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TESTIMONY

California Department of Food & Agriculture
Hearing on California Stabilization and Marketing Plans for Market Milk
Sacramento, California
April 11, 2016

Mr. Hearing Officer and members of the hearing panel:

My name is Annie AcMoody. I am the Director of Economic Analysis for Western United Dairymen. We are an association of dairy farmers, representing the state's dairy families. We are a grass-roots organization headquartered in Modesto, California. An elected board of directors governs our policy. The board of directors approved the position I will present here today during a special meeting on March 16, 2016.

Joining me today are Rob Vanden Heuvel of Milk Producers Council and Lynne McBride of California Dairy Campaign. While they plan on presenting additional testimony at a later time, I want to point out their presence again this year as it represents strong unity in the producers' community. The proposal we are presenting today was submitted as a joint effort between the three producers trade associations. In addition, it has the full support of the three main coops in the state – CDI, DFA and LOL. The clear unity you see today is testimony to the undeniable disruption caused to California dairy families and their employees by the inequity in 4b pricing compared to the price discovery mechanism in states operating under the federal system.

We would like to again thank Secretary Ross for the call of this hearing on her own motion. We would also like to thank Governor Brown for his oft expressed support and recognition of California agriculture and dairy in particular as being a driver intrinsic to California's economy. The issue at hand for this hearing, the whey portion of the Class 4b formula, is not a new source of concerns for the producer community. We appreciate that the Secretary recognizes it needs to be addressed, especially in light of the upcoming expiration date for the temporary formula in place.

The topic of adjusting the whey portion of the Class 4b formula is not new. In fact, it goes back to 2007, when the fixed whey factor was implemented on December 1. With a fixed factor, it was only a matter of time before prices would fall significantly out of alignment with federal order pricing. The issue became particularly apparent in 2011 as the value of dry whey started to rise. The producer community, concerned with the inequity, overwhelmingly supported some changes. Land O'Lakes submitted a petition, and agreeing the issue should be revisited, the Department called for a hearing on June 30, 2011. Support from dairy producer organizations and cooperatives was unparalleled – all sought changes that would bring the California 4b price in closer alignment with federal order prices. This support and common position among producer organizations and coops was not typical at the time, but it has remained throughout the last five years and is still very clear today.

As a result of the 2011 hearing, the Department decided to implement changes, eliminating the fixed whey factor and replacing it with a sliding scale. Those results were a slight improvement, but fell short of getting California prices in closer alignment with Federal Order prices. An update to the whey scale occurred in 2012, when the Secretary increased the upper end of the scale by 10 cents. Following this decision, she created the Dairy Future Task Force in the hopes of finding common ground between industry participants to improve the California pricing system. Almost three years later, no significant changes occurred. Recognizing the issue of whey pricing was still present and a critical concern to producers, the Secretary called a hearing on her own motion a year ago. A temporary scale was developed. When it was announced, it appeared it could yield some additional revenues for producers. This was welcomed news for producers who had been advocating for a change for almost four years. Unfortunately, as we stated in our proposal letter, for the period August 2015 to February 2016, the temporary scale generated an average of 3.4 cents per hundredweight more to the Class 4b formula than the previous formula would have.

Every producer group in this state has worked hard on getting this issue resolved. While we very much appreciated the change in direction with the temporary formula, we would like to reiterate our preference for a different whey scale. One which we believe would create a fair method to calculate whey in the Class 4b formula in the long run. And one which we would like to see implemented on a permanent basis.

We will delve into more details later, but in short, our proposal adjusts the whey scale to allow the whey value in the Class 4b formula to mirror the whey value in the Class III formula. More specifically, as outlined in the Department's analysis, if the producers' proposal had been in place for the past five years, the California Class 4b price would have averaged \$1.38/cwt higher with our proposal. This represents \$0.64/cwt on the overbase price.

Relationship to Federal Order

It is no secret that the last few years, the gap between the Class III and the Class 4b price has caused much producer dissatisfaction. The part of the California Food and Agricultural Code that states "the methods or formulas shall be reasonably calculated to result in prices that are

in a reasonable and sound economic relationship with the national value of manufactured milk products” (Section 62062) has been mentioned by many at each of the whey-related hearings, but we want to reiterate it today because it is of particular interest to us: producers want to be on a level playing field with producers in the rest of the country.

According to CDFA analysis, with the current formula, the Class 4b price would have averaged \$1.85 per hundredweight less than the federal order Class III price for the period March 2011 – February 2016. This in itself should be evidence that the current Class 4b formula fails to determine the cheesemilk’s value appropriately. Clearly, the current scale violates the mandates outlined in Section 62062 of the Code.

The deviation between Class III and 4b prices can be caused by several factors. Notably, formula differences such as different price series (CME vs NASS), make allowances, yield and formula construct contribute to the divergence. But the whey value is what creates the most variance between the two class prices and it seems the Secretary recognized that, calling a hearing with a scope pertaining only to the whey value in the Class 4b formula last year. It must be recognized that while the temporary scale failed to generate additional needed revenues for producers, it decreased the gap between the Class 4b whey value and the Class III whey value.

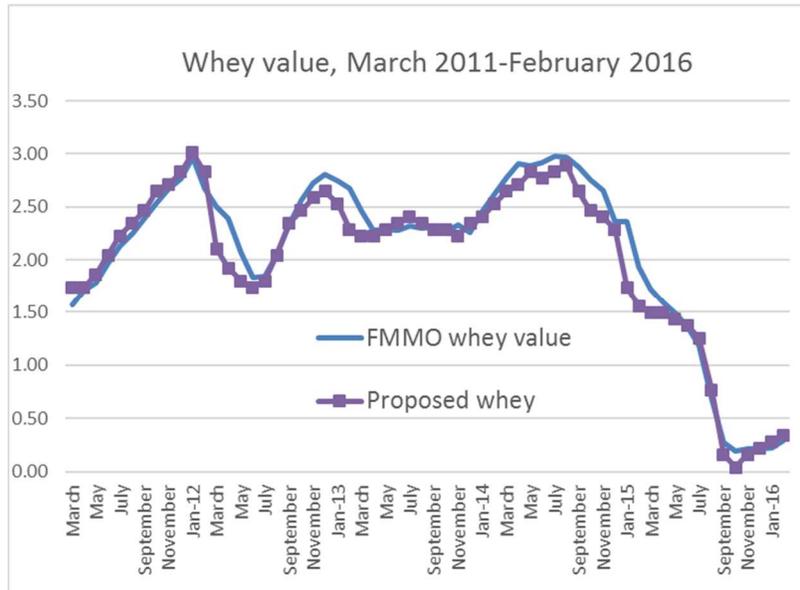
Producers would very much like to see the Class 4b equal to the Class III price, but we realize the scope of this hearing does not allow for such a proposal. The next best thing is getting a comparable whey value in Class 4b to the one generated by the Class III formula. If a formula that achieves that had been in place for the past five years, like the one we are proposing, the difference between Class 4b and Class III would have been -\$0.46/cwt, instead of the - \$1.85/cwt with the current formula. California cheesemakers would have still gotten to pay a cheaper price for cheesemilk than their Federal Order counterparts.

Our proposal would achieve a much closer relationship between Class 4b and Class III by removing the potential for unbearable discrepancies in the whey portion of Class 4b that can occur if we do not more closely tie our whey value to the end product pricing formula used in federal orders. As outlined in our proposal, we propose the following whey value in Class 4b:

Average Western Monthly Dry Whey per lb		Whey Value per cwt		Average Western Monthly Dry Whey per lb		Whey Value per cwt	
Less than \$0.2000		\$0.0000		\$0.5300	to	\$0.5399	\$2.0414
\$0.2000	to	\$0.2099	\$0.0360	\$0.5400	to	\$0.5499	\$2.1022
\$0.2100	to	\$0.2199	\$0.0968	\$0.5500	to	\$0.5599	\$2.1629
\$0.2200	to	\$0.2299	\$0.1575	\$0.5600	to	\$0.5699	\$2.2237
\$0.2300	to	\$0.2399	\$0.2183	\$0.5700	to	\$0.5799	\$2.2845
\$0.2400	to	\$0.2499	\$0.2791	\$0.5800	to	\$0.5899	\$2.3453
\$0.2500	to	\$0.2599	\$0.3398	\$0.5900	to	\$0.5999	\$2.4060
\$0.2600	to	\$0.2699	\$0.4006	\$0.6000	to	\$0.6099	\$2.4668
\$0.2700	to	\$0.2799	\$0.4614	\$0.6100	to	\$0.6199	\$2.5276
\$0.2800	to	\$0.2899	\$0.5222	\$0.6200	to	\$0.6299	\$2.5883
\$0.2900	to	\$0.2999	\$0.5829	\$0.6300	to	\$0.6399	\$2.6491
\$0.3000	to	\$0.3099	\$0.6437	\$0.6400	to	\$0.6499	\$2.7099
\$0.3100	to	\$0.3199	\$0.7045	\$0.6500	to	\$0.6599	\$2.7706
\$0.3200	to	\$0.3299	\$0.7652	\$0.6600	to	\$0.6699	\$2.8314
\$0.3300	to	\$0.3399	\$0.8260	\$0.6700	to	\$0.6799	\$2.8922
\$0.3400	to	\$0.3499	\$0.8868	\$0.6800	to	\$0.6899	\$2.9530
\$0.3500	to	\$0.3599	\$0.9475	\$0.6900	to	\$0.6999	\$3.0137
\$0.3600	to	\$0.3699	\$1.0083	\$0.7000	to	\$0.7099	\$3.0745
\$0.3700	to	\$0.3799	\$1.0691	\$0.7100	to	\$0.7199	\$3.1353
\$0.3800	to	\$0.3899	\$1.1299	\$0.7200	to	\$0.7299	\$3.1960
\$0.3900	to	\$0.3999	\$1.1906	\$0.7300	to	\$0.7399	\$3.2568
\$0.4000	to	\$0.4099	\$1.2514	\$0.7400	to	\$0.7499	\$3.3176
\$0.4100	to	\$0.4199	\$1.3122	\$0.7500	to	\$0.7599	\$3.3783
\$0.4200	to	\$0.4299	\$1.3729	\$0.7600	to	\$0.7699	\$3.4391
\$0.4300	to	\$0.4399	\$1.4337	\$0.7700	to	\$0.7799	\$3.4999
\$0.4400	to	\$0.4499	\$1.4945	\$0.7800	to	\$0.7899	\$3.5607
\$0.4500	to	\$0.4599	\$1.5552	\$0.7900	to	\$0.7999	\$3.6214
\$0.4600	to	\$0.4699	\$1.6160	\$0.8000	to	\$0.8099	\$3.6822
\$0.4700	to	\$0.4799	\$1.6768	\$0.8100	to	\$0.8199	\$3.7430
\$0.4800	to	\$0.4899	\$1.7376	\$0.8200	to	\$0.8299	\$3.8037
\$0.4900	to	\$0.4999	\$1.7983	\$0.8300	to	\$0.8399	\$3.8645
\$0.5000	to	\$0.5099	\$1.8591	\$0.8400	to	\$0.8499	\$3.9253
\$0.5100	to	\$0.5199	\$1.9199	\$0.8500	to	\$0.8599	\$3.9860
\$0.5200	to	\$0.5299	\$1.9806	More than \$0.86		\$4.0000	

Figure 1 illustrates how our proposal would have closed the gap between California's and FMMO's whey values in the last five years.

Figure 1: Comparison of whey values, FMMO vs our proposal

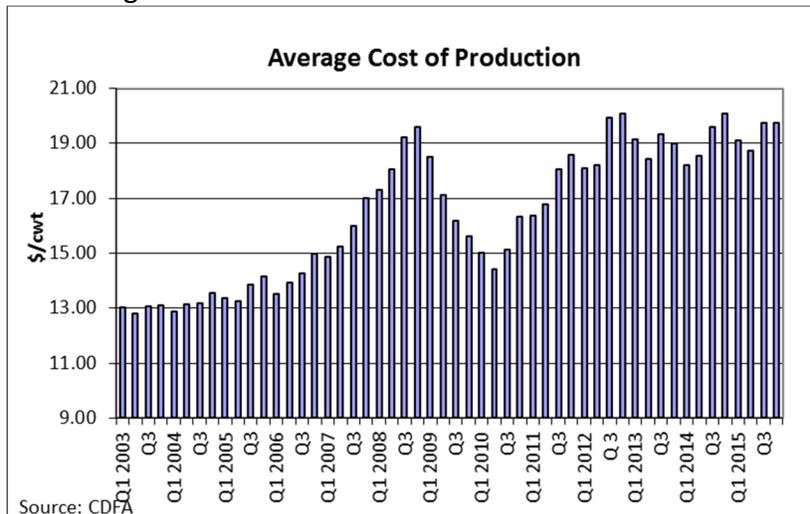


Source: USDA data and WUD calculations.

Producers are facing difficult economic conditions

Given the current volatile conditions in the industry, the years ahead will undeniably be more challenging for California dairy families. Economic and regulatory pressures are escalating in the state. Current and proposed environmental regulations have led and will continue to lead to added costs, something farmers in no other states have to deal with. Aside from this regulatory burden, costs of production on the dairy have stabilized in recent years, but in doing so also seem to have reached a new higher norm. The following chart illustrates the trend.

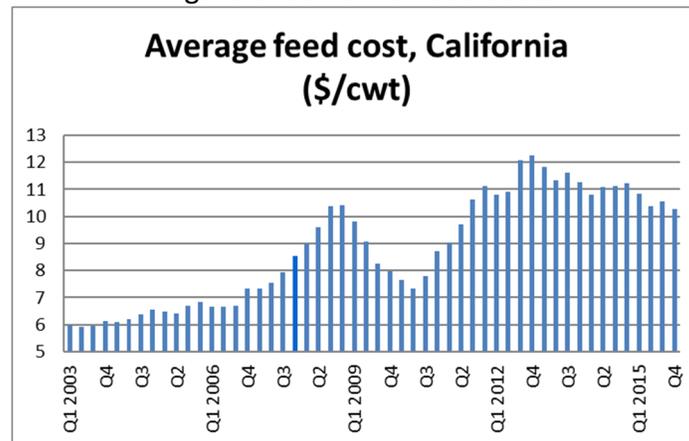
Figure 2: California Statewide Cost of Production



Source: CDFA

A minimal softening in feed costs had been a notable mover in the reduction in cost of production observed from the first quarter of 2009 to early 2010. According to CDFA data, feed costs rose from just over 51% of the total cost of production in 2003 to 60% of total costs by the third quarter of 2008. Following that high, there was a slow decline but it was short lived: since fall 2010, feed prices climbed again, and while there was a bit of a slowdown in 2013 and recently, feed costs remain high. Again, a new higher “normal” seems to have been reached.

Figure 3: California Feed Costs



Nationally feed prices may be lower than 3 years ago, but costs remain higher comparatively for California operations. As an example, according to USDA data, in 2015 the average alfalfa hay price in California was \$185/ton; the average U.S. price was \$163/ton. This trend is not only valid for 2015: looking at the past five-year averages a similar difference, with prices in California averaging \$217/ton, versus \$193/ton in the U.S. Similarly, the 2015 corn price was \$4.50/bu in California versus \$3.60/bu in the U.S. (the past five-year average is \$5.55/bu in California versus \$4.97/bu in the U.S).

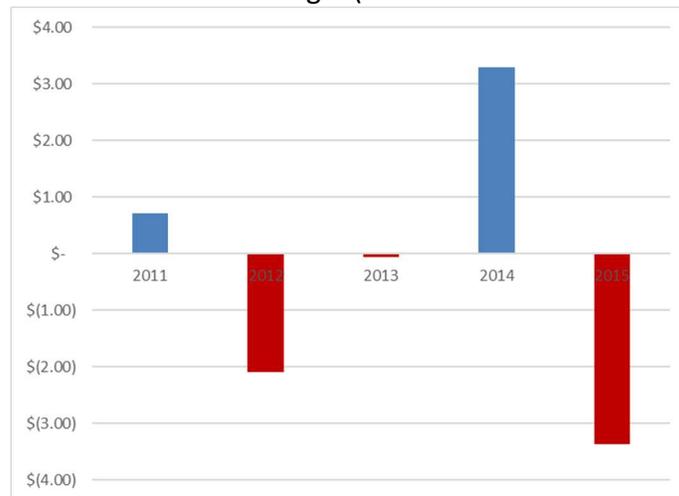
CDFA data indicates that feed costs represented 57% of the total cost of production in the fourth quarter of 2015. While 2016 cost of production data is not yet available, the significant declines in overbase prices combined with fairly steady feed prices will likely show ever more deteriorating margins for California dairy families. With current feed prices and an overbase price that averaged \$13.27/cwt for the two months of 2016, the current financial snapshot for producers is somber.

Due to all those increased costs, California dairymen have lost much of their competitive position relative to the rest of the nation. Failing to capture the value of whey, which has turned out to be a very marketable product, is hurting their competitiveness further. We reviewed the cost of production information because the Department must take it into account: “In establishing the prices, the director shall take into consideration any relevant economic factors, including, but not limited to, the following: (a) the reasonableness and

economic soundness of market milk for all classes, giving consideration to the combined income from those class prices, in relation to the cost of producing and marketing market milk for all purposes, including manufacturing purposes. In determining the costs, the director shall consider the cost of management and a reasonable return on necessary capital investment.” (Section 62062 of the Food and Ag Code).

While 2014 was no doubt a record year for milk prices in California, 2015 came around fast and hit producers’ bottom line hard. A comparison of the net income received by dairies in the state to the total cost of production illustrates the challenge clearly. The average loss in 2015 was \$3.37¹ – surpassing the positive margin experienced in 2014 (\$3.29/cwt). If you look back to 2011, there are more losses than gains.

Figure 4: California Producer Margin (Net Income less Cost of Production)

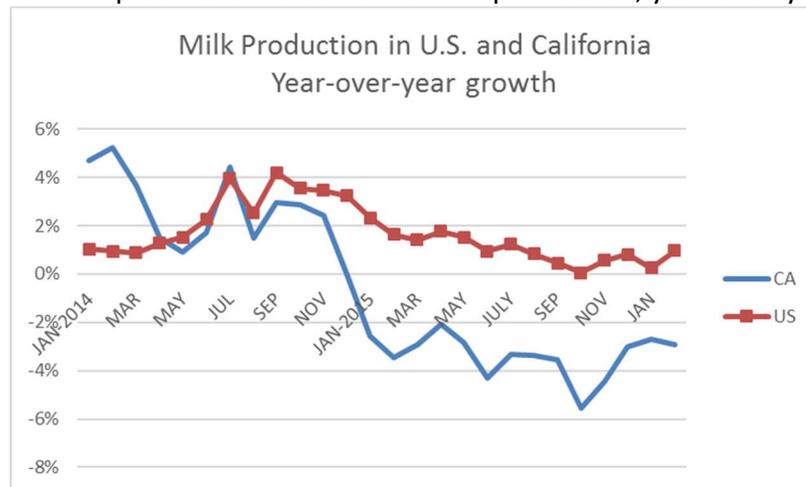


Cost of production data is not available for 2016, but based on feed prices that likely did not move much, combined with the low milk prices experienced during the first quarter of 2016, it is not hard to imagine producers’ financial situation remains dire, and will likely not improve in the near future. The average overbase price for the second quarter of 2016 will likely be in the upper \$12-low \$13 range. Current market conditions are not pointing to a rapid price recovery. During the fourth quarter of 2015, CDFA data points to a negative margin of -\$3.01/cwt. For that period, the average overbase price was \$14.60/cwt. Milk prices settled over a dollar lower than that for the first quarter of 2016. Expectations for minimum milk prices are around \$1.60/cwt lower for the second quarter of 2016. This will result in lower income over feed (assuming feed is steady, as mentioned above). If income declines by even just \$1, this will bring the margin to -\$4.01/cwt for the first half of 2016. Such financial losses per hundredweight are not sustainable and will force more farms to exit the industry.

¹Margin: total cost of production – net income. Net income: income over feed cost + feed cost

To find a clear sign that the financial situation in California has deteriorated, one needs to look no further than USDA's *Milk Production* report. Indeed, so far in 2016 (first two months), milk production in California has averaged 2.8% below last year. What's even more concerning is that the same two months last year averaged 3% below the previous year. Put another way, we are in a period of year-over-year-over-year declines. It has now been 15 consecutive months of milk production declines. In the U.S., in contrast, milk production has been up an average 0.6% in 2016 compared to last year. During the same period last year, milk production was up an average of 2%.

Figure 5: U.S. milk production vs California milk production, year-over-year changes



Source: USDA NASS

According to CDFA data, in 2015, there were 1,438 dairies left in the state, down from 1,668 five years ago. Consolidation (with dairies getting larger) has been blamed by others as a reason for the loss in number of farms, but it was not the only cause of that decline. In fact, the average size of a dairy farm in California dropped by 2 cows in 2015, to 1,215 cows. While milk per cow was down slightly year-over-year, a more concerning reality was apparent in the statistical data: a total of 41,670 cows left the California dairy herd in 2015.

In light of the financial harm inflicted on the average California dairy farm, and the milk production decline already at play, we want to reassure the Secretary that the small price increase we are here asking for today will not generate a milk glut. With milk production lower than year ago levels, the previous plant capacity issues that have been mentioned in the past should not weigh on the discussion today. Keeping a lower milk price in our state only contributes to the financial plight of dairy producers, not to bring supply more in line with capacity. Producers are the ones bearing the cost of a lack of capacity and will respond to it by either building capacity or reducing production via their plant's supply management programs.

The current why issue is one of fairness with prices observed in the rest of the country. Looking at the aforementioned cost of production data, even if we were to add an additional \$0.64/cwt in revenues this year (which is the average amount our proposal would have

generated these past five years compared to the permanent formula), it would still yield average negative margins for producers in the state. As mentioned above, we know the average overbase price for the first quarter of 2016 will be over a dollar under the last quarter of 2015 (close to \$1.45/cwt based on my estimate). Looking at a conservative scenario for the first quarter of 2016, where despite the above information we assume that income over feed costs and costs of production remain the same as in the fourth quarter of 2015: if we were to add another \$0.64/cwt (again a very optimistic unlikely scenario considering where whey prices are), the margin would still be negative by \$2.37/cwt. We would be hard pressed to find a producer willing to increase production when they are losing a significant amount per hundredweight of milk produced. We would be even more hard pressed to find a lender supportive of that idea.

California dairy farms are the backbone of the dairy economy. According to a study conducted by UC Davis, the impact generated is quite impressive. Indeed, according to that study, the dairy industry generated \$21 billion in economic activity (for a total of \$65 billion of dairy related economic activity). It supported 55,000 milk production and processing jobs (for a total of 189,000 jobs related to the dairy industry).

These past few years, the drought in California has been making headlines. While precipitations may have improved this year, it still remains a topic of concern. In a study conducted by UC Davis in 2014², it was estimated that 429,000 acres had been fallowed statewide – a \$2.2 billion loss to the state’s farming industry. When there is no surface water available, farmers have no choice but to fallow their fields or turn to underground water. But using groundwater comes at a cost, since well drilling is rather expensive. Again based on the UC Davis study, it was found the Central Valley is hardest hit, particularly the Tulare Basin, with projected losses of \$800 million in crop revenue and \$447 million in additional well-pumping costs. Those added costs that are related to the farming side of the dairy operation have been a reality for many dairies in the state, and they are not included in the cost of production data cited above.

These drought and regulation realities were met with timely higher milk prices in 2014. But milk prices have changed today, and environmental constraints and regulations remain. We are relieved to find that the Panel understands this reality, and we want to re-emphasize it as it is just as true today as it was last year. “All of these environmental costs and regulations have limited the ability of producers to expand their production. Historically, producers seeking to increase production built new dairies and expanded the number of cows on existing facilities. Conversely, environmental costs and regulations have severely limited the building of new dairies, the reactivation of dormant dairies, and reduced the re-permitting of existing dairies. Because current environmental costs and regulations are expected to remain in place, if not intensify, they are expected to limit the ability of production to grow in the future through the traditional method of adding dairies or adding a significant number of cows to the milking herd.”

² Sumner, Medellin-Azuara & MacEwan, UC Davis Center for Watershed Sciences study, 2014

Risk management

Since 2009 and the recent years of price ups and downs, margins at the dairy remain fragile. Volatility has been a buzzword in the last few years for a reason: it is here to stay. As you know, dairymen have no way of passing along added costs. To avoid a repeat of that economic catastrophe, many producers have turned to risk management tools to protect their operations. More specifically, hedging has become an increasing part of dairy operation management.

Hedging allows parties to secure prices months in advance. The effectiveness of hedging relies on many things, but especially on the relationship between futures prices and cash prices. The futures contract most commonly used by dairymen in the U.S. is tied to Class III. A hedge will never be perfect because of basis, but over time, with similar formulas, dairymen can assess their basis risk more effectively. As illustrated earlier, the spread between Class III and our milk price has fluctuated significantly over the years. Effectively, the issue of lower milk prices in California is exacerbated by the fact that the different whey factor in the California formula makes Class III futures contracts a less effective hedge than it otherwise would be. As a result, the very insurance that dairymen attempt to buy to insure some operating margin, does not perform as they intended.

Looking back at historical relationships between prices received at the dairy and Class III is certainly not a good predictor of basis because of the disparity. We understand that it is possible to be creative and use various contracts (in addition to Class III) to create a more effective hedge. But it remains that it is a much more difficult task in California to do it right. Adding complexity to a task that is already daunting to many has been enough to deter many producers.

Even the safety net that came out of the latest Farm Bill (Dairy-MPP) is an issue for California producers with the discrepancy that exists between California prices and the rest of the country. The correlation between Class III and the all-milk price (which is the price series used to determine program payments) is much stronger than Class 4b and the all-milk price. The difference between the U.S. all-milk price and Class III averaged \$1.55/cwt over the past five years. The difference between the U.S. all-milk price and Class 4b averaged \$3.40/cwt. This makes the program harder to relate to California producers with California prices being lower than national averages. The other component of that program, the feed costs, was already indirectly highlighted earlier when we discussed the difference between California corn and hay prices with the rest of the country. Lower milk prices in California, combined with higher feed costs, makes it difficult for the program to trigger during difficult times. The MPP margin for the first quarter of 2016 was \$8/cwt, which means no payment was triggered. We have highlighted the negative margins California producers have been (and are) experiencing. This program does not appear to be where dairies in California will get help, at least not currently. We understand CDFA is not responsible for this program and cannot change the feed cost portion of the issues.

But it certainly would help if the milk price portion of the formula was more in line with the rest of the country.

Whey Markets

Whether whey has a value or not is not the main question anymore: it is widely recognized that the whey stream has generated considerable revenues for the cheese processing industry. The Secretary's last decision and the temporary whey scale in place today is testimony to that. Producers in federal orders have benefited from a higher whey value in the current Class III formula – it is only fair that producers in California also get a share of this growing market.

Why updating the scale

In the 2011 Panel Report when the scale was first implemented, CDFA stated: “such a sliding scale could be devised and updated, if need be, to better correspond with California conditions compared to an endproduct pricing factor.” California conditions, as outlined above, warrant an update.

The narrow range of the sliding scale used in the permanent formula is at the root of the problem. With a ceiling capping the whey value at 75 cents, there is tremendous potential for discrepancies between the Class 4b and Class III (as illustrated above). Similarly, a floor of 25 cents also creates the potential for discrepancies. The scale proposed in our petition significantly reduces the potential for these large discrepancies.

As the panel stated in 2005 before recommending the removal of price floors from the 4a and 4b formulae: “price floors create an artificial price within a market at a level that may be higher than the naturally occurring market price”. The same is true of ceilings, creating an artificial price that may be lower than the naturally occurring market price. In this case, it has prevented producers from benefiting from that value.

In the past, it has been argued that a cap is necessary for small cheese processors who do not process whey. Whey has had a value for years. Many have found ways to make it profitable by investing in whey processing facilities – others dispose of it by selling it to dairymen so they can mix it into their feed ration for the cows. As producers frequently remind us: many dairymen sell their hospital milk to calf raisers because it makes more sense than throwing it away. Cheese plants have had plenty of time to maximize opportunities to recover value or make whey products profitable, just like dairymen found value in hospital milk.

Another key point of contention for producers: operation sizes have never been a focus in the milk pricing formulas in California – all dairy families get the same volatile price, regardless of the size of their operation. Cheese processors across the country have adapted to that reality, and have adapted well. And California dairy operations of all sizes have been facing dairy price volatility for years. Therefore, there is no place for a cap on the sliding scale on the grounds that some small cheese processors cannot afford whey price volatility.

As we have advocated for many years for a closer relationship between Class III and 4b, we believe the permanent whey scale should be updated to reflect our proposed scale. This is something we want to achieve in the long run – not just on an emergency or temporary basis. The amount of time and resources the coops spent on the FMMO hearing process is testimony to that desire (the tree trade associations also supported that process, while 32 producers directly testified). A permanent change would allow better business planning decisions for producers and processors. The proposed changes may be under a sliding scale format, but the many brackets allow for the whey value to fluctuate with whey prices. The resulting whey component value in the Class 4b formula can move quickly from a month to the next, providing a true reflection of changing values in whey markets, negating the need to make it a temporary change.

Other proposals

We oppose the alternative proposal submitted by the Dairy Institute (DI). While we appreciate their creative effort to reform the scale, it clearly falls short of achieving what needs to be done to restore fairness in the Class 4b pricing formula. CDFA's analysis reveals that over the past five years, it would have increased the Class 4b price by \$0.31/cwt. This is clearly below the \$1.38/cwt requested in our proposal. Of greater concern is a look at the last year, which may be more reflective of current commodity prices: DI's proposal would have lowered the Class 4b price by 11 cents this past year. That is based on CDFA's analysis, comparing DI's proposal with the permanent scale. Comparing the DI's proposal to the temporary scale (the one in place today) yields even more shocking results. For the past year, it would have decreased the Class 4b price by 42 cents. Going back three years, the result gets worse (-62 cents). In light of the negative margins experienced by California producers, our concern with such a possibility is great. In short, we cannot support a proposal whose intention are not to move the Class 4b price closer to the Class III price and have the potential effect of decreasing milk prices in California.

Specifically, we have objections to the use of DI's scale, and the Hearing Panel eloquently identified several of those last year. We will make good use of that Panel Report by including some of those quotes here to reemphasize their importance and relevance in this Hearing as well:

- 1) A whey factor based on WPC34 may not track a whey factor based on dry whey when comparing cheese-milk prices paid by California's out-of-state competitors with California prices. A review of the dry whey price series and WPC34 price series quoted from USDA's DMN, shows the two price series tend to trend up and down together; however, there are occurrences when the two price series will move in opposite directions or when one price series will be relatively constant, while the other is moving. Moreover, a comparison of the per-pound protein price of WPC34 with that of dry whey shows that their price movements are highly correlated, but not perfectly correlated. This indicates that there

may be occasions when a whey factor based on WPC34 may move differently than a whey factor based on dry whey.

2) The whey factor based on WPC34 appears to have merit, but the concept needs to be vetted further in order to verify and validate the commodity price and manufacturing cost factors that will be associated with the proposed whey factor.

3) The Department needs to examine the proposed DMN WPC34 price series to determine if it will function well as a commodity price series for California. This price series is based on the Western and Central parts of the U.S. Although various witnesses supported this concept, it is prudent to determine if this price series is representative of the price received by California plants. Further, it is unclear if plants making WPC of higher protein concentrations receive a similar price or a price related to the WPC34 price series. If the DMN WPC34 price series is indeed representative, then this concern would be resolved. If not, other alternatives such as a California price survey or other price discovery method would need to be established.

4) The Department is not currently performing any cost studies and is not aware of any cost studies recently completed for plants making WPC34. Before implementing a whey factor based on WPC34, any explicit or implied manufacturing cost allowance and yield factor incorporated into the whey factor should be confirmed and verified as representative of California plants. The Panel is concerned with implementing a new whey factor based on WPC34 that is not accurate and consistent with actual manufacturing conditions of California plants making all types of WPC, including WPC34.

5) The issue with confidentiality currently applies to the Class 4b pricing formula with Cheddar cheese and dry whey. This would also be true with WPC.

To our knowledge, none of these objections have been answered or researched. It is unclear whether answers could provide a framework to effectively use this proposal in the current regulatory environment. We agree that each of the objections laid out by the Panel is an important consideration.

This concludes our testimony. The members of Western United Dairymen thank CDFA staff for their effort in preparing for this hearing. We would be pleased to answer any questions you may have and request the option to file a post-hearing brief.