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February 3, 2015

**VIA FEDERAL EXPRESS FIRST OVERNIGHT**

Anne Alonzo, Administrator  
Agricultural Marketing Service  
United States Department of Agriculture  
Room 3071-S; Stop 0201  
1400 Independence Avenue, SW  
Washington, D.C. 20250

RECEIVED

FEB 5 2015

Re: Proposal for a California Milk Marketing Order

Dear Ms. Alonzo:

On behalf of the members of California Dairies, Inc., Dairy Farmers of America, Inc., and Land O'Lakes, Inc., (the "Cooperatives"), pursuant to 7 C.F.R. § 900.3 we request that the Secretary of Agriculture call a hearing to promulgate a milk marketing order for the state of California.

The Cooperatives are owned by dairy farm families and on the basis of a recent month calculation represent over 75% of the milk produced in California. Combined, they operate twelve plants and market milk to a significant majority of the state's milk buyers. The Cooperatives are significant manufacturers of butter, cheese, milk powders, cream and condensed milk. On their members' farms and in their marketing operations the Cooperatives are confronted with disorderly marketing conditions which are the basis for this proposal. The Cooperatives' leadership has met jointly and periodically to monitor the development of the proposal, and each of the Cooperatives has reviewed the proposal and fully supports its submission.

**Background**

The state of California is the largest milk producing state in the US with more than 20% of national production. According to United States Department of Agriculture (USDA) statistics, California is the country's leading dairy state. In 24 categories where a pound, a gallon, a cow, a farm or a plant can be counted, California is the top ranking state in thirteen categories, number two in six categories, number three in two categories, number four in one category and number seven in two categories. These statistics were published in

the National Agricultural Statistics Service publications Milk Production (February 2014), Dairy Products Annual (April 2014) and Production, Disposition and Income (April 2014).

California is first (category / percent of US total where applicable) in total state milk production (21%), number of milk cows (19%), production of Italian cheese (31%), mozzarella cheese (36%), Hispanic cheeses (50%), condensed skim milk (unsweetened) (37%), nonfat dry milk-- human grade (39%), butter (34%), dry buttermilk (46%), ice cream (16%), ice cream mix(16%), sherbet mix (9%) and the total value of milk production at \$7.624 billion (19%) for 2013.

The California dairy industry is ranked second in the production of all types of cheese (21%); American style cheeses (14%), other than American style cheeses (22%), sour cream (17%), lowfat ice cream (3%) and the number of dairy plants (9%). The industry ranks third for production of creamed cottage cheese (9%) and lowfat ice cream mix production (6%). The industry ranks fourth in cheddar cheese production (11%), seventh in milk per cow and seventh in the number of dairy farms (3%).

If California's milk producers adopt a federal order, the California Order would be the largest federal order pool with a monthly average volume of well over 3.4 billion pounds, eclipsing Federal Order 30's average 2014 monthly pool volume of 2.7 billion pounds. In terms of Class I volume it would be the third largest of the Orders behind Order 1 (approximately 755 million pounds) and Order 33 (approximately 517 million pounds) with an estimated monthly volume averaging 452 million pounds.

In spite of its significance nationally, California has been the most important region in the country which has not been part of the federal milk marketing order (FMMO) system. For many decades, the California Department of Food and Agriculture (CDFA) has administered a state milk marketing order and has reasonably balanced industry interests to the satisfaction of California's dairy farmers. In recent years, US milk markets have become more regional and national in scope, and FMMO regulations have evolved with those developments. National uniformity of manufacturing milk values and broad regional marketing order marketwide pools have been established. The California state system, however, has not adapted, leading to market conditions that have become increasingly difficult for California dairy farmers and the operation of the cooperatives they have built. The failure of California regulations to establish minimum prices to California producers which reflect national values for classified milk uses has cost California dairy farmers more than \$1.5 billion dollars since 2010, according to published industry estimates. Therefore, the Cooperatives and their members, representing the overwhelming majority of dairy farmers in California, are bringing this petition for a FMMO in California.

In 2014 Congress provided a necessary prerequisite for this request when it re-authorized the language in the 1996 Farm Bill which allows the USDA to promulgate a California FMMO while retaining the California state quota program. CDFA records indicate there are 2,233,428 pounds of solids not fat (SNF) quota issued (on a daily production basis). Recent CDFA published records indicate quota was traded for \$525 per pound of SNF yielding an aggregate market value of \$1.173 billion. That Congressional authorization makes clear that a California FMMO will have all the benefits and characteristics of the ten FMMOs, while maintaining the unique California system of sharing milk sales revenues through the state quota program.

The Cooperatives' dairy farmer members have carefully studied the operations and impacts of an FMMO and have concluded that a California FMMO is imperative in order for them to have the opportunity to achieve returns that are on parity with those of other dairy farm enterprises in the country.

### **Overview of the request<sup>1</sup>**

We are requesting the establishment of a California FMMO with the following key characteristics:

- The marketing area will be the State of California.
- The California state quota system will remain intact and will be administered by CDFA. The operation of the FMMO pool and the California quota program will be jointly administered pursuant to a memorandum of understanding between the USDA and CDFA and consistent with the authority of each under their respective programs.
- Classified milk uses will be established using the same four class system of product classification found in all existing FMMOs.
- Class prices for milk will follow the federal system; Class I differentials will be as presently established in 7 C.F.R. part 1000. Class II, III, and IV prices will be as presently established in all FMMOs.
- Handlers will pay classified use values to a marketwide pool from which California quota premium values will be payable to quota holders while residual uniform component values will be paid to all producers at a geographically uniform (non-location adjusted) rate, without any producer price differential (PPD).

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<sup>1</sup> The materials being submitted in support of the request include: (1) this letter; (2) proposed regulatory language; and (3) supplemental responses to the topics addressed in 7 C.F.R. § 900.22. Four copies of each are provided pursuant to 7 C.F.R. § 900.3.

- A system of transportation subsidies for the movement of milk from production areas to qualifying Class I and II processing locations will be established with payments made from the marketwide pool for the marketwide service of moving milk to Class I and II uses.
- All California plants purchasing milk from California grade A dairy producers will be pool plants. Voluntary depooling of any class of milk will not be permitted.
- Producer payment dates will provide for a partial and final check each month on dates which generally track FMMOs.
- All handlers and cooperatives will be required to file monthly reports of receipts and utilization to the Market Administrator (“MA”) of the California FMMO. Required submissions will include all information necessary for administration of the marketwide pool and the California quota program. All information necessary for continued operation of the California quota program will be made available to CDFA.
- Verification of producer weights and tests will be provided for as is presently done in the FMMO system, allowing the continuation of any and all non-duplicative California state programs.
- Multiple component pricing will be applicable both to handlers and producers, following the predominant FMMO model which prices components to handlers of Class I (fat and skim); Classes II and IV (fat and solids-not-fat); handlers of Class III (fat, protein, and other solids) and to producers (fat, protein, and other solids) on all milk.
- Fortification of milk for Class I uses to meet the California fluid milk standards will be accommodated through a fortification allowance to Class I handlers.
- Appropriate plant and producer definitions will provide for the pooling of producers and plants outside the state of California.
- Uniform classification and allocation of milk for pooling purposes will be provided for as in the FMMO system.
- Producer-handlers will operate under the uniform provisions of the FMMO system.
- Complete audit procedures will be prescribed and conducted by the FMMO MA with assistance from CDFA as necessary to audit the quota program.

### **Analysis of current marketing conditions: Comparing California and the federal system**

There are many similarities and some striking differences in the methods used by the FMMO system and California's marketing order to achieve their goals. Both systems use classified pricing, pool returns for payments to producers, compute and announce prices to the industry based on product price formulas, and audit milk buyers to assure compliance with laws and regulations that undergird the programs. Within these similarities differences can be found, which are summarized in this document. The most significant difference is the operation of California's quota program, which makes milk marketing in California uniquely different from any other milk market in the US.

### **Marketing disorder caused by current California class prices**

While both systems use classified prices the class definitions are not identical, and, in some instances, are a cause of disorderly marketing. Generally Class I (Roman numeral in the FMMO system and Arabic numeral 1 in the CDFA regulations) represents milk consumed in fluid form. Class II (Roman numeral in the FMMO system and Arabic numerals 2 and 3 in the CDFA regulations) represents milk products such as cream-based items, ice cream and ice cream mixes, yogurt, dips, cultured products, cottage cheese and milk used to produce items such as evaporated and condensed milks. The FMMO system includes all these products in a single class while the CDFA system divides them into two classes – ice cream, ice cream mixes and frozen products are Class 3 products, and Class 2 contains yogurt, cottage cheese and other “intermediate” products, such as condensed and evaporated milks. Milk used to produce cheese and whey products are Class III (Roman numeral in the FMMO system and Arabic numeral-Roman letter 4b in the CFDA regulations). Lastly, Class IV (Roman numeral in the FMMO system and Arabic numeral-Roman letter 4a in the CDFA regulations) represents milk used to produce butter and milk powders. Our proposal uses the existing FMMO classification system.

While both systems use end-product price formulas to determine class prices, the various underlying commodity price series, the effective dates for determining the prices used in the formulas, the yield constants, and the make allowances are not identical, and, in some instances, cause disorderly marketing. The CDFA system includes a factor in the Class 4a and Class 4b pricing formulas that adjusts the dairy product commodity price to reflect spatial pricing differences. The FMMO system does not make any such adjustment, and all prices for Classes II, III, and IV are uniform across the country. The fact that minimum base class prices and resulting dairy ingredient prices (for example, California Class 2 nonfat solids and Class 2 fat prices) use different underlying dairy product commodity prices and different pricing periods impacts milk marketing decisions, and, in some cases, causes disorderly marketing.

The key difference, and the primary cause of disorderly marketing conditions in California, lies in the Class 4b pricing formula. The Class 4b formula uses a very different approach to valuing whey as part of the price than the FMMO Class III pricing formula. The resulting difference between the two prices ranges from significant to extraordinary.

Class III and Class 4b prices have rarely, if ever, been equal. For the 180 months between January 2000 and December 2014, the Class III price has exceeded the Class 4b price 154 times. For the entire period the difference averaged \$0.88 per hundredweight, but the range of difference has increased significantly in recent years. Between 2000 and 2007, the difference averaged \$0.41. From 2008 to 2014, the difference averaged \$1.43 per hundredweight. From August 2012 to date, the difference has averaged \$1.96 per hundredweight.

These dates which highlight the price differences were chosen purposefully. Prior to December 2007, the CDFA regulations used an end-product price formula to assign a value to whey in the Class 4b price formula similar to that used to establish class prices and similar in construct to those used in FMMOs. When this method was used, the spread between the California and FMMO prices was much narrower and consistent. CDFA, however, discontinued the end-product pricing approach to valuing whey after November 2007.

Since 2007, CDFA has changed the whey component pricing factor contained within the 4b formula three different times. The first relationship established a fixed \$.25 cents per hundredweight contribution to the Class 4b milk price regardless of the reported market value for dry whey; this became effective December 2007. The second relationship, which was implemented in September 2011, established a bracket system or table that changed the per hundredweight contribution to the Class 4b price at fixed rates depending on the reported market value for whey. The table included a floor of \$.25 per hundredweight and a ceiling of \$.65 per hundredweight.

The last change (effective August 2012), retained the whey value contribution table but modified the interval range and increased the ceiling to \$.75 per hundredweight. Dry whey's market prices have been at high levels since 2012, and the imposed ceiling has, in effect, vastly undervalued the Class 4b price in relation to the Class III price.

For the period 2000 – 2014, the Western dry whey price has averaged \$.37 per pound and ranged between \$.14 and \$.82. For the period from January 2000 to November 2007 the Western dry whey price averaged \$.28 per pound and ranged between \$.14 and \$.82 per pound; for December 2007 to August 2011, the average was \$.34 per pound and the range \$.15 to \$.59; for September 2011 to July 2012, the average was \$.58 per pound and the range \$.48 to \$.70. Since August 2012 the average has been \$.60 per pound ranging from \$.54 to \$.67. The FMMO uses the National Dairy Products Sales Report (NDPSR) price series to price the whey

component of the Class III formula. The NDPSR and the Western dry whey price series, while not identical, are very similar. The largest variation between the period averages as described above was \$.0167 per pound.

Calculating the contribution to the Class III and Class 4b prices using the respective price series and the respective formula constructs results in a wide difference even though the underlying market prices for whey are similar. Focusing on the most recent of the historical comparison periods, August 2012 to date, the NDPSR prices and the FMMO formulas yield a contribution of \$2.56 per hundredweight, on average, to the Class III price (median \$2.56) and a range of \$2.04 to \$2.98 per hundredweight. The Western dry whey price series and the CFDA whey contribution formula for the same time period offered an average contribution to price of \$.71 (median \$.69) and a range of \$.63 to \$.75.

Said another way, a dairy farm operator with two facilities, one in California and one in a FMMO area, would have experienced two vastly different regulatory minimum prices for milk used to produce similar cheese and whey products. On average, this difference would be \$1.84 per hundredweight lower for milk from the California dairy than milk from the dairy operating in an FMMO for the period August 2012 – December 2014. This difference places the California farm in a much less competitive position to bid for land, cattle, feed, facilities, services, operating capital and labor than his counterpart whose milk is priced by FMMO regulation.

Consequently, the two systems produce different regulated minimum announced prices for similarly situated products competing in like markets. The differential pricing may cause marketplace decisions that are solely due to different regulations and not to market fundamentals. This clearly represents a disorderly market condition.

Similarly, when dairy farmers produce milk for like products for sale to many of the same markets but receive different (and, in recent months, sizably different) minimum regulated prices, they too may make marketplace decisions that are solely the result of different regulations and not market fundamentals. This disorderly marketing condition should be remedied by having the same pricing authority covering California in the FMMO system.

There are also differences in the Class I / 1, Class II / 2 & 3 and Class IV / 4a prices that generally result from differences in the underlying price series, the timing of using the prices in the series, differences in make allowances, and yield factors within the corresponding pricing formulas. The differences in prices among these classes are not as disparate as the difference between Class III/4b but may still cause disruptions in the marketplace. Having the California dairy industry included in the FMMO pricing grid would eliminate this source of disorder.

A comparison of the monthly per hundredweight prices for Classes I, II and IV for the period 2000 – 2014 and for the August 2012 – 2014 time period is summarized below:

1. Comparing Base Zone Class I FMMO and Southern California Class 1 prices:

a. The average difference for the time period of January 2000 - December 2014 was \$.23 per hundredweight (FMMO higher). The relationship between the two price series has been relatively stable for the entire period.

- The average monthly differences ranged from a positive \$1.78 (FMMO higher) to minus \$1.66 (FMMO lower).
- The median difference between the two price series was \$.20 per hundredweight (FMMO higher).

b. The average difference for the time period of August 2012 – December 2014 was \$.32 per hundredweight (FMMO higher).

- The monthly differences ranged from a positive \$1.78 (FMMO higher) to minus \$0.80 (FMMO lower).
- The median difference between the two price series was \$.30 per hundredweight (FMMO higher).

2. Comparing Class II FMMO and Southern California Class 2 prices:

a. The average difference for the time period of January 2000 - December 2014 was \$.27 per hundredweight (FMMO higher). The relationship between the two price series has widened over the entire period.

- The average monthly differences ranged from a positive \$5.21 (FMMO higher) to minus \$3.80 (FMMO lower).
- The median difference between the two price series was \$.24 per hundredweight (FMMO higher).

b. The average difference for the time period of August 2012 – December 2014 was \$.64 per hundredweight (FMMO higher).

- The monthly differences ranged from a positive \$3.05 (FMMO higher) to minus \$3.80 (FMMO lower).

- The median difference between the two price series was \$.78 per hundredweight (FMMO higher).

3. Comparing Class II FMMO prices and California Class 3 prices (note CDFA Class 3 is a single marketwide price):

a. The average difference for the time period of January 2000 - December 2014 was \$.55 per hundredweight (FMMO higher). The relationship between the two price series has widened over the entire period.

- The average monthly differences ranged from a positive \$5.50 (FMMO higher) to minus \$3.75 (FMMO lower).
- The median difference between the two price series was \$.53 per hundredweight (FMMO higher).

b. The average difference for the time period of August 2012 – December 2014 was \$.90 per hundredweight (FMMO higher).

- The monthly differences ranged from a positive \$3.33 (FMMO higher) to minus \$3.75 (FMMO lower).
- The median difference between the two price series was \$1.06 per hundredweight (FMMO higher).

4. Comparing Class IV FMMO prices and California Class 4 prices:

a. The average difference for the time period of January 2000 - December 2014 was \$.31 per hundredweight (FMMO higher). The relationship between the two price series has narrowed slightly over the entire period.

- The average monthly differences ranged from a positive \$3.73 (FMMO higher) to minus \$.26 (FMMO lower).
- The median difference between the two price series was \$.25 per hundredweight (FMMO higher).

b. The average difference for the time period of August 2012 – December 2014 was \$.21 per hundredweight (FMMO higher).

- The monthly differences ranged from a positive \$.79 (FMMO higher) to minus \$.26 (FMMO lower).
- The median difference between the two price series was \$.17 per hundredweight (FMMO higher).

There are additional disorderly implications resulting from regulatory differences which do not reflect market fundamentals. In the California system, announced Class 2 prices apply for two-months at a time and are based on butter and milk powder commodity price averages from the prior two months. For example, the August and September Class 2 price is based on commodity price data from June and July. The FMMO Class II price is announced monthly and is based on data from the prior month. Market conditions can change swiftly, and, in some cases, noticeably over the four-month period spanned by this calculation. Perhaps the extreme example would be the August and September Class 2 price (generally low months of milk production in California) are based on market data for June and July, which are generally higher months for milk production.

An example of a large Class II/2 price difference is for the months of July 2014 – December 2014 where the CDFA price was lower than the FO price by \$.96 per hundredweight in July; \$1.37 in August; \$2.14 in September and then higher by \$1.78 in October; \$3.80 in November and \$1.16 in December. Condensed skim milk (CSM) is a dairy ingredient commonly used in many products and product formulations. It is transported long distances in bulk tankers. These price differences create disorderly marketing conditions when dairy ingredients can enter markets on a spot basis to exploit short-term price disparities. For example using the September difference of \$2.14 per hundredweight in skim prices and current transport rates, the price difference could land a load of California CSM into Denver or Kansas City at a lower price and could land a load into Nashville for only a slightly higher price. Any of these deliveries could undercut local markets not based on dairy economic fundamentals but solely due to the differences in regulatory terms. Note this difference does not take into account classification differences which might cause further price differences for CSM depending on the classification of the end product and how the two respective pricing regulatory procedures might function. Again, this is consistent with the description of a disorderly marketing condition.

Our proposal adopts USDA's announced FMMO Class I differential surface for California without modification. Class I handlers will be obligated to pay according to the zone in which they receive milk. We propose a multiple component pricing (MCP) program based on three components – butterfat, protein and other solids. We do not include a somatic cell adjustor in the price structure. Similarly to all other FMMOs with MCP, Class I transactions will be billed on a butterfat – skim milk basis; Class II on a butterfat – nonfat solids basis; Class

III on a butterfat – protein – other solids basis; and Class IV on a butterfat and nonfat solids basis.

All of the existing FMMO pricing formulas for Classes II, III, and IV are incorporated as they currently exist, using the same dairy product commodity prices to calculate milk prices as is done using the current FMMO milk pricing formulas and announced on the same dates and for the same time periods. CDFA's fortification allowances are incorporated into the Class I pricing provisions. All of the component and location monies are retained in the producer blend price pool. The calendar for all reporting requirements, billing and payments is established. The time and date sequences (as set out in the draft language) allow for all necessary information to be collected and reported in a manner that generally meets with current CDFA timelines. Additionally, special consideration is given to the need for data necessary to make all payments to quota holders.

### **Quota provisions and pooling requirements**

California maintains a premium payment on the milk produced and covered by quota ownership which plays a very significant role in the California dairy industry. The program has changed over the 45 years of its existence, and while there are performance standards for quota owners, they are not onerous and require little action to maintain eligibility. For example, program regulations require that a quota payment must be applied to milk produced on a farm located in California. Additionally, to maintain quota ownership, all quota owners must ship to a pool plant every 60 days.

Quota premium payments are deducted from total pool revenues, and average about \$0.36 per hundredweight over the total volume of milk in the marketwide pool each month. In some months the total value paid out of the pool for milk marketed as quota exceeds the combined incremental revenue contributed by Classes 1, 2 and 3 to the pool in excess of Class 4 values. Consequently, in some instances revenues generated by Classes 4a and 4b are needed to fund the total value of the quota premium. Quota payments are an important component of revenues to many California dairy operators. In fact, paramount to any consideration of a California FMMO was the assurance that the quota program would not in any way be diminished or affected. Congress recognized this and in the 2015 Farm Bill language dealing with the promulgation of an FMMO in California directed that the marketing order provisions allow for the continuation of the quota program in California.

Without delving into the specific mechanics of the workings of the current California State Order pool, a few general observations can be made about the pool results. In California, the value designated as the “overbase price” is the approximate equivalent of the FMMO blend price. The revenue pool is generated by multiplying the Class prices by their utilizations. The pool is reduced by the cost of specific marketing functions, such as transportation subsidies and quota milk payments. The residual pool value is then divided by all the pounds of milk in the pool to yield the overbase price.

In California, the announced minimum price applies to all grade A milk, i.e., there is no regulatory opportunity for a plant to “depool.” Thus, no processor calculates whether it is to its economic advantage to exit the pool. Examining the relationship of the overbase price to Class 4a and 4b, it can be shown that for the last 236 monthly pools (dating back to 1995), the overbase price was higher than both Class 4a and 4b only 15 times. Or said a different way, in 221 out of 236 monthly pools either Class 4a or 4b processors would have had a financial incentive not to participate in the pool and would have tried to exit the pool to avoid minimum prices and preserve a higher value for themselves. In sum, the added value from Classes 1, 2, and 3 has not been large enough to generate monies to cover the total quota milk price payment, the transportation payment and the other minor adjustments to a monthly pool. For the period 2010 – 2014, Class 4a use has averaged 35% of all the pounds included in the pool and Class 4b has averaged 43%. So, the likely impact of allowing processing plants to exit the pool would result in a significant percentage of the pool revenues moving in and out of the pool each month. Additionally, in any given month a significant percentage of the milk supply could attempt to exit the pool and perhaps impair the funds available to fund the quota payment.

This pooling instability would represent extremely disorderly marketing conditions. Milk buyers would have little assurance of price stability or predictability in order to price their products. Dairy producers would have little assurance of price level or stability in order to make production planning and borrowing decisions. Neither buyer nor seller would have a reasonable ability to use risk management tools.

In order to preserve the quota program and maintain an orderly marketing environment, a California FMMO must retain the inclusive pooling provisions for the milk supplies delivered to a plant located in the marketing area that receives milk from a California producer just as the state order has done for decades.

Our proposal leaves all jurisdiction over quota administration, calculations, buying / selling / exchanging, and changes to the regulations to CDFA. Each month, CDFA would communicate all financial calculations relative to the net cost of quota payments to the FMMO MA. The MA would then take all steps to assure that quota values are deducted from pool revenues and paid to producers properly.

Also, the federal administrator would remit any necessary information regarding quota payments back to CDFA to allow ongoing administration of the quota program. There are no provisions in our proposal to change the current value of quota payments, which are, in fact, established by California statute. Any future changes would have to come from California authorities.

To summarize how the proposal addresses quota and pooling requirements:

1. All milk produced in the State is included in the California FMMO pool. There are no provisions to allow for milk to avoid the pool on a monthly or annual basis.
2. CDFA retains all authority and jurisdiction over quota administration. CDFA calculates and communicates the value of quota payments due to individual producers to the MA each month, and the MA verifies that all required payments are communicated to handlers and paid to producers.

### **Other order provisions**

Producers are paid twice per month based on MCP calculations. They are paid for pounds of butterfat, protein and other solids. All producers in the FMMO will receive the same component prices; in addition quota-holding producers will also receive the quota premium. There will be no producer location differentials. There is no producer price differential (PPD) value paid to producers as such. Funds generated from the PPD computation are paid across all three component values in a ratio representative of their value in the pool.

Transportation credits are paid on qualifying deliveries to plants with Class I and II usage greater than 50%, which is the standard for qualification in the California system today. Transportation allowances are funded completely by pool revenues. Because all producers share equally in the pool proceeds, it is reasonable that all producers share in the cost of supplying and balancing the higher valued use deliveries of the market. The transportation subsidy system assures that Class I and II processors located in the more urban areas of the state and that are more distant from the areas of high milk production are not at a competitive disadvantage for procuring milk. Conversely, (and consistent with the current CDFA transportation system) Class I and II plants located near the milkshed do not have access to the transportation subsidy funds. Additional provisions of the transportation program are detailed below.

Historically, the state order system has not been effective in addressing out of state milk being marketed in the state which evades the pricing and pooling requirements. Out of state milk supplies generally deliver to the Class I market directly, and may result in the seller receiving the full Class I price. Because these milk revenues are not pooled,

any costs to balance the milk supply in the marketing order are avoided, and are pushed out to pool participants. FMMO regulations would eliminate this problem. We estimate this change will provide additional revenue in pool proceeds. Additionally, FMMO regulation will extend the current FMMO producer-handler provisions to the California marketplace, synchronizing the terms and requirements impacting producer-handlers across the U.S., including an exempt plant definition to allow for uniform national treatment of the very small milk bottlers.

As the US has become more integrated into global dairy markets through dairy exports and investments in foreign markets, the volatility of dairy product markets has increased. End product pricing formulas directly transfer that volatility to farm milk prices. The spread between FMMO Class III and CDFR Class 4b severely hinders a California dairy farmer's ability to make effective use of dairy futures to hedge and protect his business from this inherent milk price risk through the current common risk management alternatives. For example, the Class III futures contract offered by the Chicago Mercantile Exchange (CME) is the most heavily used of the dairy product futures contracts. As noted earlier the Class 4b price and the FMMO Class III price differed by an average of \$ \$.88 per cwt. from January 2000 thru September 2014. More importantly, this difference, also known as the basis, displays a wide range from year to year and even month to month which drastically increases the risk that a California dairy farmer takes on when entering a Class III futures contract to hedge his milk. The fact that the CME Class III futures contract settles to the FMMO Class III price further complicates the ability to execute a successful hedge. Price movements in the Class III futures market may not be offset on a one-to-one basis in the Class 4b market. Dairy producers and processors could certainly find enhanced opportunities for milk price risk management if the California market were part of the FMMO system as class definition, and, more importantly, end-product pricing formulas would become identical. This would improve orderly marketing.

### **Performance standard provisions**

As previously mentioned, the proposal defines the marketing area as all the counties in the state of California, and all milk delivered to a plant in the marketing area from a farm located in the marketing area is pooled. A plant, wherever located, that has 25% of the milk received by the plant distributed as packaged fluid milk products and 25% of those distributions in the marketing area is classified as a pool distributing plant in the California FMMO. A plant in the marketing area which packages extended shelf life fluid milk products is pooled in the California FMMO.

There is no provision for a supply plant located in the marketing area. There are provisions for a supply plant located in Churchill County, Nevada, with performance standards that recognize the long-term association of that milk supply with the California market.

There are also provisions for supply plants located in any other area with performance standards that are more rigorous and recognize that those milk supplies have not been traditionally associated with the California market. Those supply plants are defined by touch base days, depooling / repooling provisions based on the percent repool method used in Orders 1030, 1032 and 1033, the state unit provision similar in operation to those in Order 1, and the inability to use 9(c) volumes to qualify the plant. These provisions attempt to reconcile the traditional supply relationships that have been present in the California market for many years. Additionally, they recognize an appropriate relationship between performance and sharing in pool revenues for a market that has a low Class I and II utilization.

### **Transport Program Provisions**

The proposal, as previously noted, provides marketwide service payments in the form of partial reimbursement for transportation costs for delivery of milk from supply areas to qualifying Class I or II processors (fluid use plants) to incentivize deliveries to Class I plants and to recognize the benefit to the pool of these more expensive deliveries from farm points. Generally, the fluid use plants are located in the high population centers on the California coast and the high volume milksheds are in the interior counties of the state. The Class III and IV plants are generally located in the Central Valley near the milkshed. In the current CDFA transportation subsidy program, the fluid use plants located in the milkshed do not receive a transportation subsidy. Our proposal continues this practice. The program defines the specific counties that receive a payment for milk transported. The rates are mileage-based and pay a specific rate for the miles traveled from each farm to each plant. Rates will be determined based on current available cost data. There is recognition of the local haul cost and the rates have a fuel adjustor. The transportation pool is fully funded by the producer pool as all producers share equally in the higher values generated from the sales to the fluid use plants; so all should share in the cost to supply the plants.

### **Summary and conclusion**

As we have detailed above, this hearing is a very important matter for California dairy farmers. Therefore, we respectfully request that the Department follow the hearing timelines set out in 7 C.F.R. §§ 900.20–900.33 “to the maximum extent practicable” as directed in the Conference Report for H.R. 2642, p. 389 (January 27, 2014). These timelines reflect the intent of Congress, supported by the industry at large and these cooperatives, that FMMO proceedings be deliberate and thorough, but conducted within a predictable period. Those objectives are particularly applicable to this hearing.

Anne Alonzo, Administrator  
February 3, 2015  
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For all the reasons, and on the basis of all of the information provided above, the dairy farmer members of the Cooperatives representing more than 75% of the milk production in the state of California respectfully and urgently request that the Secretary call a hearing for the promulgation of a FMMO for the state of California at the earliest possible date.

Thank you in advance for your consideration of our request.

Very truly yours,

  
Marvin Beshore  
*Attorney for California Dairies, Inc.,  
Dairy Farmers of America, Inc., and  
Land O'Lakes, Inc.*

Enclosures

- A- Proposed regulatory language for California Milk Marketing Order
- B- Supplementary responses to topics addressed in 7 C.F.R. §900.22.

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