

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
1220 N STREET
SACRAMENTO, CALIFORNIA

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8:00 A.M.

Reported by: Ramona Cota

1 our operation in the increased cost, even the Dairy
2 Institute's proposal. We think it's too high, the scale is
3 too high in it. We prefer the status quo.

4 MR. EASTMAN: That's it.

5 HEARING OFFICER SUTHER: Thank you for your
6 testimony, Mr. Paris.

7 Dr. Erba, you are up next.

8 Dr. Erba, could you please state your full name,
9 spell your last name and state your affiliation for the
10 record, please.

11 DR. ERBA: Dr. Eric M. Erba, the last name is E-R-
12 B-A, and I am representing California Dairies, Inc.

13 Whereupon,

14 ERIC ERBA

15 Was duly sworn.

16 HEARING OFFICER SUTHER: Do you have any other
17 written statements other than the ones you brought up that
18 you would like entered as an exhibit?

19 DR. ERBA: I do not. You have the one that I
20 have.

21 HEARING OFFICER SUTHER: Thank you. Dr. Erba's
22 exhibit will be Exhibit number 42.

23 (Exhibit 42 was entered into the record.)

24 HEARING OFFICER SUTHER: You may proceed.

25 DR. ERBA: Mr. Hearing Officer and Members of the

1 Panel:

2 Good morning. My name is Eric Erba and I hold the
3 position of Senior Vice President and Chief Strategy Officer
4 for California Dairies, Inc., whom I am here representing
5 today. California Dairies is a full-service milk processing
6 cooperative owned by 400 producer-members located throughout
7 California and collectively producing 18 billion pounds of
8 milk per year, or 45 percent of the milk produced in
9 California. Our producer-members have invested over \$500
10 million in large processing plants at six locations in
11 California, which will produce approximately 385 million
12 pounds of butter and 785 million pounds of powdered milk
13 products in 2015. The Board of Directors for California
14 Dairies approved the concepts contained in my testimony that
15 I will be presenting today at their May 26, 2015 board
16 meeting.

17 We thank the Secretary for calling this hearing on
18 her own motion and keeping the relevant topics narrowly
19 defined such that only alternative methods for valuing whey
20 in the Class 4b milk pricing formula are being considered.
21 Over the past four years, we have pointed out that the
22 disparity between the whey valuation in federal milk
23 marketing orders and in California remains too large to
24 ignore and continues to have far too great of an impact on
25 our member-owners' milk price. The effect on our member

1 owners of the undervaluing of whey has been addressed
2 several times in hearings similar to today's proceedings but
3 the same old inequities continue to persist. And the reason
4 is simple; the glaring problem in the Class 4b pricing
5 formula has not yet been corrected.

6 Today's hearing affords us the opportunity to show
7 our support for an improved means to value the whey portion
8 of the Class 4b pricing formula. California Dairies fully
9 supports the alternative proposal submitted by Western
10 United Dairymen, Milk Producers Council and California Dairy
11 Campaign to modify the sliding scale within the Class 4b
12 milk pricing formula that generates values for dry whey.

13 While it is outside the scope of the hearing
14 today, California Dairies also supports the regular review
15 of manufacturing cost allowances relative to the
16 Department's annual manufacturing cost exhibits.

17 I will speak now to the alternative proposal from
18 Western United Dairymen, Milk Producers Council and
19 California Dairy Campaign.

20 The milk pricing proposal that California Dairies
21 supports has a foundation based on economics, logic and
22 consistency with the California federal milk marketing order
23 effort that is being actively pursued. The proposal is
24 meant to address the singular issue of fair compensation to
25 dairy producers for milk and its components purchased by

1 processors. The current means for valuing whey in the Class
2 4b formula has been in place since August 1, 2012. It is
3 clear that it fails to track within a reasonable range of
4 the benchmark for whey valuation as established by the
5 federal Class III pricing formula. In fact, since January
6 2012, the California Class 4b pricing formula has averaged
7 \$1.95 per hundredweight less than the federal Class III
8 price, almost entirely because of the inferior mechanism
9 being used to capture the value of whey. The proposal from
10 the three producer trade associations corrects the
11 deficiency by implementing an expanded dry whey value look-
12 up table that mirrors the whey values achieved in federal
13 milk marketing orders. Within the current operating range
14 of market prices for dry whey, the proposed changes would
15 have a large impact on producer milk prices. At dry whey
16 prices of \$.40 per pound, the Class 4b price would be \$1.25
17 per hundredweight higher. And likewise, at dry whey prices
18 of \$.60 per pound the Class 4b price would be \$2.50 per
19 hundredweight higher. A graphical comparison of the
20 proposed look-up table and the current look-up table are
21 shown in the document submitted into the hearing record.

22 An acceptable level of price difference exists for
23 most of the classes of milk when comparing California milk
24 prices to federal order milk prices. The exception is Class
25 4b and it is past the time for the appropriate adjustment to

1 occur. We believe a modification to the method for valuing
2 whey in the Class 4b formula would not only restore equity
3 in what our manufacturers pay for milk relative to
4 comparable manufacturers around the country, but would also
5 generate much-needed additional revenue for dairy farmers,
6 who are facing some of the lowest milk prices seen since
7 2010.

8 The California dairy industry is the leading
9 agriculture industry in California and milk and dairy
10 products have generated the most value of any of the
11 agricultural commodities produced in California - over \$6
12 billion in each of the last five years and a record of
13 nearly \$10 billion in sales in 2014. In 2015 the California
14 Milk Advisory Board study of the economic impact of the
15 dairy industry estimates that \$65 billion in direct and
16 indirect sales is attributable to the dairy industry, as are
17 190,000 jobs statewide.

18 However, as hard as it may be to comprehend given
19 the dairy industry's legendary status in California, there
20 are signs that the producer side is not faring well at all.
21 Simply, the billions of dollars cited in milk sales do not
22 translate directly to dairy farm profitability, and the lack
23 of profitability has a predictable effect on dairy farm
24 operations. Over 480 dairies have exited the dairy industry
25 since 2007. From California Dairies' own perspective, we

1 now have 165 fewer dairies in operation than we did in 2007.
2 That trend has not abated but has continued into 2013, 2014
3 and 2015. Over the last two years, the past 24 months,
4 California dairies has lost more than 50 dairy farms that
5 were producing a combined 2.7 million pounds of milk per
6 day. Most of these dairies were sold at auction and are
7 completely out of production today.

8 The direction that the industry is headed is not
9 sustainable without suffering widespread consequences.
10 Banks, vendors, suppliers, feed companies, milk hauling
11 companies, and milk processing plants are mindful of the
12 conditions being faced by their dairy customers. They also
13 know the dairy industry well enough to understand what it
14 means when dairy farms exit the industry. These affiliated
15 business partners are dependent on the health of dairy
16 farming operations, and a collapse on the milk production
17 side of the dairy industry has grave consequences for the
18 survivability of their own operations.

19 The regions of the state where the dairy industry
20 has flourished have also been the leading areas of
21 unemployment. These counties have been reporting high
22 unemployment numbers relative to the state average for the
23 last several years. Further increases in unemployment rates
24 can be expected as dairies continue to exit the business.

25 And I will run through some of these. These are

1 based on April 2015 information obtained from the U.S.
2 Bureau of Labor Statistics. The California average for
3 unemployment is 6.5 percent, Fresno County, 11.2 percent,
4 Kern County, 11.1 percent, Kings County, 11.9 percent,
5 Madera County, 11.5 percent, Merced County, 12.9 percent,
6 Stanislaus County, 10.4 percent. And the leading dairy
7 county in California, Tulare County, 13.2 percent. That's
8 April 2015 information.

9 It is well-known that California is facing the
10 worst drought in over a century. Calendar year 2014 was
11 California's driest year dating back to the 1800s and four
12 consecutive dry years have left millions of acre-feet of
13 empty space in reservoirs across California. On April 1,
14 2015 California Governor Brown directed the first ever
15 statewide mandatory water reductions. Not surprisingly, the
16 drought has had and will continue to have significant
17 implications for dairy farms in California.

18 To chronicle the negative impact of the drought, I
19 have asked members of California Dairies about their
20 decisions for growing feed for their dairies. I am
21 including just three of these in my testimony today as
22 substantiation of the impact of the California drought on
23 dairy farming.

24 Dairy 1 farms 780 acres. In a year with normal
25 rainfall, the dairy grows 120 acres of alfalfa and 660 acres

1 of corn. However, the drought has altered the planting
2 decision to include zero acres of alfalfa, 320 acres of corn
3 and 460 acres of sorghum. Alfalfa and corn take substantial
4 amounts of water and cannot tolerate stress well. While
5 sorghum takes less water than corn and is more stress-
6 tolerant, sorghum does not have the same nutritional
7 qualities of corn, which will force Dairy 1, as well as all
8 other similarly situated dairy producers, to buy
9 supplemental feed for their dairy rations.

10 Dairy 2 farms 1,200 acres. In a year with normal
11 rainfall, the dairy grows 300 acres of alfalfa, 400 acres of
12 corn and 500 acres of sorghum. This year, the dairy will
13 farm zero acres of alfalfa and 900 acres of sorghum. The
14 remaining 300 acres will be unfarmed.

15 My last example, Dairy 3, farms 1,300 acres. In a
16 year with normal rainfall, the dairy grows 300 acres of
17 alfalfa, 700 acres of corn and 300 acres of sorghum. This
18 year, the dairy will farm, again as the other ones did, zero
19 acres of alfalfa, 250 acres of corn and 400 acres of
20 sorghum. There will be 650 acres left unfarmed on Dairy 3.

21 Many of our dairymen are reducing the amount of
22 corn silage used in their dairy rations. They typically
23 supplement the rations with more alfalfa hay, which must be
24 brought in from out of state. The Department's *Cost of Milk*
25 *Production 2014 Annual* verifies that dairy-quality alfalfa

1 hay is an expensive supplemental feed and averaged over \$300
2 per ton in 2014. Current prices in 2015 are no different;
3 delivered costs range between \$300 and \$325 per ton for
4 dairy-quality alfalfa hay.

5 We recognize that attempting to establish a milk
6 price high enough to erase the historical financial losses
7 sustained by producers as a result of years of inappropriate
8 whey valuation is problematic. As stated in my testimony,
9 the proposal that we support is meant to address the
10 singular issue of fair compensation to dairy producers for
11 the milk and its components provided to processors. Said
12 another way, producers are entitled to be compensated fairly
13 for the product they produce.

14 I am going to answer a question that Mr. Eastman
15 asked earlier in my testimony, which I was very pleased
16 about, by the way.

17 There seems to be a common theme underlying past
18 hearing decisions by the Department, and that is to say, if
19 there is sufficient milk supply to service milk processing
20 plants then there is no need to increase the milk price. A
21 corollary to this basic notion is that establishing a higher
22 minimum price will only lead to more milk production. It
23 does not take much of an analyst or a historian to conclude
24 that managing the state's milk supply by adjusting minimum
25 pricing formulas only occasionally is ineffective and

1 inefficient. All of the major cooperative and some of the
2 proprietary plants arrived at that same conclusion years ago
3 and adopted programs that allocate milk production shares to
4 producers based on the ability of the entity to handle its
5 milk supply. These programs are actively managed and can
6 adjust with market condition much faster than the Department
7 can call hearings and institute milk pricing changes.

8 California Dairies supports the whey valuation
9 proposal submitted by Western United Dairymen, Milk
10 Producers Council and California Dairy Campaign. It is
11 logical, has an economic basis and is consistent with the
12 producer-led effort to pursue a federal milk marketing order
13 in California. We urge the Department to adopt the proposal
14 as a means to bridge the financial gap from where California
15 milk prices are today and where they need to be to prevent
16 further attrition on the producer side of the California
17 dairy industry.

18 Thank you for your attention. I am happy to
19 answer any questions you have and I do request the option to
20 file a post-hearing brief if necessary.

21 HEARING OFFICER SUTHER: Dr. Erba, your request to
22 file a post-hearing brief has been accepted.

23 Any questions from the panel?

24 MR. EASTMAN: I guess I'm back first again.

25 On page four of your testimony you talked a little

1 bit about the drought's effect on a few dairy farms that
2 grow some of their own feed. Do you have any sense of the
3 cost comparison between them having to buy supplemental
4 feed, sort of the transition from farming their own or a
5 portion of their own feed to what it will cost to have to
6 buy supplemental feed or whatever change that they are going
7 to make?

8 DR. ERBA: I would just -- I will estimate - I'll
9 have to verify this and get back to you - but a 20 to 25
10 percent higher cost to purchase and bring in from out-of-
11 state -- kind of the kicker there is it doesn't grow
12 locally.

13 MR. EASTMAN: Right.

14 DR. ERBA: Compared to what they could do if they
15 had the resources themselves. It's clearly better for them
16 to be able to grow their own forages. And I think you
17 probably know that California dairy farmers get into real
18 trouble when they can't produce enough forage to feed their
19 own dairies. When they have to bring in forage from out-of-
20 state it gets to be very expensive very quickly. So I'll
21 check on that but 20 to 25 percent is about what I would
22 say.

23 MR. EASTMAN: Great. If you could just provide
24 some information to sort of illustrate that sort of cost
25 comparison that would be great.

1 And then I had a question regarding the answer to
2 the question I didn't have to ask you so I appreciate that,
3 saves us a minute or so.

4 DR. ERBA: And we are all about saving time.

5 MR. EASTMAN: I had a question

6 DR. ERBA: We're all about saving time.

7 MR. EASTMAN: That's great. So you mentioned how
8 the cooperatives have their production basis and can utilize
9 that to respond to whatever milk supply balance there is
10 with regards to plant capacity. How do you view that
11 changing under sort of a hypothetical situation? Already we
12 have received some testimony, we might hear more, that would
13 suggest that any increases to the 4b price could inevitably
14 cause some small or medium sized cheese plants to go out of
15 business, which would represent some portion of the milk
16 supply. What that is, probably neither one of us know.

17 But if that were to actually happen and that
18 represents 1, 2, 3 percent of the state's milk supply, do
19 you view that you, as the cooperatives who handle most of
20 the milk supply, you would be able to handle that within
21 just the scope of your production basis? Would you feel
22 you would ship some milk out of state? Is there any sort of
23 concern about that happening, sort of in the current
24 framework with which we are operating right now?

25 DR. ERBA: I think it would be callous and

1 careless to say that we don't care about the industry beyond
2 our own members. We absolutely do and we would absolutely
3 do anything to prevent that from happening. But I will give
4 you a flip side, Mr. Eastman, and that is: we have lost a
5 lot of dairies over the past few years and that doesn't seem
6 to get a lot of recognition or attention; but that continues
7 to happen even today. Even last year when we had
8 extraordinary milk prices and extremely high margins we
9 still lost dairies. Obviously not as many but we did lose
10 dairies. So we are concerned about the general health of
11 the dairy industry but we want that balance and that's why
12 we are supporting the proposal that we are.

13 As far as the milk supply and how you might
14 allocate that. Our view is that the milk supply -- and you
15 heard it earlier today from some of the other witnesses.
16 The milk supply, the pressure to produce more milk in this
17 environment is extraordinary. There are so many factors at
18 work against increasing milk supply today we didn't have
19 five years ago or ten years ago. I just can't see that we
20 would ever return to those levels and stay there. There's a
21 lot of competing competition for the resources that dairy
22 farms use. Land and water are huge ones now. It would be
23 very difficult to say that the dairy industry is going to
24 return to those golden years that we have had in the past, I
25 just don't see that happening.

1 I think the likelihood of milk supply going down
2 is much higher than it going up, and how you allocate that
3 milk among the buyers is going to be a challenge in the
4 coming years. Now I'm not saying that it doesn't matter if
5 we lose a few processors. Again, we very much care about
6 the health of the overall dairy industry, but I am not so
7 sure that that is going to be a problem that we are going to
8 have difficulty managing. We will pull milk out of our own
9 plants if we have to. That's the advantage we have for
10 having the setup we have with six processing plants.

11 MR. EASTMAN: So in summary, you would argue that
12 over the last five to ten years, per se, besides the
13 regulatory milk pricing sort of issues that we have been
14 continually talking about for a number of years now, you
15 view that currently the other sort of factors that affect
16 milk production like you mention, but it's water, land use,
17 competition, regulatory costs and implications of those.
18 Even if the proposal from the trade associations were to be
19 adopted, you would still think that those other factors
20 would impede us from getting back to sort what we
21 experienced maybe 5, 10, 15 years ago. Was that an accurate
22 statement?

23 DR. ERBA: I think so. We have maintained our own
24 supply management program, capacity allocation program is a
25 better way of saying it from our point of view. That has

1 been in place since 2008 and we have never taken it out of
2 place. The last time we had to charge back our members was
3 three years ago. I think the days of that being a major
4 concern are probably past us.

5 MR. EASTMAN: Thank you. I think that's what I
6 had.

7 MR. SHIPPELHOUTE: In your reading you mentioned
8 the hay prices for 2015. Could you repeat those for me,
9 please?

10 DR. ERBA: Sure. I actually just talked with one
11 of our folks this morning and asked what the current price
12 was and he quoted me \$300 to \$325 a ton delivered.

13 MR. SHIPPELHOUTE: And that's for supreme?

14 DR. ERBA: Yes, dairy-quality.

15 MR. SHIPPELHOUTE: No more questions.

16 MR. LEE: Regarding the proposal by the Dairy
17 Institute using the different way of determining the whey
18 factor? Do you have an opinion as to the new methodology?

19 DR. ERBA: Actually, Dr. Schiek and I talked about
20 this before the hearing was called. We were actually in
21 good conversation about this idea of bringing something
22 other than dry whey as the basing point for determining the
23 whey price and there is some validity for that, I don't
24 argue that one bit.

25 The area where we departed in agreement,

1 unfortunately, Dr. Schiek, was the price levels. So no
2 matter how you determine, no matter what you use to
3 determine the price level, that's where we found there is a
4 deficiency. Whether it's dry whey, WPC or some other
5 product. If the price level is right I don't think we would
6 really have much of an argument for why you should or should
7 not use WPC relative to dry whey. Our main concern is the
8 price level.

9 MR. LEE: Do you think the concept, the
10 recognition in California particularly, the concept of using
11 that pricing mechanism, would that be more -- I don't want
12 to say it would be better but more reflective of what goes
13 on in California?

14 DR. ERBA: Even in the days when I was here
15 working at the Department we had difficulty getting
16 information on dry whey. It just isn't really done here so
17 I do not argue that that's necessarily the best way. Then
18 again, you could look at all of the commodities we have for
19 each one of those milk prices and say, is that really the
20 best commodity to be used to set the milk price? I think
21 it's all, it's all debatable.

22 We produce a lot of Italian-type cheeses in
23 California. That doesn't appear anywhere in the formula.
24 Is that really -- the way we do it with cheddar cheese, is
25 that really the best way? I don't know. I think you could

1 make an argument that says, maybe there are different ways
2 of doing it. But no matter what the methods are, the price
3 level to me is what's the most critical and I think that's
4 where we have a departure of agreement on. It is not
5 necessarily the methods, it's where you end up price-wise.

6 MR. LEE: Thank you.

7 HEARING OFFICER SUTHER: Any other questions from
8 the panel?

9 Thank you for your testimony, Dr. Erba.

10 Mr. Dryer, you are up next.

11 Mr. Dryer, will you please state your full name,
12 spell your last name and state your affiliation for the
13 record, please.

14 MR. DRYER: Actually my full name is Ray Gregory
15 Dryer. My father insisted I be named after him and then my
16 mother made sure I was never known by any name other than
17 the one that she chose, which is Greg, so it's Greg Dryer.

18 (Laughter.)

19 MR. EASTMAN: We'll call you "Greg" then.

20 HEARING OFFICER SUTHER: Could you state your
21 affiliation, please.

22 MR. DRYER: The last name is Dryer, D-R-Y-E-R.

23 HEARING OFFICER SUTHER: Can you state your
24 affiliation too, please, for us.

25 MR. DRYER: I work for Saputo Cheese USA,