

Milk Producers Council

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks -\$.0375 \$1.8475
Barrels -\$.0225 \$1.8675

Weekly Average

Blocks -\$.0705 \$1.8445
Barrels -\$.0140 \$1.8680

CHICAGO AA BUTTER

Weekly Change -\$.0325 \$1.2850
Weekly Average -\$.0360 \$1.2915

DRY WHEY

NASS w/e 10/06/07 \$.4126 WEST MSTLY AVG w/e 10/06/07 \$.4050

NON-FAT DRY MILK

Week Ending 10/5 & 6

	Price	Volume
Calif. Plants	\$2.0482	9,711,773
NASS Plants	\$2.0534	13,752,437

John Kaczor is unavailable to write his commodity comments for this week's report. He will be back next week.

FRED DOUMA'S PRICE PROJECTIONS...

OCT 12 EST: Quota cwt. \$20.98 Overbase cwt. \$19.29 Cls. 4a cwt. \$21.19 Cls. 4b cwt. \$17.58

A REPORT ON THIS WEEK'S HEARING REGARDING CLASS 4A AND 4B FORMULAS

(By Rob VandenHeuvel)

Background

This week, the focus of much attention in the CA dairy industry was on a hearing held by the California Department of Food and Agriculture (CDFA) to determine if drastic changes to the class 4a (butter and powder) and 4b (cheese) are necessary. The hearing was requested by several small-to-medium sized cheese manufacturers who argued that due to the recent spike in dry whey values and the ensuing rise in the 4b price, which determines what they pay for their milk, their operations were in crisis mode. Their letter stated, "Cheese manufacturers do not realize the full revenue that is attributed to them by the current 4b formula and are incurring losses that threaten their financial viability." These petitioners pleaded with CDFA to immediately hold an emergency hearing to remove the "whey cost factor" that was added to the 4b formula in 2003.

This is not the first time this request has been made. Cheese makers have asked CDFA multiple times since 2003 to remove the whey cost factor from the formula. In the previous two hearings on this subject, the CDFA hearing panel agreed with the cheese makers and recommended that the whey cost factor be removed from the formula. However, in both instances, the Secretary overruled the panel's decision and maintained the whey cost factor in the formula, although the make allowance for whey was raised substantially in 2006.

In response to this petition, MPC sent a letter to CDFA asking that the hearing request be denied. In that letter, MPC pointed out that the minimum price established by the 4b formula is based on bulk cheddar cheese, the lowest value commodity cheese in the market. So while these small specialty cheese makers are buying their milk based on bulk cheddar cheese value, they are selling their product at the higher prices associated with specialty cheeses. You

can read the letter from MPC here:

http://www.cdffa.ca.gov/dairy/pdf/hearings/2007/correspondencempc_aug21_07.pdf.

Despite this opposition from MPC and other producer groups, CDFA decided there was enough merit for a hearing and scheduled it for October 10, 2007.

The Producers' Compromise

While MPC and other producer groups believe that the current inclusion of a whey factor in the 4b formula is appropriate, an effort began to find a middle-ground that would continue to provide a value for whey products for producers, while also addressing the concerns of the small cheese makers that are unable to process the kinds of valuable whey products that the larger-scale processors are able to. As this newsletter reported last month, an alternative concept was proposed to CDFA on behalf of MPC, Western United Dairymen (WUD) and the Alliance of Western Milk Producers (representing California Dairies, Inc. and Dairy Farmers of America). This proposal would exempt from the whey cost factor the first 100,000 lbs. per day that a manufacturer processes into cheese. It would also tie the make allowance for dry whey to the make allowance for nonfat dry milk plus \$0.03 per pound to account for extra costs associated with processing whey. Finally, the proposal includes a “snubber” that would prevent the whey factor from being negative and draining on the pool when the price of dry whey drops below the make allowance.

Other Alternative Proposals

Most of the other alternative proposals came from processors and requested adjustments to the make allowances for cheese, butter and powder. However, one alternative proposal of note came from California Dairies, Inc. (CDI). Their proposal would create a \$0.50 per cwt. credit for the first three years of operation for any new or expanding plant capacity. Historically, CDFA has used increased make allowances as a tool to incentivize new plant capacity, but CDI testified that it may be more appropriate for CDFA to target those incentives only to new capacity rather than spreading the incentives across all processors. MPC endorsed this concept in our testimony, which can be read at <http://www.milkproducerscouncil.org/oct07testimony.pdf>.

The Hearing

The hearing lasted two days, with witnesses testifying all day Wednesday, and continuing Thursday morning. While each individual witness had a different spin, the presence of two opposing sides was clear. On the one side, the cheese makers argued that the whey factor was creating a formula that dramatically overpriced class 4b milk and that factor needed to be eliminated. On the other side producers argued that the recent whey market has shown that there is a definite value for whey and that it should remain part of the formula.

The day opened up with testimony from the petitioners. Included in this group were representatives from F&A Dairy (Newman, CA), Farmdale Creamery (San Bernardino, CA), and Marquez Brothers International (Hanford, CA). These witnesses told their stories of increased operating costs and their struggles to recoup the whey value as dry whey prices shot up rapidly earlier this year. They argued that producers are receiving a premium due to increased whey value, regardless of whether or not the whey is actually being processed and sold. Scott Hofferber, the Controller for Farmdale Creamery, argued that the wet whey stream coming off cheese operations has zero value in its raw form, and that producers should not be entitled to the profits received by processors that invest in equipment to turn an otherwise valueless byproduct into a sellable commodity.

In addition to the proposal by the small cheese makers, the other major proposal put forth by the processors was presented by Dr. Bill Schiek from the Dairy Institute of California. The Dairy Institute, which represents 34 milk processors in California, proposed the elimination of the whey factor in the class 4b formula, as well as increases to several make allowances and adjustors in the class 4a and 4b formulas. The Dairy Institute is strongly opposed to the compromise presented by MPC, WUD and the Alliance, stating that it would “provide potential relief to only the smallest plants.” They are also strongly opposed the CDI proposal to incentivize new plant capacity, stating that it “treats competitors making the same products or competing for the same inputs differently.”

During his testimony, Dr. Schiek discussed the shortage in processing capacity in California. Some of his remarks included:

- “The regulated price for milk used in manufactured products, particularly cheese, is too high.”
- “Milk output growth is accelerating...dairy manufacturing plant capacity has not been keeping up.”
- “More cheese plant capacity is at risk for loss due to...the whey factor in the class 4b formula.”

- “It is the duty of the Secretary to address this situation.”

Dr. Schiek also echoed the comments of earlier witnesses in arguing that producers should not be entitled to the revenues derived from whey processing operations. In fact, Dr. Schiek went a step further to argue that producers “are not entitled to the cheese, butter, and nonfat dry milk revenues received by dairy product manufacturers either.” Instead, he argued “producers are entitled to a market price that will bring forth an adequate supply to meet the demand for that commodity.”

Other witnesses that supported the comments of Dr. Schiek and the petitioners were John Jeter (Hilmar Cheese), Joe Paris (Joseph Gallo Farms), Sharon Hale (Crystal Cream and Butter Company), Michael McCully (Kraft Foods), Sue Taylor (Leprino Foods Company), and Greg Dryer (Seputo Cheese USA Inc.).

The first witness testifying on behalf of producers was Tiffany LaMendola from Western United Dairymen. Tiffany expressed the producers’ strong opposition to completely removing the whey factor from the 4b formula and outlined the joint alternative proposal drafted by MPC, WUD and the Alliance. Her testimony pointed out that according to CDFSA data, by exempting the first 100,000 lbs. of raw milk per day that a cheese maker processes, 35 of California’s 60 cheese plants will be completely protected from paying *any* whey factor and the remaining cheese makers would receive substantial relief through this exemption. After discussing the MPC/WUD/Alliance alternative proposal, Tiffany also addressed the other ideas put forth for the hearing, such as the CDI credit for new plant capacity. She testified that while WUD was not able to endorse the credit at this time, they are working to establish an “industry committee to deal directly with plant capacity and develop a strategic plan for the industry.”

On behalf of Milk Producers Council, I also testified on the importance of maintaining a whey value in the class 4b formula and the merits of the MPC/WUD/Alliance alternative proposal. I also expressed MPC’s recognition that something should be done to address the shortage in plant capacity, but across-the-board increases in make allowances provide no such incentive. Instead, MPC supports the more targeted and transparent proposal put forth by CDI. On this issue, I did point out, however, that it is the cooperatives, and not CDFSA, that either need to build the capacity or apply some long overdue discipline on their members. In the conclusion of my testimony, I stated “the State of California can no longer take on the responsibility to find a California home for every gallon of milk any California producers want to produce.”

Also testifying on behalf of producers in support of the MPC/WUD/Alliance proposal were Bill Van Dam (Alliance of Western Milk Producers), Kevin Abernathy (California Dairy Campaign), and Linda Lopes (California Dairy Women).

The CDFSA panel was also able to hear testimony directly from dairy producers. Barbara Martin, Ray Souza, Joe Mendoza, Jr., and Rien Doornenbal all testified in support of the MPC/WUD/Alliance proposal. These witnesses were able to give a more personal testimony on the economic pain dairy producers felt during the extremely low milk prices of 2006. These producers explained that dairies, too, are facing increased costs of production, and that elimination of the whey cost factor from the formula would be devastating to producers throughout the state.

The CDFSA panel will now consider all the testimony presented, as well as any post-hearing briefs that are filed in the next week. Under California rules, they will be issuing a final recommendation sometime in the next two months.

Managers Note: This was the first hearing I’ve testified at, and quite frankly, a painful hearing to sit through. Listing to the plights of the cheese makers, it’s difficult to separate the facts from hyperbole. Stories of economic crisis and financial losses were commonplace in the testimony given.

Throughout the hearing, the overriding question coming from the CDFSA hearing panel was, “How do we find a middle ground?” “How do we bring both sides together to find a compromise?” What was frustrating to the producers was that the panel seemed to not even recognize the MPC/WUD/Alliance proposal as a compromise!

It was as if the panel completely ignored the fact that this latest producer proposal is the largest concession offered on the issue of whey since its inclusion in 2003. The producers showed a good faith effort at finding a middle ground, and in fact, reached out to several cheese maker representatives, to no avail.

It will be interesting to see how the hearing panel reacts to the firm line taken by the cheese makers that no compromise is acceptable and that the whey factor needs to be completely taken out of the formula.

End