybe we could lower our production by reducing inputs and

1 at the same time slowing down the losses that we were
2 incurring.

3 We found out by spending a lot of time with
4 spreadsheets and knowing how cows respond to taking away
5 inputs, whether that be feed or management practices. We
6 consulted with the smartest people who have doctorates in
7 the dairy industry and the determination was that there is
8 nothing we could do to slow down production on the dairy
9 that would lower costs enough so that we would be losing
10 less money.

11 So no matter how high the feed costs were, no
12 matter how low the milk price was, reducing production
13 simply would result in greater losses. The best business
14 decision for each individual dairymen was to go to his lines
15 of credit, and hopefully he had lines of credit that were
16 established with his banker during better economic times.
17 Go to his lender and borrow heavily and produce all that he
18 could on his particular facility. There was nothing else
19 they could do.

20 My banker refers to a dairy farm as a huge
21 investment in a single use facility. We cannot sell the
22 cows and use our dairy facilities for any other use.
23 Neither can we simply walk away from our dairy facilities.
24 Because as opposed to homeowners, our loans are not -- and I
25 repeat not -- non-recourse. If I walk away from my dairy my

1 banker will find me.

2 I would agree that to -- I would argue that today
3 we do not have too much milk in the state. The Department
4 seems to be very concerned that we have too much milk. And
5 it is almost like the Department seems to take on a
6 responsibility, want to take on a responsibility of making
7 sure we don't have too much milk. And I don't quite
8 understand why you feel that that is part of your
9 responsibility.

10 We have, and I would argue, we have exactly the
11 right amount of milk in the state. And the reason we have
12 exactly the right amount of milk in the state today is
13 because we are experiencing today in California something
14 historic, something brand new that has never happened
15 before. And what that is, is that every dairy today has
16 either a co-op base or a cap on their production if they are
17 producing for a private processor. And those bases and
18 those caps can be enforced or taken off at any time by the
19 co-ops and the processors.

20 I live in Escalon so I was here yesterday. I went
21 home and I was up at 5:30. I was on my dairy; I was helping
22 my herdsman. After I was finished with that I went into my
23 office to see how much milk I had produced yesterday as well
24 as for the month of May relative to my co-op base. I ship
25 to two different co-ops.

1 One of my co-ops I was 60,000 pounds over for the
2 month of May. That's about a load. That particular co-op
3 did not impose any penalties on my milk, but I had received
4 a letter from them several months ago warning me and
5 reminding me that I have a base with my co-op.

6 And also warned me that there are people who
7 belong to other co-ops that have their production -- have
8 their bases enforced that are moving either milk or cows. I
9 would say cows. That are moving cows to this particular co-
10 op, thereby taking advantage of the fact that the one co-op
11 is not enforcing their base. And also warned us that if we
12 are doing that and that's found out, that could be a good
13 reason for us to be dismissed as members of my co-op. So I
14 am going to take this very seriously.

15 If my co-op says -- one of my co-ops says, you
16 know what, if you take milk from your other dairies that
17 aren't coming here and ship it to me or move cows around, if
18 we find that out you're going to be gone, that's serious.
19 So I didn't do that, of course. (Laughter.)

20 The other co-op, the other co-op had sent a, had
21 sent a letter out that -- in March that for April and May
22 the deductions might be as much as \$3 to \$6 per
23 hundredweight. And I started looking at the number of cows
24 I had and how that might affect me and I made a decision to
25 sell a load of cows out of state. I reduced the milk

1 production that was produced on my dairy. I had an
2 incentive to reduce the milk production on my dairy, and I
3 did it. And I felt good about it.

4 The processors are only accepting the amount of
5 milk that they need. Some may be going out of state with
6 the dairy farmer bearing the cost. Some of it may even be
7 finding its way to Texas. We heard testimony yesterday that
8 there is a demand there to produce cheese. I suppose some
9 of the milk that -- the little bit of milk that I produced
10 that was over my base, it may very well have found its way
11 to Texas. So we have -- what we have here is a fundamental
12 shift.

13 We also heard some moans and groans. Oh my
14 goodness, we are sending some milk to the calf ranches. How
15 terrible is that? You know what, it should not matter to
16 the Department if that milk is going to calf ranches. That
17 is the dairymen's responsibility. If he wants to sell it to
18 a calf ranch for whatever the calf ranch wants to pay for
19 it, if he wants to give it to the calf ranch, that is
20 entirely his business. So they have -- if the dairymen, if
21 it is in his best interest to sell it to a calf ranch, it
22 makes them happy. It makes the calf ranch owner happy. And
23 you know what, it makes the calves happy too because they
24 are getting real milk instead of replacement. That's it for
25 my testimony.

1 HEARING OFFICER ROWDEN: Questions? Thank you
2 very much. May I have the next witness list, please. Okay,
3 Edwin Rizo.

4 MR. RIZO: Good morning.

5 HEARING OFFICER ROWDEN: Please state your name,
6 spell your last name and for the record let us know who you
7 are affiliated with.

8 MR. RIZO: Edwin Rizo, R-I-Z-O, and I am
9 affiliated with Rizo Lopez Foods. It's a cheese company
10 that we market Mexican-style cheeses under the Don Francisco
11 label. And I am here to read a letter that my brother Ivan,
12 who is my partner, sent to the Department on March 7th and
13 just to add additional comments.

14 First of all, thank you for the opportunity. This
15 is the first time I have ever been to one of these hearings
16 and participated so here we go.

17 We manufacture and sell Hispanic-style cheeses
18 under the Don Francisco label. We have been manufacturing
19 cheese in Riverbank, which is just about 10, 15 miles east
20 of Modesto, California, since 1996 but we have been selling
21 cheese since 1990. Peluso Cheese Company was making the
22 cheese for us at the very beginning. We are the largest
23 employer in the city of Riverbank. We serve many of the
24 smaller Hispanic grocery markets with two million pounds
25 high-quality cheese throughout California each month.

1 We purchase our milk from local dairy farmers
2 through two co-ops, Pacific Gold and CDI.

3 The petition submitted by Western United Dairymen
4 is asking for an increase in the whey pricing factor. We
5 respectfully ask that you deny their request.

6 Since the implementation on September 1st, 2011 of
7 the increased whey factor on the 4b price formula our milk
8 cost has increased by an average of about 40 cents a
9 hundredweight. We have no income from the whey stream in
10 our plant. That is since 1996, over 15 years. In fact, it
11 costs us about \$140,000 a year to dispose of our whey. It
12 was difficult for us to maintain our competitive when we
13 have the fixed 25 cents factor in the pricing formulas.

14 We are in the process of building a new facility.
15 We will be processing our whey through a reverse osmosis
16 system, which will only concentrate to about 26 percent
17 protein, and I believe it is going to go to cow feed.

18 We hope that this will help us to at least break
19 even in our whey stream. Any more increase in the price
20 will put us at a loss on the whey again.

21 We know that producers are experiencing some
22 financial distress. But raising costs on the processors
23 would only tend to eliminate their markets in a time of
24 increasing milk production.

25 I would like to add that I have been in the dairy

1 business practically since 1980. I went to school here at
2 the University of California at Davis. I'm originally from
3 Nicaragua, immigrated here. I am a proud US citizen. And I
4 work for a lot of dairy people. I did consulting for
5 dairymen in the areas of milk quality. And when I started
6 my business in 1990 two of my original partners were
7 dairymen. So I have a lot of friends and a deep feeling for
8 dairymen.

9 And some of them have asked me through one period
10 or another if I can take their milk. I cannot. It's just
11 by the law. I know there is excess milk. And a dairyman in
12 the past said something about economic choices and I think
13 we all do have economic choice. I made an economic choice
14 or an economic following a dream in 1990 and I have been
15 doing okay. But this increase in the whey pricing factor
16 has made us invest in about closer to \$2 million to be able
17 to try to break even on the whey. And that's an economic
18 decision. We all have to make economic decisions. I just
19 feel that we risk and we get our compensation for it.

20 I thank you for the opportunity for allowing us to
21 express our sentiments. And sorry for not being, again, a
22 polished speaker but thank you.

23 HEARING OFFICER ROWDEN: Questions?

24 MR. EASTMAN: You mentioned that -- in the first
25 part of your testimony you were reading from a letter that

1 had been sent to the Department --

2 MR. RIZO: By my brother.

3 MR. EASTMAN: Right. It might be a good idea, if
4 you wanted to submit that as evidence and to be part of the
5 hearing record. If you feel so inclined.

6 MR. RIZO: Yes. I think it was posted at the
7 website but --

8 MR. EASTMAN: Okay.

9 MR. RIZO: -- we'll do it.

10 MR. EASTMAN: That was all I had.

11 HEARING OFFICER ROWDEN: Thank you.

12 At this time we are going to take a short break of
13 about five minutes and figure out what the rest of the day
14 will be here. We will reconvene back here at 11:20.

15 (Off the record at 11:14 a.m.)

16 (On the record at 11:23 a.m.)

17 HEARING OFFICER ROWDEN: We have changed our
18 minds. We will break for lunch now and reconvene at 12:30.

19 (Off the record at 11:23 a.m.

20 for the lunch recess.)

21

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25

1 California, particularly those operating with a purchased
2 feed model, are under financial stress today after
3 experiencing significant losses in 2009, followed by a
4 couple recovery years prior to what has become a negative
5 cash flow period for many this spring. Producers using the
6 same model across the country experienced similar patterns
7 of stress and profitability of differing magnitudes over the
8 last several years. There is also no doubt in my mind that
9 net returns to dairymen in California must be competitive
10 with alternative milk producing regions over the long term.

11 But regulated minimum milk prices are only one of several
12 factors that drive the level of net returns and they should
13 not be viewed as the sole solution to farm financial stress.

14 The overall supply and demand balance drives the finished
15 product values that determine the overall market value of
16 milk, including the regulated price and over-order premiums.

17 Additionally, cost structures of intermediaries such as
18 cooperatives and haulers and milk production cost structures
19 impact farm profitability. It is therefore important to
20 recognize the change in the regulated minimum milk price is
21 not the sole source of a relief for dairy farm profitability
22 issues.

23 The Western United and the Producer Coalition
24 proposal is an attempt to remedy the current farm financial
25 stress by modifying the regulated minimum Class 4b price

1 formula in a way that is in conflict with basic principles
2 of minimum regulated milk price policy. Specifically,
3 regulated minimums should be set at levels that contribute
4 to orderly marketing of milk. This necessitates that the
5 regulated prices for hard manufactured products be set at
6 levels that clear the market. Therefore, the logical
7 construct of an end-product price formula, such as that used
8 in the California system, is that the formulas generate a
9 milk value representative of the most generic products that
10 can be universally produced by entities subject to the price
11 regulation. The preponderance of testimony at this and
12 prior hearings indicates that whey processing is a highly
13 capital intensive operation that is not economically viable
14 on a small scale basis, and therefore cannot be considered a
15 product that can be universally produced by entities subject
16 to the price regulation. This necessitates that the
17 valuation of whey in a milk price formula must be approached
18 with extreme caution.

19 In that context, I am testifying today in
20 opposition to the Western United and Producer Coalition
21 proposal. That proposal:

22 Sets the whey portion of the Class 4b regulated
23 minimum milk price at a level that exceeds returns
24 achievable through sweet whey production in California.

25 And jeopardizes the California cheese plant

1 capacity associated with operations that cannot economically
2 process their whey into a product that is at least as
3 commercially viable as sweet whey. As this plant capacity
4 exits the market it also jeopardizes producer viability in
5 geographies where the cost of hauling milk to alternate
6 processing capacity and the likely decrease in competitive
7 premiums resulting from the associated reduced competition
8 from milk exceeds the blended gain achieved by increasing
9 the minimum regulated price.

10 Regulatory Backdrop.

11 The Producer Coalition proposal is premised upon a
12 desire to bring the valuation of whey in the Class 4b
13 formula in the California milk pricing system into closer
14 alignment with the valuation of whey in the Federal Milk
15 Marketing Order system. In doing so, significant
16 differences in how the prices apply within the two regulated
17 systems are rationalized away. Specifically, manufacturers
18 in California must pay the minimum regulated price for all
19 Grade A milk processed, whereas manufacturers outside of
20 California can choose whether to participate in minimum milk
21 price regulations. The only entities upon which the minimum
22 regulated milk price is fully binding in the federal system
23 are bottlers. Manufacturers of all other dairy products
24 make an economic decision regarding participation. Even if
25 they opt to buy milk pooled under the Federal Order system,

1 they can purchase milk at below regulated minimums.

2 Using the whey example, a producer located near a
3 small cheese plant without whey processing capacity may
4 determine that the small cheese plant provides him with the
5 highest return for milk net of hauling, even if that cheese
6 plant is paying below Class because of the lack of a whey
7 revenue stream. In the Federal Orders, nothing precludes
8 the plant from buying the milk below Class or the dairyman
9 from selling it below Class, which in this scenario yields
10 him the highest return. In contrast, under the California
11 system, a similarly situated dairyman could not opt for the
12 economically rational choice of selling Grade A milk at
13 below Class to his neighborhood cheese plant, even if it
14 nets him more than paying for the haul to the next closest
15 market. This effectively sets up a scenario where the local
16 plant that does not have a whey revenue stream closes due to
17 inability to recover the Class price, and the dairy producer
18 nets a lower milk price than he would have received had he
19 accepted a price that is below Class.

20 The inclusion of an explicit whey factor in
21 regulated milk pricing had its origin with the
22 implementation of Federal Order reform in January 2000.
23 Similar to California, many cheese plants outside California
24 did not and do not have whey processing capacity. However,
25 the inclusion of the whey factor within the Federal Order

1 system was expected to boost the Class III price by a modest
2 enough amount that a small cheese maker that lacked
3 sufficient scale to cost-effectively process whey was
4 perceived to be able to cover the whey portion of the milk
5 price through premiums garnered on the specialty cheeses it
6 produced. In its first year of implementation, the whey
7 factor contributed 29 cents per hundredweight to the Federal
8 Order Class III formula.

9 During the five year period from January 1998 to
10 December 2002 that CDFA analyzed prior to incorporation of
11 an explicit whey factor in the 4b formula in April of 2003,
12 the contribution to the Class 4b regulated minimum milk
13 price would have been just shy of 24 cents per
14 hundredweight. This also was perceived by many to be within
15 the range that a specialty cheese maker without whey
16 processing capacity could cover through premiums on their
17 specialty cheeses.

18 The explicit inclusion of a whey factor became an
19 increasing challenge for those without whey processing
20 capacity as whey prices strengthened a few years later.
21 With whey driving up regulated minimums by over \$3 per
22 hundredweight at times in 2007, plants without whey
23 processing capacity struggled and some were shuttered. In
24 Federal Order areas, some plants that are located in dense
25 cheese production regions were able to recoup some value by

1 the sale of whey to consolidators as prices increased. But,
2 as John Umhoefer of Wisconsin Cheese Makers Association
3 noted in multiple editorials already in the hearing record,
4 the whey factor was even problematic for those cheese makers
5 selling to consolidators in Wisconsin. The whey factor was
6 also problematic for manufacturers of whey proteins because
7 sweet whey values in the milk price formulas outstripped
8 returns for protein and lactose at time. It was not
9 uncommon in that time frame for cheese makers unable to
10 recover the whey value assumed in the Class III milk price
11 formula to negotiate with their suppliers for relief from
12 the full Class price.

13 But, in California manufacturers do not have the
14 choice of whether to participate in the minimum pricing
15 regulation if they are purchasing Grade A milk, and the
16 viability of several cheese plants was threatened during the
17 high whey price period of 2006 and 2007. In recognition of
18 the crisis created by the explicit whey factor, CDFA
19 replaced it with the fixed factor of 25 cents in December
20 2007. A subsequent change in formulas in September 2011
21 allowed the whey contribution to the 4b price to flex up to
22 65 cents as whey prices fluctuate.

23 The sum and substance of this discussion is that
24 the existence of an explicit whey factor is problematic for
25 cheese makers without whey processing capacity, regardless

1 of whether they are operating in the Federal Orders or
2 California. However, the binding nature of the California
3 regulations limits market-based approaches to relief and
4 limits the range of milk values that can be ascribed to
5 whey.

6 CDFA's 2011 Panel Report is still correct.

7 Key considerations elaborated in CDFA's panel
8 report for last year's Class 4b hearing are still relevant
9 and correct. Quote:

10 "In the cheese making process, it is
11 impossible to capture all the vat milk solids in
12 the final cheese product. The residual milk
13 solids are contained in the whey stream, which is
14 the byproduct of making cheese. Other than whey
15 cream, recovering those milk solids from the whey
16 stream requires large capital investments and
17 economies of scale."

18 In this week's hearing, Barry Murphy's testimony
19 indicated that a whey plant needs to process a minimum of
20 one million pounds dilute whey per day to be economically
21 viable. So that statement from the last Panel Report is
22 still accurate.

23 Another statement from the Panel Report, quote:

24 "Still, only larger cheese operations have
25 been able to achieve the economies of scale

1 necessary to make it economically feasible to
2 recover the solids in the wet-skimmed whey.
3 Department data show that in 2010, only 10 (sic)
4 of the larger processors out of the 58 cheese
5 processors in the state processed whey in any
6 form."

7 Going to current data, as of the first quarter of
8 2012, only 11 of 57 cheese plants process whey. And that
9 was found in the background materials for the 4b hearing.

10 CDFA also properly interpreted the Food and
11 Agriculture Code as it relates to reasonable alignment. And
12 there's a lengthy discussion on pages 24 and 25 of the Panel
13 Report that I will not attempt to reiterate but they have a
14 very thorough and well thought out examination of what the
15 statutes mean.

16 One final point, a quote from the Panel Report
17 once again:

18 "California statutes provide no similar
19 flexibility; all Grade A milk purchased by
20 processors, whether the manufacturing plant
21 operates within the pool or separately from the
22 pool, depooled, must purchase the milk at state
23 established minimum class prices. Because of
24 this, California Class 4a and 4b prices have to be
25 set at levels that will clear the market of all

1 milk that has not been processed in the higher
2 usage milk classes, 1, 2 and 3. As a result of
3 this difference, a strict comparison of the
4 California Class 4b price to the Federal Order
5 Class III, without considering other factors, is
6 inappropriate if processors operating in federal
7 orders are not strictly required to pay the
8 federal order price at all times."

9 This is still true today.

10 Western United/Producer Coalition Proposal Assumes
11 Lower Whey Processing Cost than Prior CDFA Studies.

12 The Western United and Producer Coalition proposal
13 overvalues the whey stream, even for those who can produce
14 sweet whey in California. Although it does not explicitly
15 incorporate a manufacturing cost allowance, the values
16 ascribed to whey in their proposal would exceed the levels
17 justified based upon the CDFA cost studies that were
18 published during the period when an explicit factor was in
19 the formula. Although the studies are now approximately
20 five years old, there is no reason to believe that
21 California processing costs have dropped significantly in
22 that time frame. Our fully loaded labor rates in California
23 are 40 percent above our labor rates outside California and
24 many other cost categories are meaningfully higher in
25 California than in our plants outside of California.

1 At this point I would like to depart from my
2 prepared testimony and comment on a few other items that
3 have come up in this hearing. One Item I'd like to address
4 is managing price risk on behalf of dairy farmers or
5 manufacturers in California under the current 4b formula.

6 There has been testimony from various witnesses
7 that the Class III contract, futures contract, has too much
8 basis risk to effectively be used. I understand that
9 argument. What I would suggest is that the NASS cheese
10 contract that has very low basis risk and has gained enough
11 liquidity that we use it fairly extensively. And to the
12 extent that more producers wanted to use that, that would
13 emulate the 4b formula quite closely. That would contribute
14 to even greater liquidity and opportunity for them to manage
15 their price risk. So the fact that you don't have as tight
16 a connection to Class III should not be an obstacle in terms
17 of managing price risk amongst California dairymen.

18 I would also like to touch briefly on the issue of
19 depooling. There has been testimony that has been very
20 narrowly stated, is how I can most politely describe it,
21 about depooling. I think there was one witness that
22 described that even if milk is depooled in the Federal Order
23 system that, in fact, the minimum class price is paid. And
24 the scenario that was outlined in the testimony was related
25 to milk that was under contract between a co-op and a cheese

1 maker and under contract at a minimum Class III price and
2 the benefit of depooling accrued to the co-op.

3 That's not how all of milk supplies are arranged
4 in the Federal Order and there are many cheese makers who
5 have direct supplies. And so once you depool you
6 essentially are going to be trying to compete with the other
7 players in that marketplace and can make that choice of
8 whether to pass through that Class III value or whether to,
9 in fact, pocket the difference between the Class III value
10 and the blend price and pay, again, below Class.

11 One thing as well that is being obscured in some
12 of the discussions on depooling is the pricing of distressed
13 milk and an inference that, in some cases I think I picked
14 up and interpreted an inference that there is no distressed
15 milk. And I can tell you that within the last two months I
16 have been offered and I have also been charged costs that
17 range from \$3 to \$7 under Class for distressed milk. There
18 are those safety valves in the Federal Order system and they
19 are used.

20 Finally, I'll move back to my prepared testimony.
21 The Need to Rethink Regulated Pricing Structure.

22 Leprino appreciates the efforts of Secretary Ross
23 to stimulate a dialog about revisions in the regulated milk
24 pricing system that are needed in order for all sectors of
25 the California dairy industry to thrive and leverage growing

1 global opportunities. Over 13 percent of US milk is now
2 exported in the form of various dairy products. Leprino and
3 many other manufacturers have made significant investments
4 in developing exports that will drive up demand for US dairy
5 products, and along with it, the demand and price for raw
6 milk. These are the opportunities that will raise all ships
7 and restore financial health to the industry. It is time
8 that we ensure that our milk pricing system facilitates
9 rather than inhibits leveraging this opportunity.

10 In addition to reviewing the milk pricing system
11 in the context of global opportunities, the industry needs
12 to collaborate about the regulated pricing system in the
13 context of production concentration that threatens the
14 Department's ability to publish the cost data necessary to
15 have an informed discussion in the hearing process that
16 keeps end product price formulas relevant. Even without the
17 confidentiality issues that will restrict publication of the
18 cost study reports for some products, patterning make
19 allowances in the regulated price formulas after very large
20 scale efficient plants creates a barrier to entry for plants
21 that are not of comparable scale. The maturity of the
22 California industry makes small and medium scale plant
23 investments more likely than large scale plants. But those
24 plants will find it difficult to achieve the cost structures
25 provided for in the make allowances. The industry should

1 step back and discuss long-term objectives and align the
2 policy tools with those objectives.

3 The Department should reject the Western United/
4 Producer Coalition proposal and the entire industry should
5 dedicate its energy and efforts toward longer term policy
6 reforms that will benefit all sectors, including producers.

7 Thank you for your time and consideration. I
8 respectfully request permission to file post-hearing briefs.

9 HEARING OFFICER ROWDEN: Your request is granted.
10 Questions?

11 MR. EASTMAN: I guess I can write my questions
12 faster than they can. I have a couple of questions. The
13 first one is when you were talking about risk management you
14 mentioned NASS Class III futures, is that what you said?

15 MS. TAYLOR: Yes.

16 MR. EASTMAN: Do you think that maybe when you
17 submit your post-hearing brief you could explain a little
18 bit, amplify exactly maybe how the liquidity or how that
19 market has come on.

20 MS. TAYLOR: Certainly, I'd be glad to.

21 MR. EASTMAN: Give just some background-type
22 information.

23 MS. TAYLOR: Certainly.

24 MR. EASTMAN: When you were discussing the topic
25 of depooling you mentioned that obviously there's some

1 plants that would contract with co-ops to get their milk and
2 then you mentioned that others, I imagine, would just be
3 contracting with independent shippers. Is that --

4 MS. TAYLOR: Yes.

5 MR. EASTMAN: -- what you were hinting at?

6 MS. TAYLOR: Yes.

7 MR. EASTMAN: And so do you feel that when they
8 are negotiating below class or for below class milk prices
9 do you think that the range that they negotiate is always
10 in-between the Class III and say the blend price in that
11 area or does it go beyond that? You mentioned that range.
12 I'm just curious if that tends to be the range or it can
13 even go to different places or points?

14 MS. TAYLOR: In the case of depooling, economic
15 depooling, the reason why I used the blend is one of the
16 benchmarks is using a basic assumption that most of the
17 competitors in the marketplace will be paying blend. And so
18 to stay competitive you would be using that as a, as a
19 benchmark. Theoretically, you could have periods of extreme
20 surplus where it would go below blend. But typically the
21 window I would expect in a depooling scenario would be to
22 essentially capture the spread between the Class III and the
23 blend.

24 MR. EASTMAN: And then you mentioned that over the
25 last couple of months the plants, Leprino's plants have

1 taken distressed milk at below class prices. And I'm
2 curious, what areas of the country were those plants located
3 in?

4 MS. TAYLOR: And I should clarify.

5 MR. EASTMAN: Okay.

6 MS. TAYLOR: I was offered and I was charged, I
7 did not take it. We didn't have the plant capacity to take,
8 to take that milk.

9 MR. EASTMAN: Okay.

10 MS. TAYLOR: And the charges were when we had
11 plant breakdowns and we had to divert some milk and we were
12 obligated to cover those diversion costs on behalf of our
13 milk suppliers. But that was in Nebraska.

14 MR. EASTMAN: That's the Central?

15 MS. TAYLOR: It's part of the Central Order, yes.
16 My understanding, because I had a lengthy discussion about
17 the appropriateness of that pricing and was given visibility
18 to where that milk was diverted to. My sense is that it was
19 a pretty widespread price surface to spread the distressed
20 milk throughout the Midwest and going somewhat into even the
21 Southwest.

22 There is also a letter that I have that was sent
23 from two of the major co-ops in the Northeast that was
24 outlining the disruptions in the Mideast that caused some
25 significant charges back to producers as well. Again

1 evidence there was milk moving at distressed prices.

2 MR. EASTMAN: And when it comes to distressed milk
3 does that tend to be milk that just either goes above
4 contract or it turns out to be a situation maybe during the
5 spring flush when milk supplies are high? Is it strictly
6 just when milk is long, that's when distressed milk moves or
7 are there other circumstances other times of the year when
8 you would see that happening?

9 MS. TAYLOR: It's typically when milk is long
10 relative to the demand. And that can occur during the
11 spring flush, it can occur during other holiday periods. It
12 can occur Thanksgiving, Christmas. Occasionally it will
13 occur during school breaks, even in the spring depending
14 upon what the overall supply and demand balance is in a
15 particular marketplace. It's most extreme in the spring
16 period.

17 It was, I believe, unusual this year because the
18 first time that I gained visibility to that distressed
19 pricing of \$3 to \$7 this spring was in March. And usually I
20 would have associated that kind of pricing in Federal Orders
21 where you keep production closer to -- well at least in the
22 northern parts of the country where you peak close to
23 Memorial Day, I would have associated that kind of pricing
24 more with the May time period. But it was already at those
25 price levels in March.

1 MR. EASTMAN: So when it comes to that distressed
2 milk then, does that have to end up getting diverted to a
3 non-pool plant in order to -- if you're in Federal Orders is
4 that sort of that mechanism? Is that how that works?

5 MS. TAYLOR: Yes. My understanding is that pool
6 plants -- that there are -- actually there are several
7 different nuances and designations and I probably am not
8 expert enough to go very deeply into it. But we have
9 partial-pool plants, plants that are partially pooled.
10 Actually I suspect the DFA witness could give you all sorts
11 of nuances on how different plants can be designated. But
12 typically it would have to go to somebody who is not a full-
13 pool plant. And cheese plants typically in the Federal
14 Orders are non-pool.

15 MR. EASTMAN: And then I have a question that we
16 have asked of other witnesses today. You could argue that
17 Leprino, since they have plants in California and then
18 plants outside the country where they possibly pay a higher
19 price for milk than in California, as a business model you
20 could leverage that to some extent to beat out your
21 competitors who may or may not have a plant in California or
22 in an unregulated area. How would you respond to that?

23 MS. TAYLOR: It's true that we have capability to
24 produce whey and so we do have a revenue stream that is
25 based on our investment and our innovation, just like any

1 other investment/innovation that people use to differentiate
2 their product lines, to reinvest in our business.

3 Right now it happens to be that we are reinvesting
4 heavily in developing global markets. Our offshore
5 production is limited to the UK to serve the EU. Our
6 objective is to supply areas outside of the EU from a US
7 supply base. We opened a sales support office in Singapore
8 about a year ago with chef talent, marketing, sales. All
9 the kinds of support that you need to really break open that
10 market. So yes, we do have a revenue stream that we are
11 benefiting from and we are reinvesting it into developing
12 markets.

13 MR. EASTMAN: And I just have one more question.
14 I may not be popular today, or this afternoon.

15 On the second page of your testimony at the end of
16 the second paragraph under the Regulatory Backdrop section
17 you mention a few scenarios. At the end you mention a
18 scenario where that -- if you have a local plant that is not
19 able to -- does not have a whey revenue stream, the
20 inability to handle that situation, that ultimately that
21 probably would end up with that plant closing. Is that more
22 of a theoretical type argument or do you have evidence or
23 data to show that that is indeed happening?

24 MS. TAYLOR: Well that happened. This is under
25 the scenario where you fully value whey or value it at a

1 level that outstrips the capacity of that plant to absorb
2 it.1 And my recollection is that there were at least two
3 plants in California that closed prior to the change in the
4 whey factor in 2007. I do -- I am not familiar with the
5 location. So it is a theoretical scenario from the
6 perspective of, you know, remotely located plant with few
7 other good market opportunities. But from the perspective
8 of, do plants get forced out if you overvalue the milk
9 minimum pricing perspective, that is not theoretical.

10 MR. EASTMAN: And so do you have any sense or do
11 you know of any plants that are going to be possibly closing
12 their doors under that scenario since, say, last summer's
13 hearing then we implemented the sliding scale and moved away
14 from the fixed 25 cent value.

15 MS. TAYLOR: I am not directly familiar. There
16 were other witnesses in this hearing that referenced three
17 plants that they knew of. And my understanding is that
18 Imperial Cheese did submit a letter, I have not seen it.
19 But I did take a look on Mapquest last night at the distance
20 between Imperial Cheese and what I presume would be the next
21 closest whey processing location, and Visalia is my
22 assumption but I haven't done thorough research on that, and
23 that's 400 miles. My sense just looking at where El Centro
24 is located relative to other markets is that if there are
25 producers associated with that plant in that region at this

1 point in time it may be the scenario that would face them if
2 that plant closes, but that's conjecture.

3 MR. EASTMAN: Great, thank you.

4 MS. GATES: Just one quick question. The Leprino
5 plants, the Tracy plants are already at capacity, correct,
6 if I understood correctly?

7 MS. TAYLOR: They are operating at our desired
8 capacity at this point in time. We have a little bit of
9 headroom, not much.

10 MS. GATES: But based on sales?

11 MS. TAYLOR: Yes.

12 MS. GATES: Your contracts.

13 MS. TAYLOR: Yes.

14 MS. GATES: Thanks.

15 HEARING OFFICER ROWDEN: All right, thank you.
16 Jared Fernandes. Please state your full name, spell your
17 last name and for the record let us know what your
18 affiliation is.

19 MR. FERNANDES: The name is Jared Fernandes, the
20 last name F-E-R-N-A-N-D-E-S. I am a dairyman partnered with
21 a family partnership called Fernoak Farms in Tulare,
22 California.

23 Whereupon,

24 JARED FERNANDES

25 Was duly sworn.

1 HEARING OFFICER ROWDEN: Please.

2 MR. FERNANDES: This is my first hearing I have
3 ever been to. I'm a young producer, third generation dairy
4 farmer. Watched my dad, learned from my grandpa. I've been
5 tackled as the next generation to try to minimize our risk
6 in our operation.

7 We always had a support price that kept a pretty
8 good floor for us and now in the last four or five years,
9 ten years, we have had this extreme volatility in our
10 industry and we can go through periods where we lose a lot
11 of money. So I am not going to go over how times have been
12 tough, you have heard enough of that testimony in this
13 hearing.

14 But my goal is to try to minimize our risk in our
15 farm. Had a lot of pressure from our bank to minimize our
16 risk. The way they tell us is, the more risk you can
17 minimize is less risk for us also.

18 About three years ago I decided i was going to
19 start learning now to hedge, hedge milk and protect my
20 floor. And I started enrolling in some hedging classes and
21 research brokers from throughout the country.

22 One of the first things that I realized is
23 dairymen in California don't hedge, we don't hedge our milk.
24 And why is that, I asked. Why don't we hedge our milk?
25 It's because we have so much basis. And the basis that the

1 Midwest producers can use and the Class III price to hedge
2 and we have our California price, there's this basis.

3 But I have been advised that you still should
4 hedge 40 percent of your milk that relates to the Class III
5 and your 4b and you typically will have a basis that ranges
6 from 50 to 75 cents a hundredweight. As long as you can
7 monitor that basis it's not -- the risk isn't as bad because
8 you've just got to bank on you're going to lose about 50 to
9 75 cents below the Class III price.

10 So the last two years I've decided to -- I figured
11 the only way I'm going to learn is I'm going to have to
12 start doing some hedging and start playing this game. And
13 the last year I hedged 45 percent of my milk. I put 45
14 percent of my milk into what's called a Call Option because
15 to put a floor on your milk is extremely expensive. And you
16 can't afford -- even if your cost production is \$16, \$17,
17 you can't afford to protect that floor so you have to go
18 somewhat below as disaster insurance. And in order to pay
19 for that floor you have to sell the Call. So you have to
20 sell the top end to give up -- take that money to help pay
21 for the floor.

22 So the last year I put a Call of around a \$15
23 floor with an \$18 top. So I figured my cost production was
24 somewhere in the \$16 range. I had protection on 40 percent
25 of my milk below 40 percent. But if milk went up to \$20,

1 \$25, I'm going to give up that profit. But I am not greedy.
2 I am not out here to make a killing, I am out here to
3 protect my bottom line to keep my banker happy and to stay
4 in business.

5 Well this last year I got to experience extreme
6 volatility in the basis and now I have lost all confidence
7 to even hedge milk. I experienced this year prices above
8 the Call, so I was losing money. But yet my price was in
9 the range but I saw the spread go from a typical 50 to 70
10 cents in December of close to a \$2 spread over my over-base
11 price. And so I had to experience milk money coming out of
12 my check on the call without my price being protected.

13 Now I have continued with those options forward
14 because you make these decisions well in advance and I had
15 protection throughout this year too. I feel more
16 comfortable having those protections. But I think that if
17 we could get the price closer to the Class III price it will
18 reduce our risk of hedging our milk, which in the long-term
19 makes us less risky and safer and gives us the ability to
20 stay in business.

21 I know that when I -- I am still a basic learner
22 on hedging milk. I'm still learning a lot about it, there's
23 a lot more to learn. But the one tool that we have that we
24 use is mainly the Class III hedge. And that's predominately
25 because of the liquidity in Class III.

1 There was a comment about there's other markets
2 out there to use and I have been advised to use Class III
3 just because of strictly liquidity. The liquidity is not
4 quite there in the other forums. There is Class IV futures,
5 there is cheese futures, there is whey futures. I'm
6 starting to learn about these things and these may be tools
7 that we are going to use in the future. But I wasn't
8 advised a year ago to use those tools, I was advised to use
9 the Class III. And strictly because of liquidity in those
10 fields.

11 And I just -- I would love to continue to hedge
12 milk. I would just love to see the consistency of the price
13 to stay as close to the Class III. It just makes it easier
14 for us to do anything. And that's mainly all I wanted to
15 testify about.

16 HEARING OFFICER ROWDEN: Questions? Thank you
17 very much. Mr. Hollon.

18 MR. HOLLON: Let's see, we're on page two?
19 (Laughter.)

20 HEARING OFFICER ROWDEN: Actually you are on page
21 eight and we're starting with the paragraph "Additionally."

22 MR. HOLLON: On page eight.

23 HEARING OFFICER ROWDEN: Yes.

24 MR. HOLLON: Additionally, there is no discernable
25 pattern of different behavior surrounding the months in

1 which milk was depooled.

2 This section is talking about, again, depooled
3 milk and the information that is in Table 6.

4 Reviewing the five price comparisons from the
5 month prior to the month of depooling, and from the month of
6 depooling to the month after, confirms that depooling did
7 not add to the handler's ability to pay as a whole. In some
8 month-to-month comparisons the value over Class III went up
9 and in some months it went down. It seems clearer to
10 conclude that the general level of pay over a multi-month
11 period remained about the same regardless of the pooling
12 status. This is logical as any firm's strategy to attract
13 and maintain a milk supply must be a long-term plan and
14 cannot be based on a single or a few months' market
15 conditions.

16 I'm going to skip the next paragraph. I think
17 that point has been referred to half a dozen times.

18 Pool Plants Versus Non-Pool Plants in Federal
19 Orders.

20 There also seems to be some misunderstanding of
21 the role that pool and non-pool plants in Federal Order
22 process. A pool plant is one that meets the various but
23 specific definitions of a plant. A pool plant may be a
24 plant with high Class I or II usage like a bottling plant
25 with fluid milk production and/or cultured products and/or

1 ice cream and cream products, or a plant that manufactures
2 butter, milk powders, condensed milk products or cheese
3 products. A pool plant may be cooperative owned, privately
4 held. A special class of pool plants is a supply plant that
5 serves the purpose of assembling and shipping milk to the
6 market and providing balancing services to the market and
7 frequently manufactures dairy products also. A non-pool
8 plant can do all of the above except produce Class I fluid
9 use products. However, the key point to realize is that the
10 milk delivered to a pool plant or to a non pool plant is
11 included in the Orders' equalization pool by the seller. In
12 Order terms that's the handler on the milk, so as to collect
13 values from the Order pool. The handler completes all the
14 necessary reporting requirements to have the milk included
15 in the Order blend price pool. They insure that all the
16 rules are complied with. Unlike California where milk is
17 included in the pool unless it opts out on an annual basis,
18 milk that participates in a Federal Order must meet
19 performance requirements that are defined by each Order.
20 The types of requirements are generally identical, all
21 producers must deliver some quantity of milk to the market
22 and that delivery earns the right to associate milk with the
23 pool. I referred to those earlier as producer touch base
24 rules. DFA, as a pooling handler, makes sure all of the
25 milk of its members meets the requirements monthly, reports

1 to the Market Administrator as required, submits and
2 collects monies from the pool and pays its members. The
3 billings to pool and non-pool plants are not different due
4 to pool status. We negotiate prices in the same manner.
5 Negotiations may be based on service level, component make-
6 up, seasonal variation or contractual performance. They may
7 be on a spot basis or long-run basis. Most if not all price
8 negotiations have the appropriate Federal Order minimum
9 price either directly or in component form as an initial
10 minimum reference point.

11 Equally important is our settlement with the
12 Federal Order pool is made on the basis of the appropriate
13 Class price. That is when we remit or collect funds from
14 the blend price pool the Market Administrator determines our
15 payment, assuming that we collected the minimum class price
16 on the transaction. If a sale is made for more than the
17 minimum price the over-class value belongs to the seller and
18 is not netted against the pool payment; if a sale is under
19 class value the seller's ability to pay producers is reduced
20 because the seller is not made whole by the Order for under
21 class values. The pool integrity at the class price minimum
22 values is maintained. So the seller either collects at
23 least the minimum class value from the buyer or pools the
24 milk and settles with the pool at the minimum class value.

25 Dealing with temporary oversupplies of milk

1 production.

2 In several prior decisions it has been advanced that
3 somehow the state's responsibility is to provide for prices
4 that will clear the market and not allow for chronic levels
5 of excess milk supplies. We do not think this is the
6 responsibility of the state. We don't find that language in
7 the statute, and perhaps of equal importance, we don't find
8 evidence of action that would cause us to believe the state
9 is fulfilling that role.

10 In the California market, only producers bear the
11 burden of dealing with excess supplies of milk. They both
12 capitalize and operate facilities to deal with excess
13 supplies, pay for the balancing of those supplies or
14 institute plans to reduce milk production. There is no
15 evidence that in the last period of temporary oversupply,
16 roughly January 2008 through June 2008 -- I think that
17 period was referred in some information in Mr. Scheik's
18 testimony also -- with estimated milk production exceeding
19 capacity in the months of February or May was solved by any
20 action of CDFA. In fact, during that period the change in
21 whey factor contribution, and that was when the 25 cent cap
22 program started, resulted in a positive contribution to
23 producer revenues compared to the predecessor formula.

24 The rapid reduction of milk supplies was
25 overwhelmingly the result of the institution of producer

1 base plans by the major cooperative suppliers in the state,
2 including DFA.

3 I might add at this point that I have been
4 involved in numerous conversations with milk suppliers and
5 regulatory groups and trade associations from other parts of
6 the country asking, how did that happen? Did that base plan
7 work? Because typically in our industry, as was pointed out
8 yesterday by one or two of the producers, sometimes it's
9 hard to have base plans because dairy farm members are
10 pretty independent and decisions by co-op boards to put in
11 base plans are pretty difficult. They are not made easily.

12 There's lots of haranguing and harassment, occasionally
13 there is legal action. And so to put them in place is a
14 pretty major ordeal.

15 The current 2012 situation has been dealt with by
16 the restart of cooperative base plans that resulted in milk
17 production cutbacks. I forget his last name, the gentleman
18 who spoke earlier in the morning who talked about getting
19 two letters. He's in two different co-ops with two
20 different base plans. He got letters explaining them
21 happening. Made decisions and made responses to those
22 letters. The DFA restart has served its purpose and the
23 assessment on over-base production has been eliminated
24 effective June 1.

25 Additionally, seasonal fluctuations that result in

1 short-term over-supplies of milk are a usual occurrence in
2 our industry because of the nature of the milk production
3 and the seasonality of demand. We need to recognize that
4 some surplus balancing will always be a part of our industry
5 and as a result should be recognized by CDFA.

6 Small plants and whey processing.

7 I would like to ask a question of those that
8 requested the hearing workshop for a schedule to be expanded
9 of plants that process liquid whey. And I have to admit I
10 didn't go back and look at the website but were you able to
11 generate a table on that? The table that exists was plants
12 that processed -- and I think that's only dry whey. And
13 we'd asked if there could be more detail on plants that
14 processed liquid whey?

15 MR. EASTMAN: I don't remember that request.

16 MR. HOLLON: Okay.

17 It has been noted that smaller plants are not able
18 to recover the costs or generate revenue or profit streams
19 from marketing whey. This is imply not true in our
20 situation. The DFA Turlock, California cheese plants falls
21 into the Group 7 category, two levels below the large plant
22 category of the table. The Pounds of Milk Processed into
23 Cheese published for the hearing workshop. We manufacture
24 Italian variety cheeses. We further process the liquid whey
25 via a fines saver process, a separator process, a filtration

1 system process and produce a pasteurized product for sale in
2 condensed liquid form. We sell this product in several
3 markets as food grade whey and the byproduct as animal feed.

4 At this time we do not manufacture any dry whey products.
5 In 2011 our plant was profitable and the whey operations
6 contributed 17.5 percent of the plant's gross margin.

7 I'm going to skip the next paragraph for that too
8 has been referred to.

9 In summary, we have shown that Federal Order Class
10 III is the appropriate price for the Secretary to use as a
11 benchmark for the Class 4b price in meeting the standard of
12 a price that bears a "reasonable and sound economic
13 relationship with the national value of manufactured milk
14 products." The Class III price is the minimum price
15 standard for approximately 75 percent of the nation's milk
16 supply. As such the CDFA 4b price should value whey in its
17 formula in a manner similar to that of the Class III. We
18 have demonstrated that the prospect of depooling milk in
19 Federal Order manufacturing plants does not does not yield a
20 competitive advantage to those plants. And in the largest
21 competitive sphere, Federal Order 30 plants consistently pay
22 above the Class III price, even after adjusting the price to
23 standard components and the producer price differential
24 values. There was no discernible pattern of advantage or
25 disadvantage from depooling when examining mailbox prices.

1 We note that concerns over excess surplus volumes should not
2 be an issue for this proceeding as only producers absorb the
3 cost of dealing with that issue. There is no evidence that
4 any action of the state has caused any corrective behavior
5 int his regard. We have also noted our own cheese plant,
6 not among the largest plants in terms of capacity, is able
7 to have a profitable whey marketing business. And we raise
8 the question of how can the state perpetually justify the
9 position that all dairy farmers should willingly subsidize
10 small manufacturing plants forever.

11 Finally, we want to call your attention to an
12 active and ongoing campaign to specifically recruit
13 California dairy farm families to invest or even move their
14 farms to the I-29 corridor in South Dakota. Members of what
15 is termed the "I-29 team" are running billboards in
16 California, placing ads in the dairy press, visiting farms
17 and hosting farmers. While the tag line "No Base, No Quota,
18 Milk Your Cows in South Dakota" grabs your attention, it
19 will certainly cause California farmers to consider the
20 alternatives.

21 The milk processing and procurement and feed
22 companies involved in the recruitment among others --
23 include among others, Agropur, Bel Brands, Davisco Foods and
24 Valley Queen. I would make a comment, we do business in
25 some form with all of those companies and they are all

1 sizable cheese manufacturers, credible businesses. You
2 know, solid competitors and customers. Other partners
3 include the state of South Dakota and the lending firm, Bank
4 of the West and Farm Credit Services of America.

5 In a recent Cheese Reporter story Jon Davis of
6 Davisco Foods was quoted as "We're collectively trying to
7 organize a movement to recruit any dairy farmers who
8 currently don't milk cows here."

9 Tim Czmowski of Agropur's Hull, Iowa facility
10 specifically credited the state of South Dakota for a strong
11 effort and desire to grow dairy. He went even further in
12 nothing, "The Governor and his team have declared and
13 identified the growth of dairy as the number one economic
14 development opportunity." he said. "The governor and
15 Secretary Bones wanted those 10 to 12 dairymen in Tulare to
16 know the state of south Dakota is open for business. They
17 wanted them to know South Dakota was ready to work with them
18 in regard to permitting. There is ample feed, ample water
19 and ample space to grow. The reaction I saw was really
20 positive. They're pretty pro-business in South Dakota. And
21 he, the governor, was stressing to those farmers that we
22 want them to grow with us."

23 I would add that we are familiar with other
24 similar efforts led by Secretaries of Agriculture in other
25 states, none quite as active as this one. We have been

1 approached by at least one Secretary of Agriculture to say,
2 we'd like to understand better how the California dairy
3 model works, could you set up a tour for us to go out to
4 California and visit some dairies.

5 These South Dakota plants are located Federal
6 Order markets, paying premiums for milk above the Class III
7 price and paying values for whey that reflect what we are
8 proposing rather than the current price.

9 We hope both the Secretary and the Governor will
10 see the importance of keeping dairy number one in
11 California.

12 Again I want to thank you for the opportunity to
13 testify. And I do request the opportunity to submit a post-
14 hearing brief and we'll be happy to answer any questions the
15 panel may have. And I would like to address a handful of
16 questions that have been asked of some of the other
17 witnesses earlier in the proceeding.

18 HEARING OFFICER ROWDEN: First of all your request
19 for a brief is granted.

20 MR. HOLLON:

21 HEARING OFFICER ROWDEN: Questions from the Panel?

22 MR. EASTMAN: All right, I was just going to go
23 through some of the attachments.

24 MR. HOLLON: Yes.

25 MR. EASTMAN: Obviously you brought a number of

1 things. You have to bear with me here a second. I think
2 for the most part a lot of these are pretty straightforward
3 in terms of what they show and where the data came from.

4 MR. HOLLON: Yes.

5 MR. EASTMAN: The first question comes from Table
6 4.

7 MR. HOLLON: Yes.

8 MR. EASTMAN: And so I wanted to ask you, was this
9 data, is it publicly -- is it on a website, did you ask for
10 it specifically and receive it from USDA or where -- what
11 was the source, so to speak?

12 MR. HOLLON: The source is AMS; it is not publicly
13 available. The 2011 number is publicly available and it was
14 published in Dairy Market News, of which date I don't have
15 but I'll be glad to give you my copy. But it was -- the
16 2011 number was. The 2000 to 2010 numbers I requested AMS
17 to produce those for me and Joe Gaynor, who is the Branch
18 Chief, did so. And of course they indicate depooling
19 volumes by Orders for all collectively. And you know what,
20 the trend has been to a great reduction.

21 MR. EASTMAN: When it came to -- I'm assuming that
22 when you requested the data did they provide details about
23 what would be included or not included in the data set?
24 Whether this is just milk that's pooled just for -- I mean
25 depooled just for price considerations or --

1 MR. HOLLON: That is correct.

2 MR. EASTMAN: Is it just for that?

3 MR. HOLLON: It is just --

4 MR. EASTMAN: Because I know in your testimony you
5 did give a number of different --

6 MR. HOLLON: Only Item 4 in my testimony is
7 included. And I inquired about that to make sure that I
8 would know what the table represented.

9 MR. EASTMAN: Do you know whether or not under the
10 other options besides this one item, number 4, did they have
11 data regarding the other circumstances?

12 MR. HOLLON: They did not.

13 MR. EASTMAN: It's not collected or they weren't
14 able to --

15 MR. HOLLON: It's not collected that I'm are of.
16 Part of their audit process, they would check and see if a
17 producer touched base or not. Typically we find that out,
18 to our dismay, after the fact when the milk is then depooled
19 if the producer didn't meet that requirement.

20 On a month-to-month basis your handler diversion
21 limits, those are calculated at pool time. If for some
22 reason you were not able to pool all your milk you generally
23 know that but they don't keep any tables on that. I asked,
24 I asked that question.

25 MR. EASTMAN: I imagine you would have, that would

1 be a smart question to ask.

2 When it comes to -- we heard a couple of different
3 categories of milk, you have non-pooled or depooled milk and
4 then you have discounted or distressed milk. Do you have
5 any sense of whether any distressed milk data would have
6 made it into this or was this strictly just depooled for
7 pricing reasons?

8 MR. HOLLON: This is strictly depooled for pricing
9 reasons. And again I would say, I am not aware of any milk
10 that was depooled for distress purposes. In fact, it would
11 -- you depool for economic -- we'll go to the next table for
12 a minute.

13 MR. EASTMAN: Okay.

14 MR. HOLLON: This is 2011. Took the Class II
15 price, the Class III price, the Class IV price, the Blend at
16 the base zone in Order 30 and just simply subtracted them.
17 And so in January if you were in charge of pooling milk for
18 DFA on Order 30 and you had sales to a Class II stand-alone
19 ice cream plant, it's pretty difficult to do if it's an
20 integrated plant. But you have a stand-alone ice cream
21 plant, stand-alone yogurt plant, stand-alone cottage cheese
22 plant. You would do your estimates and you would say, I
23 know the Class II price is 16.79, the best guess the Blend
24 is going to be 14.12, I think I'll not pool that and keep
25 that \$2.67 in my pocket. And you may do that and you look

1 at Class III and say, no, there I've gained 64 cents.

2 So if you were in a distressed milk in January,
3 you would say, well gee, I'd like to get the 64 cents
4 because distressed is not, is not returning me very much.
5 So you probably would make that decision.

6 And as you look down this table, you look down for
7 the course of the year and you count the Class IIs, there's
8 one-two-three-four-five-six-seven-eight-nine times -- eight
9 times that would be an economically positive decision if you
10 could estimate it correctly in advance.

11 Class III it was only one time. Again at the base
12 zone.

13 In Class IV, one-two-three-four-five, five times.

14 So in the table that's published in the hearing
15 record or in the workshop notice that outlines those
16 categories, really it looks like most of the time in 2011 it
17 was Class II and Class IV milk. so even a smaller --

18 MR. EASTMAN: I assume the red map, that's just
19 the boundaries of Federal Order 30, correct?

20 MR. HOLLON: That is correct. In terms of some of
21 the analyses that I did. And I made a point of saying, the
22 mailbox milk price I chose was Wisconsin. I wanted to point
23 out it was almost all in the marketing area. The biggest
24 piece of the marketing area.

25 MR. EASTMAN: Now if I remember correctly Table 6,

1 which is the grand-daddy of all the tables.

2 MR. HOLLON: How about that

3 MR. EASTMAN: I guess it's the Rose Bowl.

4 (Laughter.)

5 MS. GATES: It's so he could read it and see it.

6 MR. EASTMAN: Yeah, I appreciate that. Some of us
7 don't have young eyes.

8 MR. HOLLON: I was thinking of Mr. Dryer's comment
9 about 60. It didn't sound too bad to me. (Laughter.)

10 MR. EASTMAN: All right. So with this it looks
11 like this data just comes from probably the Market
12 Administrator Office, Federal Order 30.

13 MR. HOLLON: It all comes from the Market
14 Administrator office but it is not all easy to obtain in one
15 fell swoop.

16 MR. EASTMAN: Okay. So they may have had to --

17 MR. HOLLON: Not they.

18 MR. EASTMAN: Oh, you did, okay. So they pointed
19 you in some directions and you had to do all the hard work.

20 MR. HOLLON: Well, I knew where the directions
21 were but it still had to be done that way. Have years, how
22 many pounds were in the pool, what was Class III, what was
23 the blend, the Class III price.

24 And in order to get an apples and apples
25 comparison -- I mean, the mailbox price has values of

1 components over standard. So you say, gee, that's going to
2 be higher but it's got extra component value in it. It's
3 also got the value embedded in it that the regulation brings
4 us, the PPD. So if I wanted to make a comparison I ought to
5 try to take those things out to have an apples and apples
6 comparison the best I could make.

7 MR. EASTMAN: And that one was column -- once you
8 have corrected for the standard components, et cetera,
9 that's 24?

10 MR. HOLLON: Twenty-five. That's right. It's 24
11 after it's been corrected and 25 is the difference.

12 MR. EASTMAN: Perfect.

13 MR. HOLLON: So if you were to take the results of
14 the tape, of the chart -- I'm sorry, the results of the
15 large spreadsheet and look at Chart 1, you can take -- you
16 can look and see that there was only one month out of a
17 bunch of months that there was a payment below Class III.
18 Lots of months there were payments well above Class III.
19 The red bars are the months when milk was depooled. And so
20 it was pretty hard for me to conclude from, you know, this
21 information that there was a financial advantage to the
22 people who depooled milk.

23 And I would point out one other thing, at the risk
24 of Federal Order minutiae, you would go back to the last map
25 that's green, the Class I Price Surface. Unlike California,

1 everyone gets the same blend price in California. And the
2 transportation, what accommodations are made for
3 transportation in California is done outside the pool
4 structure. Generally inside the Order system and in all
5 Orders there is some special accommodations in some Orders
6 that's done inside, if you will, of the Blend price
7 structure. So the Blend is announced at the primary
8 consumption point, which would be Chicago in this Order.
9 And then the price is scaled back to the milk supply.

10 So when I compared the PPD, when I took that value
11 out, I was taking out the PPD at the base zone in Chicago,
12 where there's not many farms in Chicago. There's no cheese
13 plants left in Chicago. And they're all further out. So
14 actually the scenario if I had perhaps said, well okay, how
15 about if I use the \$1.70 because that has most all the
16 cheese plants in it. I would have gotten -- all of the blue
17 bars and Chart 1 would have been even bigger. But sometimes
18 that is a hard thing to explain so I used the base zone for
19 the basis of my comparison. And again, blue bars and even
20 the red bars are above the line.

21 And our proposal is not saying, you've got to pay
22 exactly Class III to be parity. And besides, these guys are
23 paying even more so you have to do what they do. But, you
24 know, we're looking at a minimum. And not even -- I think
25 Mr. -- the Western United proposal had some data that said

1 the proposal would result in something less than the Class
2 III price.

3 So I want to hopefully put some, you know, data to
4 go along with the comments of our point that I think that
5 the depooling issue is a Trojan Horse. And so I hope the
6 decision doesn't ride on it.

7 I would like to make a comment about
8 Mr. Gallagher's addition.

9 MR. EASTMAN: So you're going to make a comment
10 about this appendix, this exhibit?

11 MR. HOLLON: Yes, there's three points I want to
12 make. In fact, one of them was made pretty eloquently by
13 Mr. Fernandes just now. Mr. Gallagher is a DFA co-worker.
14 He has been involved in dairy risk management for over 15
15 years. If you wish you can read his speeches and
16 presentations but he would be considered an expert in the
17 field if there was such a thing.

18 At the bottom of the paragraph, the very bottom
19 paragraph. He has discussed dairy risk management with
20 thousands of dairy farmers. Our own DFA hedging program we
21 have four people who are out in the country, much of the
22 time explaining the program, how it works. We do seminars,
23 we explain, we set up. And there's a real person you can
24 call that you don't have to punch three numbers to get to
25 the person to do it.

1 The second paragraph on the next page. I want to
2 read that paragraph because I think it hones in on the
3 point. And this was the point that Mr. Fernandes made.
4 "From 2005 to 2010, the Class III basis generally was in a
5 range of +\$1 to -\$1.50 --". And if you remember he said
6 that he could generally expect the results of his hedge to
7 need to be adjusted by about 75 cents. And as long as that
8 was consistent he could work with that. "-- with few
9 divergences outside the range." And there's a chart in the
10 back that I want to show that shows this.

11 "Although not exact, California dairy farmers
12 could expect that an \$18, for example, Class III
13 hedge would result in a pay price of around \$16.50
14 or better. Now the basis has become more negative
15 and uncertain with ranges between -\$1 and -\$2.50.

16 Combined with higher production costs and with
17 feed being contributing factor, the change in
18 Class III basis is an economic shock to the system
19 and negatively impacting California members'
20 ability -- California dairy farmers' ability to
21 hedge."

22 And again as Mr. Fernandes said, the second to the
23 last paragraph talks about the confidence in using the tool.
24 It begins to erode. That's graphically -- look at Exhibit,
25 the Graph G-3 where you see that trend. It goes from

1 January of 2000 up to about 2009 or '10. Here are some
2 spikes, you know, up and down. But if you were to eyeball
3 an average of about 75 cents you could see that. You get up
4 to 2010 and the line falls off pretty dramatically. and so
5 that says, if you want to use this tool, now how much you
6 estimate your estimates are going to be off has grown by a
7 bundle. And we would say that our proposal would have an
8 effect on that.

9 There was a comment made, it was a question asked
10 of one of the earlier witnesses about shouldn't the solution
11 -- I'm going to paraphrase. But shouldn't a solution be all
12 California stuff? And I just want to point out that in the
13 Federal Order make allowances there is California data
14 included in the nonfat dry milk make allowance, the whey
15 allowance and the butter make allowance.

16 And if you go back to those records of those prior
17 price formula decisions you would see that CDFA data and
18 part of Mark Stevenson's data where he actually came out to
19 California and took his model and worked through with Ms.
20 Reed to see how it compared with what you were doing here,
21 and some of that information was used in those make
22 allowances. So I think it's fairly safe to say that if that
23 is a criteria there is some weighting of that.

24 Amber asked several persons some questions about
25 cows are up, milk production is up and farms are out and

1 down. On the surface that doesn't compute. I want to point
2 out a couple of things that just in the first half of this
3 year I went back and had someone pull out for me temperature
4 and rainfall data.

5 We picked Visalia because it's in the heart of the
6 big production area. And January temperature was higher
7 than average and higher than any other year by a small
8 amount except for 2010. February was the same, temperature
9 was higher than average and higher than any other year
10 except 2010. So temperature-wise we were able to get a jump
11 on the flush. And if you go to the remaining March, April
12 and May, we moved back around to about the norm but warmer.

13 Look at precipitation levels, same thing.
14 Rainfall was .42 average for 2012. For those four months an
15 average is 1.24 inches, so like way less than half. Only
16 one time in 2007 was there less rain. So we had a great --
17 warmer temperatures, drier condition. That same thing
18 happened in February so we got a big jump to the flush. So
19 one of the non-issues was just simply cow comfort.

20 There have been two or three witnesses, one in
21 particular, who talked about sort of the standard holding
22 pens, 90 animals. And you can kind of bounce up but you
23 suffer a little bit in cow comfort, which then you suffer in
24 milk production per cow. The cows are pretty happy. The
25 temperature was pretty good, it didn't rain very much. So

1 that's a non-issue. A non, I guess if you will, price
2 issue.

3 Another question about cow numbers is beef cattle
4 prices have been at all time highs. The agricultural prices
5 was released yesterday. The beef cattle price was like
6 \$121. Average the last five years, \$96. If you look at the
7 five months of this year it's been averaging in the \$120
8 range so it's time to cull. If I want to cull my herd I
9 could get a great price for it so I'm going to take some
10 out.

11 But there's lots of replacements that are
12 available. The USDA's January cattle report indicates we
13 are still at all time highs. Mr. Gailey talked about how
14 because of sex semen and the availability of heifers there
15 is an ample supply. So I can sell my lower end at a really
16 good price and I can buy a replacement heifer at a lower
17 price. So several of those things have just combined, I
18 think, to impact some of that first quarter of this year,
19 first four or five months of this year milk production.

20 Lastly, quite a few questions about distressed
21 milk and so I wanted to, you know, to throw out -- the data
22 on that is going to be pretty -- it's not going to be in the
23 public realm, in the main. There is Dairy Market News
24 information as has been discussed. That tends to hit the
25 headline side of it. And I would say if you're going to

1 give weight to that then you need to go and look in the file
2 and look for their report, the loads of milk that went out
3 of the Upper Midwest into the Southeast. And bear in mind
4 that's going to carry some extreme premium values and there
5 may be some offsets there. And actually, actually that
6 number is pretty hard. They do publish that on a weekly
7 basis and on a seasonal basis.

8 And there have been -- Mr. Ahlem, in the record,
9 he was asked that question. He started out his testimony by
10 saying his plant was approximately 200 loads of milk a day,
11 6,200 in a month. And when the question about distress
12 loads, his answer was "dozens." So I don't know all the
13 particulars with that but dozens against 6200 doesn't -- you
14 know, in whatever forum, doesn't come out to a tremendous
15 amount.

16 I looked in our own records for two locations,
17 first here in California. We have not moved, to my
18 knowledge and I could find out, any loads of milk directly
19 out of state but we have moved condensed milk out of state.
20 And we move about 16,000 loads of milk a month and less than
21 one percent of those moved out of the area. And quite a few
22 of those moved to our own plant so I guess you could argue,
23 where does that go? I would say inside of DFA we have
24 different profit centers so there's sometimes competition
25 for that. But nonetheless it's all, you know, end to end.

1 And I also looked in the Central Area, which would
2 be an overlap with the Central Corridor, milk into
3 Minnesota, milk into Wisconsin. I asked them some similar
4 questions for a crude monthly comparison. And there we move
5 about 12,240 loads of milk in a month. And during March
6 just under two percent of those would have fallen in the
7 distressed milk category.

8 And many, many times in that part of our operation
9 we have year-round negotiations with buyers so that we may
10 prearrange. You know, we'll agree to sell you milk in the
11 fall at this premium and retain the right to have access to
12 your plant in flush times at a different premium. And
13 during the same time period when something under two percent
14 was going in a distress mode the other 98 percent was moving
15 at negotiated values.

16 So again I would -- you know, I guess the comment
17 for the record is to the extent this is going to carry
18 weight, 98 and 2 needs to carry some of that weight. or 99
19 and 1. And these are one or two months out of the year
20 because it doesn't -- it's not a 12 month arrangement. So
21 that further bleeds down. Because I think you will agree we
22 are not trying to set, we are not trying to set the price
23 based on a one month experience. It's part of your
24 responsibility to look at a broad basis.

25 And I think that is the end of my questions I

1 wanted you to ask me so I could answer them. (Laughter.)

2 MS. RANKIN: I have one question that you have not
3 asked yourself yet. (Laughter.)

4 MR. HOLLON: Okay.

5 MS. RANKIN: One page four of your testimony you
6 talked a little bit about -- at the bottom you talked about
7 Idaho and Utah plants.

8 MR. HOLLON: Yes.

9 MS. RANKIN: And how they use their own private
10 end product pricing formulas.

11 MR. HOLLON: Yes.

12 MS. RANKIN: Does that mean maybe using their own
13 manufacturing cost data within their own plant?

14 MR. HOLLON: Yes.

15 MS. RANKIN: Okay. And then you just mentioned
16 that they are leaning towards Class III now.

17 MR. HOLLON: Not leaning.

18 MS. RANKIN: Or they're going --

19 MR. HOLLON: One of the plants changed their whole
20 -- they went out to the members and said, if you'll do this
21 we'll pay you Class III plus this. If you lose Class III
22 plus that -- if you want to do that, we'll pay you Class III
23 minus that. The other plant put out a proprietary formula.

24 Because we sell to them we have some access to that formula
25 and that's the basis of the 90-95 percent correlation with

1 Class III. Trying to figure out what it would be as we
2 negotiate.

3 MS. RANKIN: Thanks.

4 HEARING OFFICER ROWDEN: All right, thank you.

5 MR. HOLLON: You're welcome.

6 HEARING OFFICER ROWDEN: Patricia Van Dam. For
7 the record, your full name, spell your last name and let us
8 know who you're affiliated with.

9 MS. VAN DAM: My name is Patricia Van Dam, V-A-N,
10 D-A-M, and I'm the owner with my husband and son of Two B
11 Dairy in San Bernardino County. And my --

12 HEARING OFFICER ROWDEN: Please.

13 MS. VAN DAM: What? I'm sorry, what?

14 Whereupon,

15 PATRICIA VAN DAM

16 Was duly sworn.

17 HEARING OFFICER ROWDEN: Okay. Please.

18 MS. VAN DAM: I guess pretty much this is going to
19 be the emotional part of it. I have never come to one of
20 these hearings. But listening to all the manufacturers, you
21 know, want to deny the price increase. And I'm thinking,
22 the dairy industry in California has contributed \$8 billion
23 to the state of California. And over the past four years,
24 we used to have 800 cows and now we're down to 500 because
25 of the economics of it. And so when I hear them quibble

1 over that we cannot pass on the increase in production as to
2 what I come from, but yet I can go to a grocery store and
3 see \$5 cheese in good times and bad times. And it kind of
4 makes me sad that in another four years I probably won't be
5 in business just because of the economics.

6 To me this is the emotional part and I hope you
7 take that into account. Thank you.

8 HEARING OFFICER ROWDEN: Any questions? Thank you
9 very much. Rien Doornenbal. You have been sworn in, sir.

10 MR. DOORNENBAL: We have all heard testimony the
11 last two days that milk cow numbers have gone up in the
12 state of California from March 2011 to March 2012. The
13 number of cows that have gone up is 23,000 cows.

14 We have 1625 dairymen in California. The average
15 dairyman in California has 1100 cows on each dairy, on their
16 dairies. If you divide the 23,000 cows by 1625 dairymen,
17 each dairy is only up on the average 14.15 cows. That's not
18 a lot of cows for each dairy to be up.

19 We have heard from Tom Barcellos, Stephen Mancebo
20 and just a few minutes ago from Mr. Elvin Hollon from DFA,
21 why the average dairy in California of 1100 cows would find
22 it efficient -- would find it efficient to be milking what
23 turns out to be, rounded out, 15 more cows in March of 2012
24 than what they milked in 2011. I don't have to go over
25 those reasons.

1 My prior testimony I told you that I sold a load
2 of cows in March. My sweet spot on my dairy is now no
3 longer the number of cows that I milk, it is being right at
4 my base from my co-ops.

5 My second sweet spot on my dairy, if my co-ops are
6 not penalizing me for any production over my base, is 1600
7 cows. A few more are okay.

8 Just today in this room Mr. Francis Pacheco from
9 DFA reminded me that for the month of June there will be no
10 penalties for production over my DFA base. Apparently DFA
11 has economic reasons to let any producer that wants to go
12 over his base.

13 My other co-op I referred to has not been sending
14 me any nasty warning letters lately so I'm assuming they're
15 okay if I go over my base.

16 Guess how many cows I have for sale today? None.
17 Because I am going to produce as much milk as I can and stay
18 right around my sweet spot of 1600 cows on my dairy because
19 that is what I have to do if I have any hope of surviving.

20 I would also like to support Mr. Hollon's
21 testimony that even some processors in unregulated milk
22 price areas depend on the federal milk marketing price to
23 negotiate a price that they contract with producers. I know
24 that -- I know for a fact that a lot of milk in the
25 unregulated area of Idaho and Utah is based on the Federal

1 Order Class III price.

2 For example, I am intimately aware, this is not
3 hearsay, this is -- I am intimately aware of some producers
4 that are contracted with their processor in the Idaho/Utah
5 milk-shed area and they are using the federal milk marketing
6 Class III price. And they are essentially being paid the
7 Class III price plus or minus 25 cents per hundredweight
8 depending on the quality. There is no threat of any kind of
9 depooling because it doesn't apply in an unregulated area.
10 That is the contract that these processors and producers
11 have settled on.

12 And I would be willing to give you more details of
13 -- I would be willing to give the Panel more details of
14 those contracts but the rest of it in this setting would not
15 be appropriate because much of it is proprietary.

16 And that concludes my testimony.

17 HEARING OFFICER ROWDEN: And questions? Thank
18 you.

19 MR. EASTMAN: I just have one quick question. So
20 when you were referring to the cow numbers it sounds like
21 you were just referring to the -- USDA's numbers that they
22 release each month with production and cow numbers when you
23 were citing the 23,000 additional cows, correct?

24 MR. DOORNENBAL: Yes, yes. I am not aware of any
25 other data.

1 MR. EASTMAN: No, that sounds familiar. Just
2 clarifying just for the record's sake.

3 MR. DOORNENBAL: Okay.

4 HEARING OFFICER ROWDEN: Next up is the invitation
5 to the United Dairymen to use up their remaining 18 minutes
6 of presentation.

7 MR. BARCELLOS: Mr. Hearing Officer, Tom
8 Barcellos, President of Western United. We yield the
9 balance of our time and we'll make any additional comments
10 in our post-hearing brief.

11 HEARING OFFICER ROWDEN: Okay. Okay. The
12 Coalition. You guys will have a total of 39 minutes.

13 MS. GATES: No, 21.

14 HEARING OFFICER ROWDEN: No? He said he'd yield.
15 Excuse me.

16 MR. EASTMAN: No, he's giving up the time.

17 MS. GATES: He's giving up the time.

18 HEARING OFFICER ROWDEN: He's giving it up, okay,
19 excuse me. All right, you have 21 minutes. And again, what
20 we're looking for is additional factual information and
21 minimize any argument/rebuttal.

22 MS. MELBY: Thank you. I did not intend to use 39
23 minutes even if I had it. (Laughter.)

24 The dairy families of California have come
25 together completely unified, in total alignment in an

1 unprecedented way to ask the Department to just give them a
2 fighting chance. This kind of overwhelming support without
3 more speaks volumes about the gravity of the fundamental
4 inequities created by a seriously flawed formula.

5 Producer by producer you have heard the facts from
6 those who have firsthand personal knowledge of the negative
7 effects of a pricing system that is failing them, even as it
8 unjustly enriches their processor brothers and sisters.

9 In an effort to preserve a system from which only
10 they can benefit, processors urge business as usual. Or
11 even worse, a rollback to a system that clearly was not
12 working at the time, will not work now and which the
13 California dairy producers strongly oppose.

14 The testimony that we have heard over the past two
15 days from the processors is notably without any
16 documentation or data to support it. We waited and waited
17 for hard documentary evidence to support their position, we
18 did not see it.

19 The testimony appears designed to instill fear
20 based upon unfounded threats of doom based upon the
21 speculation that if the Department considers any reasonable
22 and sound economic relationship with the national value of
23 manufactured milk, as the law requires it to, then
24 processors may consider closing their doors. Such crystal
25 ball predictions --

1 HEARING OFFICER ROWDEN: Excuse me. I'm going to
2 interrupt you. I believe the Panel heard the testimony from
3 all sides and what this kind of sounds like is sort of a
4 summation. So please, stick to facts and statistics, things
5 that are not in evidence right now, please.

6 MS. MELBY: Okay. We thought it would be
7 appropriate to comment on our observations of the testimony
8 as it came in. Is there a rule against doing that? Should
9 we refrain from doing that?

10 MS. GATES: I think what the Hearing Officer is
11 saying is that's coming back as a debate or rebuttal. And
12 the purpose of the hearing is to gather all testimony and
13 evidence based on what you -- you know, your time when you
14 come up to do that. And that's kind of what this whole
15 process is about.

16 MS. MELBY: Right. Well, it's new to us because
17 we heard it for the first time and so the purpose of the
18 presentation was to set forth our observations about the
19 testimony. So that's new to us. Anyway, you'll stop me if
20 I've done something that's not in keeping with the
21 procedure.

22 Our point is that speculation cannot be the basis
23 for any decision of the Panel. That the law really does
24 matter. Just as I cited it in our original presentation,
25 the law is so important. And it does matter and it gives us

1 great guidance and tells us what has to be done here. The
2 playing field does not need to be level. The law gives us
3 the way to do that. It guides the Panel.

4 And the petition sets forth in great detail and
5 we'd like to refer the panel back to the petition, a
6 solution that is consistent with the law that is fair, that
7 is not over-reaching. That the Coalition worked very hard
8 to put together to make it as evenhanded as possible, to be
9 consistent with what the law is and to give them a fighting
10 chance.

11 I walked down the hall several times as I was here
12 over the last two days and I saw that the CDFA has a poster
13 that's out in the hallway. It says, "Be patient and do the
14 right thing." The producers have been very patient, at a
15 cost of \$300 million in 2011, which is mounting in 2012 and
16 soon to be billions of dollars to the producers of
17 California.

18 And now it asks the CDFA to please do the right
19 thing in following the law. Which is mandatory. And it's
20 clear and it's a law that respectfully must be followed.

21 The Coalition asks that the proposed amendment be
22 adopted and that the law be given full force and full
23 effect. Because it's fair, because it's detailed, because
24 it has the full support of all of the producers in
25 California. Because it's not over-reaching. Because this

1 is not business as usual.

2 This hearing is not business as usual. It came at
3 a short interval after the last hearing and a lot of comment
4 has been made, negatively I might add, about the fact that
5 there is something bad about that. We view it to the
6 contrary.

7 The system is working the way the system should
8 work. There is a problem, it needs to be addressed. And if
9 the solution to the problem is implemented consistent with
10 the law, and if that turns out not to be something that
11 works well but we think that it will be, but if it doesn't
12 then there is a procedure for redress. And that procedure
13 is set forth under the law and it will be dealt with.

14 So we ask the Panel to look at the documentation
15 and to data that has been submitted by Mr. Hollon and by
16 others. To consider what is at stake here, which really is
17 the viability of the dairy producing industry in California,
18 and to level the playing field because that is what the
19 statute requires. Thank you.

20 HEARING OFFICER ROWDEN: Questions?

21 MS. MELBY: Thank you.

22 HEARING OFFICER ROWDEN: Okay, the representative
23 from Farmdale.

24 MR. HOFFERBER: We have nothing that we couldn't
25 offer in a post-hearing brief, we'll handle it that way.

1 HEARING OFFICER ROWDEN: All right, thank you.

2 Any other witnesses back there?

3 Okay. Mr. Francesconi.

4 MR. FRANCESCONI: Yes, Mr. Hearing Officer. The
5 Department has received a letter and I would just like to
6 introduce it. And this letter was received from Los Altos
7 Foods Products, Inc. on June 1st, 2012. And it was signed
8 by Raul Andrade. I'm not sure what number you're on but if
9 you can give me that number then I can mark it.

10 HEARING OFFICER ROWDEN: That's Exhibit 66.

11 (Exhibit 66 was received into evidence.)

12 MR. FRANCESCONI: Okay. And that's all I have to
13 include at this time.

14 HEARING OFFICER ROWDEN: Okay, that will conclude
15 the hearing. I would like to remind everyone that post-
16 hearing briefs will be due by 4:00 p.m. Friday, June 8th.

17 Again, is there anybody else that wishes to
18 provide any more testimony?

19 All right, thank you very much for your
20 cooperation. We're adjourned.

21 (Thereupon, the public hearing adjourned at
22 1:31 p.m.)

23 --oOo--

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CERTIFICATE OF REPORTER

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

I further certify that I am not of counsel or attorney for any of the parties to said public hearing, nor in any way interested in the outcome of said matter.

IN WITNESS WHEREOF, I have hereunto set my hand this 11th day of June, 2012.

RAMONA COTA, CERT*478