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VIA EMAIL TO Clerk of the Board, commentletters@waterboards.ca.gov

September 19, 2013

Felicia Marcus, Chair
State Water Resources Control Board 1001 "I" Street
Sacramento, CA 95814

Re: 9/24/13 BOARD MEETING, Item 8, "Consideration of a proposed Resolution adopting emergency regulations revising the core regulatory fee schedules contained in Title 23, Division 3, Chapter 9, Article 1, Sections 2200, 2200.5 and 2200.6 of the California Code of Regulations – Oppose

Dear Chair Marcus:

On behalf of Dairy Cares, thank you for the opportunity to submit the following comments regarding the above-referenced proposed Resolution.

Dairy Cares is a coalition of California's dairy producer and processor organizations, including the state's largest producer trade associations (Western United Dairymen, California Dairy Campaign, Milk Producers Council, California Farm Bureau Federation and California Cattlemen's Association) and the largest milk processing companies and cooperatives (including California Dairies, Inc., Dairy Farmers of America-Western Area Council, Hilmar Cheese Company, and Land O'Lakes, Inc.). Formed in 2001, Dairy Cares is dedicated to promoting the long-term sustainability of California dairies.

Dairy Cares opposes the State Water Resources Control Board's (hereafter "Board") adoption of the proposed resolution. We request instead that fees for all Confined Animal Facilities (CAF) as identified on page two of the revised staff report for Item 8, and in Attachment 2 of same, be set at the same level as those imposed on these Dischargers during the 2012-13 fiscal year. We further request that your Board direct staff to begin a process to hear and consider recommendations from stakeholders before any further increases to CAF fees are considered in future fiscal years. California dairy farms have suffered great economic hardship in the past several years, driving more than a fifth of the state's dairy farms out of business. During the same period, permit fees for CAFs have nearly tripled (the latest proposal would result in a 46.4 percent increase over last year's fees and a 163 percent increase since 2006), partly as an unfortunate result of there being fewer dairies from which to collect fees due to bankruptcies and business failures, resulting in the Board's proposal to assess even larger fees for the remaining dairies to recapture lost revenue.

SUMMARY OF COMMENTS

Dairy Cares' further comments are summarized as follows:

I. Dairies have suffered severe economic losses and cannot bear additional fee increases at this time.

II. Allowing dairies to continue to suffer severe economic losses threatens the production foundation of an industry that generates 443,574 jobs and $63 billion in economic activity and as such is valuable to the people of California.

III. California Water Code Section 13260 requires that the Board consider certain factors including the "pricing mechanism of the commodity produced" when "establishing the amount of a fee that may be imposed on a confined animal feeding and holding operation … including but not limited to a dairy farm." Dairy Cares does not believe the Board's staff adequately considered or applied this provision when proposing the resolution and fee increase.

IV. To prevent driving businesses from the State of California, the Board should limit future fee increases for dischargers engaged in competitive private enterprise and for whom there is limited or no ability to pass on increased costs to the market.

DETAILED COMMENTS

I. Dairies have suffered severe economic losses and cannot bear additional fee increases at this time. Dairies have nevertheless paid significant compliance costs to date while investing millions in compliance assistance efforts that have helped achieve high rates of compliance.

According to data from the California Department of Food and Agriculture (CDFA), 105 dairies went out of business in 2012, continuing a trend of dairy losses going back several years. In fact, between the end of 2006 and the end of 2012, 411 dairies went out of business, reducing the number of dairies statewide from 1,974 to 1,563. In other words, more than a fifth of California's dairies have closed in the past six years.

Dairy closures continue at a rapid pace in 2013. Western United Dairymen reports additional dairy closures since the beginning of 2013 (see Attachment A) and "complete dairy dispersal" auctions continue at a rate of several per month (see attachment B).

CDFA reports that in the past six years, "cost of production" has exceeded the "California overbase price," a benchmark of how much producers earn for milk, in five of those years. Losses were worst in 2009 when cost of production exceeded the overbase price by more $6.05 per hundredweight. However, dramatic losses continued over the past two years, with negative margin of $3.45 per hundredweight and $2.63 per hundredweight in 2012 and 2013, respectively. And the cost of production for 2013 is calculated by CDFA as $19.16 per hundredweight, the highest level ever. The majority of the cost of production increases are attributed to sharp increases in the cost of livestock feed, which has more than doubled since 2003; however, cost of environmental regulations has also been cited as a factor (Attachment A).

It is also important to note that even the 75 to 80 percent of the state's dairies that remain in business are not necessarily profitable or economically stable. With a trend in declining margins, many dairies are struggling to remain solvent, and as we continue to see frequent foreclosures and bankruptcies, it is clear that many are losing this struggle.

At the same time these disastrous economic losses were occurring, the Board has steadily increased annual permit fees. The proposed resolution would increase fees by 46 percent, resulting in a near tripling of fees for dairies since 2006-07 (a cumulative 163 percent increase). Fees which began at $4,360 per year in 2006-07 for large dairies would increase to $11,436 under the current proposal – an annualized increase of about 23 percent every year since 2006-07, despite dramatic losses in dairy profit margins and overall dairy numbers.

In the Central Valley, where approximately 85 percent of the state's dairy herd is located, compliance with water quality regulations includes preparation of an Engineered Waste Management Plan (WMP), a Nutrient Management Plan prepared by a certified professional, and extensive collection, testing, analysis and recording of environmental data, including soil, water, manure and plant tissue sampling. All dairies are required to monitor their existing supply wells. In addition, installation of monitoring wells is required, or alternatively, dairies may participate in a Representative Monitoring Program (RMP). Preparation and submittal of annual monitoring reports to the Regional Board, and extensive record-keeping, are required; such records are subject to inspection during visits by Regional Board field inspectors. Compliance costs associated with these requirements are estimated by Dairy Cares to be between $15,200 and $29,159 per farm annually since 2007. Collectively the industry has spent at least $120 million in compliance costs since 2007, although some estimates range as high as $239 million.

In addition to the investments of individual dairy farms, various dairy industry organizations have invested millions of dollars in organized efforts to improve water quality and achieve regulatory compliance. For example, over the last few years the largest outreach and education effort in the history of the California dairy industry was conducted via the California Dairy Quality Assurance Program (CDQAP). More than 111 separate classes were held around the valley for more than 1,400 Central Valley and North Coast dairy owners and operators and an emerging network of dairy environmental compliance professionals. CDQAP – funded entirely by the dairy industry – created more than 100 educational tools (templates, report forms, instructional documents and videos, etc.) to assist dairy families and their compliance teams in understanding and implementing water quality regulations.

The fact that dairies continue to go out of business at a steady and rapid pace, along with substantial evidence on cost of production from CDFA, suggests that dairies already are facing more costs than they can bear and need relief, not further increases. Dairy Cares asserts that the result of additional fee increases at this time will be an acceleration in dairy farm foreclosures and bankruptcies, further reduction in the number of dairies, and a continuing negative economic spiral.

Instead of further exacerbating the negative economic situation, we strongly request that the Board call a "time out" related to any fee increases so it can fully examine options and alternatives to an additional, disastrous fee increase. Dairy Cares does not believe that the Board freezing CAF fee levels at 2012-13 levels poses serious harm for anyone. While it will result in a small decrease to the Board's projected reserves at end of 2013-14, it will not cause the Board to run at a deficit nor will it necessitate fee increases for other dischargers in the current fiscal year. Rather, it may stave off further dairy bankruptcies and allow time to develop alternative fee schedules that are more equitable and affordable and preserve the health of this vital California industry.

II. Allowing dairies to continue to suffer economic losses threatens the foundation of an industry that generates 443,574 jobs and $63 billion in economic activity and as such is valuable to the people of California.

California's dairy industry, built on the foundation of 1,563 family-owned dairies statewide,[1] generates significant value and economic stimulus for California, particularly within the Central Valley. Even as these farms suffer declining margins and threats to their economic survival, it is important to realize that they are part of a larger economic web; as such, continued losses of dairy farms threatens a broader economic sector. Dairy farms generate jobs in a variety of sectors, from employees on the farm, providers of farm and veterinary services, other farmers who grow feed, processors of milk and dairy products, and in transportation of feed, milk and dairy products, and many others. According to a California Milk Advisory Board analysis,[2] California's dairy industry is responsible for creating a total of 443,574 jobs and $63 billion in economic activity. The same report estimated that a typical dairy cow generates $34,000 in economic activity annually and a herd of 100 cows creates about 25 jobs.

The economic value of the dairy industry is particularly important within the Central Valley, where 89 percent of the state's cows and 81 percent of the state's dairy farms are located, as well as a significant fraction of the state's 117 dairy processing plants. The jobs generated in the Central Valley are particularly important, given routine double-digit unemployment rates in many rural counties and a high reliance on a healthy economic sector. California dairy farms also

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[1] Source for this an all data on number of dairies, cows and farm gate value of milk: CDFA.ca.gov/dairy/dairystatsannual.html

[2] http://www.californiadairypressroom.com/node/289, study by J/D/G Consulting using economic output multipliers developed by the U.S. Department of Commerce, Bureau of Economic Analysis. Based on 2008 data (size of the California dairy industry in number of cows has declined about 3.4 percent since 2008 but the economic impact of the industry is expected to be roughly similar today as to 2008 due to slightly higher overall levels of milk production).

produced about 41.7 million pounds of milk in 2012, about a fifth of the nation's milk supply. As such, dairies play an important role in food and nutrition security for California and the nation. According to the U.S. Department of Agriculture, intake of dairy products is linked to improved bone health, may reduce the risk of osteoporosis, and is especially important to bone health during childhood and adolescence, when bone mass is being built. As a result the USDA recommends intake of the equivalent of two to three cups daily of milk in American diets.[3]

III. California Water Code Section 13260 requires that the Board consider certain factors including the "pricing mechanism of the commodity produced" when "establishing the amount of a fee that may be imposed on a confined animal feeding and holding operation … including but not limited to a dairy farm." Dairy Cares does not believe the Board's staff adequately considered or applied this provision when proposing the resolution and fee increase.

California Water Code Section 13260 (D) states that "In establishing the amount of a fee that may be imposed on a confined animal feeding and holding operation pursuant to this section, including, but not limited to, a dairy farm, the state board shall consider all of the following factors:

- (i) The size of the operation
- (ii) Whether the operation has been issued a permit to operate pursuant to Section 1342 of Title 33 of the United States Code.
- (iii) Any applicable waste discharge requirement or conditional waiver of a waste discharge requirement.
- (iv) The type and amount of discharge of the operation.
- (v) **The pricing mechanism of the commodity produced**. (bold added for emphasis)
- (vi) Any compliance costs borne by the operation pursuant to state and water quality regulations.
- (vii) Whether the operation participates in a quality assurance program certified by a regional water quality control board, the state board or a federal water quality agency."

Dairy Cares does not dispute that the Board has considered the above factors when setting fees <u>in the past</u>. For example, the Board allows fee discounts for quality assurance program-certified dairy farms, and also adopted initial fee structures that were intended to impose a smaller burden on CAFs than on some other regulated dischargers. Dairy Cares acknowledges and appreciates those considerations in the past.

However, with the reduction in the number of dairies, subsequent increases and proposed increases in fees since 2007, and the decision to apply the costs of additional planning programs such as Basin Planning, TMDLs and GAMA to dischargers, Dairy Cares asserts that the Board

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[3] http://www.choosemyplate.gov/food-groups/dairy-why.html, http://www.choosemyplate.gov/food-groups/dairy-amount.html

staff has now drifted away from both the plain intent and the spirit of the Water Code Section 13260:

- The code states clearly that the conditions above must be examined "when establishing the amount of a fee…" Dairy Cares asserts that this duty applies not just when the initial fees schedules were adopted, but each and every time fees are increased, particularly when fee increases are substantial.
- There is no evidence in the publicly available record of this proposed resolution to suggest that all of the above factors required by statute were considered in this proposed fee schedule. Furthermore, Dairy Cares asserts that they cannot have been considered adequately because consideration of the plain facts that a) dairies are operating at negative margins for more than two years and continue going out of business at a rapid pace, and b) dairies cannot pass on cost increases due to the "pricing mechanism of the commodity produced" would have forced the Board staff to conclude that the fee increase would cause additional grave economic harm.

Unless the Board staff has reached the absurd conclusion that the above factors must be considered but need not be acted upon – even if failure to do so will cause serious economic harm to dischargers – it is impossible to conclude that the required factors were adequately considered. Regardless, Dairy Cares asserts that the consideration of the factors above should be included in the administrative record of the proposed decision by the Board.

Dairy Cares further observes that Water Code Section 13260 (B) states that "the total amount of annual fees collected pursuant to this section shall equal the amount necessary to recover costs incurred in connection with the issuance, administration, reviewing, monitoring, and enforcement of waste discharge requirements and waivers of waste discharge requirements." While Dairy Cares does not dispute that these factors were considered when CAF fees were initially established more than seven years ago, given the proposed total increase since that time of 163 percent, combined with fact that the regulatory program itself has not increased nor decreased staffing since then, we believe a new and updated analysis is needed to demonstrate that the proposed fee increases are "necessary to recover costs…" as identified above.

IV. To prevent driving businesses from the State of California, the Board should limit future fee increases for dischargers engaged in competitive private enterprise and for whom there is limited or no ability to pass on increased costs to the market.

Dairy Cares believes and asserts that the Board is engaged in a good faith exercise to pass the costs of permitting, planning and other programs, formerly funded by the Legislature through the General Fund, to Dischargers, as directed by the Legislature.

However, Dairy Cares asserts that the Board has authority and discretion to consider and adopt different methods of allocating costs for these programs among dischargers. Further, Water Code Section 13260 appears to suggest that the Board has a duty to consider doing so.

It cannot be disputed that there is a varying degree among different types of Dischargers to pass on the costs of water quality compliance and fees to their customers. For example, Publicly Owned Treatment Works (POTWs) are often government operated and have an ability to pass both their compliance costs and their direct fees to ratepayers and/or taxpayers. This is not always the case with private enterprise and especially not the case with dairy farms. Dairies have an extremely limited ability to pass on costs because they deal in a commodity whose price is regulated by the State of California, and because it is a commodity whose market price is determined by global factors but whose production costs are affected by local factors. Therefore, production costs generated by state regulatory requirements – should they exceed the costs in regions competing with California – tend to put California-based producers at a competitive disadvantage. We note in Attachment A, page 8, figure 5, that California milk production in early 2012 dropped below production in competing state Wisconsin, and has remained below since. Dairy Cares asserts that this is largely because of shrinking margins, which are affected by regulatory compliance costs.

It is the position of Dairy Cares that the Board, if it is serious about protecting the environment and the ability of businesses, including dairies, to remain viable in California, must consider the ability of Dischargers to pass on regulatory fee increases to the market before adopting increases in fees. Further, if the fee increases will unreasonably impact the economic viability of Dischargers within the State, then alternatives to fee increases should be identified and considered, including but not limited to reallocating fees to other Dischargers more able to pass on costs, reduction of program costs through efficiency measures, and setting of priorities toward overall cost control.

Conclusion

For the reasons stated above, Dairy Cares opposes adoption of the proposed Resolution and again requests a temporary freeze on CAF fees at 2012-13 levels for the 2013-14 fiscal year. Our coalition is committed to working with your staff and Board to identify alternatives that will allow the Board to meet its obligations without serious adverse economic consequences to dairies. We look forward to assisting you in such a process.

Once again, thank you for the opportunity to provide comments.

Sincerely,

J.P. Cativiela
Program Coordinator

C: Charles "Chuck" Ahlem, Chairman, Dairy Cares

Michael Boccadoro, Executive Director, Dairy Cares
Theresa "Tess" Dunham, Somach, Simmons and Dunn
Paul Sousa, Environmental Services Director, Western United Dairymen
Kevin Abernathy, Director of Regulatory Affairs, Milk Producers Council
Denise Mullinax, Associate Director, California Dairy Quality Assurance Program
Lynne McBride, Executive Director, California Dairy Campaign

SEPTEMBER 19, 2013

ATTACHMENT A

SEPT. 12 TESTIMONY OF WESTERN UNITED DAIRYMEN TO CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE

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TESTIMONY

California Department of Food & Agriculture
Hearing on California Stabilization and Marketing Plans for Market Milk
Sacramento, California
September 12, 2013

Western United Dairymen

Presented by

Tom Barcellos
President

Mr. Hearing Officer and members of the hearing panel:

My name is Tom Barcellos. I am the President of Western United Dairymen. Our association is the largest dairy producer trade association in California, representing approximately 900 of 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 at the July 19, 2013 board meeting.

We would like to thank Secretary Ross for the call of this hearing on our petition. WUD advocated for price relief at the last two emergency hearings held on December 20, 2012 and May 20, 2013 and continues to believe that price relief is necessary. Dairy families in the state have struggled in 2012, especially in the second half of the year. 2013 certainly has not been easier, with months of milk prices remaining under the cost of production. While we appreciate the Secretary's goal of finding a long term solution with the implementation of the Dairy Future Task Force, we need dairy families to make it through these difficult financial times.

Beyond emergency price relief is the need to fix the whey portion of the Class 4b formula. Producer groups have advocated for the last few years that the Department needs to modify the Class 4b formula to better track the whey value generated in the Federal Order Class III formula and the market price for cheese. The Class 4b formula was slightly modified over the recent years, but we still believe it falls far short of generating a fair value from whey.

To expand on both those issues, WUD respectfully submits a proposal to consider amendments to the Stabilization and Marketing Plans for the Northern and Southern California Marketing Areas (Plans). Specifically, WUD proposes a temporary price increase on the Class 4b formula: for Class 4b milk solids-not-fat, five and twenty-eight hundredths cents ($0.0.528) per pound. The appropriate changes to the Plans are presented in Appendix A. The second requested change is to increase the current whey scale's cap from 75 cents to a dollar per hundredweight.

<u>Background</u>

Arriving at this position was a lengthy process that did not begin with this petition. With the fixed whey factor implemented on December 1, 2007, it was only a matter of time before prices would fall significantly out of alignment with federal order pricing and the market price for cheese. 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 change.

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 price and the market price for cheese. Western United Dairymen specifically submitted an alternative proposal requesting changes that would have allowed the whey value in California to track very closely to the whey value generated by the Federal Class III formula. As a result of the hearing, the Department decided to implement changes, eliminating the fixed whey factor and replacing it with a sliding scale.

The changes resulting from the June 30, 2011 hearing and implemented on September 1, 2011 were a slight improvement for producers: the whey value was now allowed to fluctuate. However, while WUD appreciated the modification, it still fell far short of a fair method to determine the whey value in the Class 4b formula. Hence, WUD submitted a petition to the Department on December 2, 2011. In the petition, WUD proposed modifying the current sliding scale in the Class 4b formula to allow the whey factor to more closely reflect the whey value generated by the current Class III formula and the market value. At the time, the difference between California's whey value and federal orders since the new sliding scale's implementation averaged a staggering $1.75/cwt. California dairy families clearly needed a better way to capture whey value. Unfortunately, the Department decided not to act on the matter and denied the hearing request.

After the Department's denial, the issue remained and producer discontent intensified. Our board discussed asking for reconsideration or immediately filing another petition. We stressed the imperative of resolving this issue sooner rather than later. Our board was not going to give up on lost producer revenue and decided to petition again. Industrywide support on the producer side was evident. Lengthy discussions took place and producer groups agreed on the requested changes that were argued for at the May 31-June 1, 2012 hearing. The Secretary agreed to raise the top end of the whey scale by an unfortunately very small 10 cents.

Following ever increasing producer discontent, WUD decided to petition the Department again in August 2012. The objective, once again, was the bring the whey value in the Class 4b formula more in line with the whey value generated in the Class III formula and the market price for cheese. That petition also included a dry whey credit concept. The Department denied the petition on the specious basis that the Secretary lacks the authority to implement such a credit.

This moved Dr.Pan to introduce a bill in the California legislature in December 2012. The producer community has rallied behind this bill and fought for its passage since. The price relief needed from a fair adjustment to the Class 4b formula is crucial to the producer community. While we appreciate the Secretary's willingness to act quickly by calling this emergency hearing, we continue to believe relief needs to come from the significant discrepancy that exists in the pricing of whey in the Class 4b formula. In short, the inflexibility of the Panel to recommend bringing pricing of whey in closer alignment with Federal Orders and the market price has been a source of frustration for the producer community since producer prices were disconnected from the market by CDFA in 2007.

Not only does the producer side of the industry believes a change is warranted, but the processor side also agrees. After many disagreements over potential legislation, the proposed changes in our petition were agreed upon by the processor side of the industry as being reasonable. The agreement is outlined in the attached letter from Joe Lang, representing the Dairy Institute of California (see appendix B).

The need for emergency price relief

Given current 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 state have to deal with. Aside from this regulatory burden, costs of production on the dairy have increased significantly. The Secretary, with the appointment of the task force, understands the challenges ahead and the need for a long term solution. In the meantime, dairy producers are facing tough economic times. If producers are to make it through these difficult times, price relief is needed.

To understand why dairy families are in such a precarious situation, a little historical perspective is helpful. As everyone well remembers, producer milk prices fell significantly through most of 2009, posting an overbase price of only $9.60 per hundredweight in July 2009. For the second half of 2009, prices slowly increased but by the beginning of 2010, prices dropped again to the $12-$13 per hundredweight range. With a statewide average cost of production of $15.02 per hundredweight for the first quarter of 2010, the financial situation for dairy producers was unbearable. Prices eventually showed some signs of improvement and the overbase made it all the way to $15.94 per hundredweight in October. With the statewide average cost of production of $15.13 per hundredweight at the time, some producers were likely experiencing positive margins again.

While milk prices were improving, the cost of production was also increasing. Improving dairy prices is good news, but it will take a prolonged period of improved margins for dairy producers to recover the immense losses and eroded equity that arose from the economic disaster of 2008 - 2010. Revenues per cow in 2010 did not come close to the losses per cow incurred in 2008 - 2009. 2011 was an improvement but 2012 has proved to be financially challenging for a lot of dairymen. After all the aforementioned losses, another downturn proved unbearable for many.

According to CDFA data, 105 dairies went out of business in 2012 alone. Just in our association membership, additional dairy sell outs occurred since the beginning of 2013. In addition to these disturbing figures, reports of family dairies having filed for bankruptcy in the last twelve months are abundant. Conversations with a few dairy producers seeking bankruptcy protection revealed that attorneys have had a hard time keeping up with the dairy demand. Additionally, the number of USDA/EQIP contracts cancelled in the state is striking evidence of the impact dairies going out of business have. The values of cancelled contracts per year for are staggering: $2,762,796, $2,584,771, $1,708,037, $649,961 (for 2009, 2010, 2011 and 2012, respectively).

The number of dairy farms in distress is not surprising if you take a look at financial data compiled by the accounting firm Frazer LLP. According to their latest available data (2012), dairies in Southern California, the San Joaquin Valley and Kern County have lost a significant amount of money with average net incomes of -$3.41/cwt, -$2.87/cwt and - $2.83/cwt, respectively. Those numbers were not available at the last hearing, and those alone should strike the Department as clear evidence dairies are financially struggling and orderly marketing of milk on the producer side is not happening.

If the Frazer LLP numbers are not sufficient enough, a comparison of California overbase prices to the average cost of production in California since 2001 reveals the challenge faced by producers. Production costs were on a steady upward trend until the beginning of 2009. The difference between the cost of production and overbase price in 2009 is striking evidence of the catastrophe that occurred for California dairy families (see Table 1). The years following 2009 were unfortunately plagued by more volatility and negative margins. It is hard to imagine how dairy producers were able to recoup these staggering financial losses.

Table 1: California Dairy Production Margin

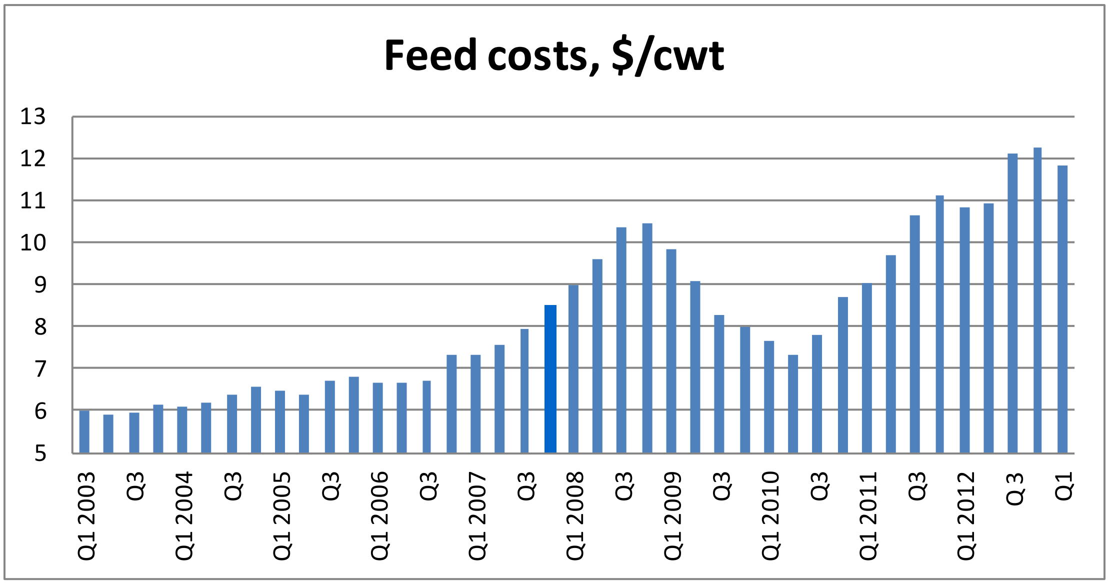
(per hundredweight)	**CA statewide cost of production**	**CA overbase price**	**Margin**
2001	12.24	13.11	**0.87**
2002	12.61	10.24	**-2.37**
2003	12.44	10.70	**-1.74**
2004	12.75	13.89	**1.14**
2005	13.43	13.17	**-0.26**
2006	14.18	10.87	**-3.31**
2007	15.77	17.27	**1.50**
2008	18.53	16.02	**-2.51**
2009	16.86	10.81	**-6.05**
2010	15.23	13.92	**-1.31**
2011	17.45	17.53	**0.08**
2012	19.08	15.63	**-3.45**
2013	19.16	16.53	**-2.63**

Source: CDFA

A disturbing fact about this picture is the trend that stands out. Clearly, margins have been deteriorating.

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. Feed costs dropped to an average of 56.5% of the cost of production for the second quarter of 2010; lower, but still historically high. The slow decline in feed costs was short lived: since fall 2010, feed prices have skyrocketed and reached a record high in the third quarter of 2012 at $12.09/cwt. This caused a record high cost of production of $19.94/cwt. These records were soon broken with the fourth quarter of 2012 data, with feed costs at $12.24/cwt and cost of production above $20/cwt ($20.08/cwt). Figure 2 shows the dramatic increase in feed costs experienced at the dairy.

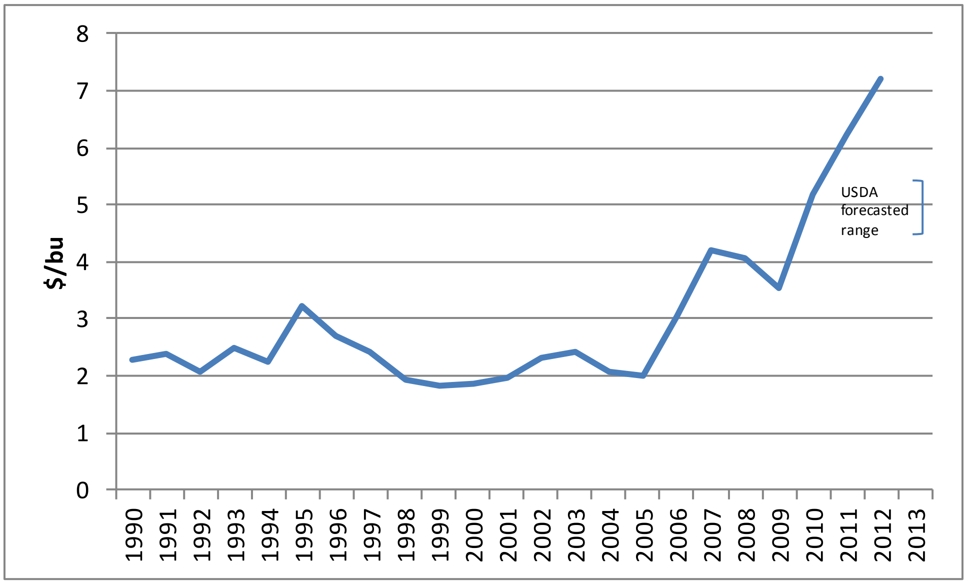
Figure 2: California Feed Costs



While feed costs appear to have softened some for the first quarter of 2013, they still represent nearly 67% of the total cost of production – the highest percentage on record. And despite the small drop, one can clearly see by looking at Figure 2 that they remain clearly above historical norms.

The significant declines in overbase prices combined with fairly steady record high feed prices struck California dairy families in a way no one could see coming. The drought that plagued most of the U.S. during summer 2012, creating a never before seen feed price escalation, is an unusual situation. While the latest USDA *World Agricultural Supply and Demand Estimate* report came out somewhat bearish for corn prices (the forecasted range is $4.50 to $5.30 per bushel for the 2013/14 season), we have to keep in mind this is an estimate. After three straight adverse growing seasons, we're not out of the woods. And even if that range may look good compared to last year's prices, compared to historical averages, it still represents very expensive grain (see Figure 3).

Figure 3: Corn prices received

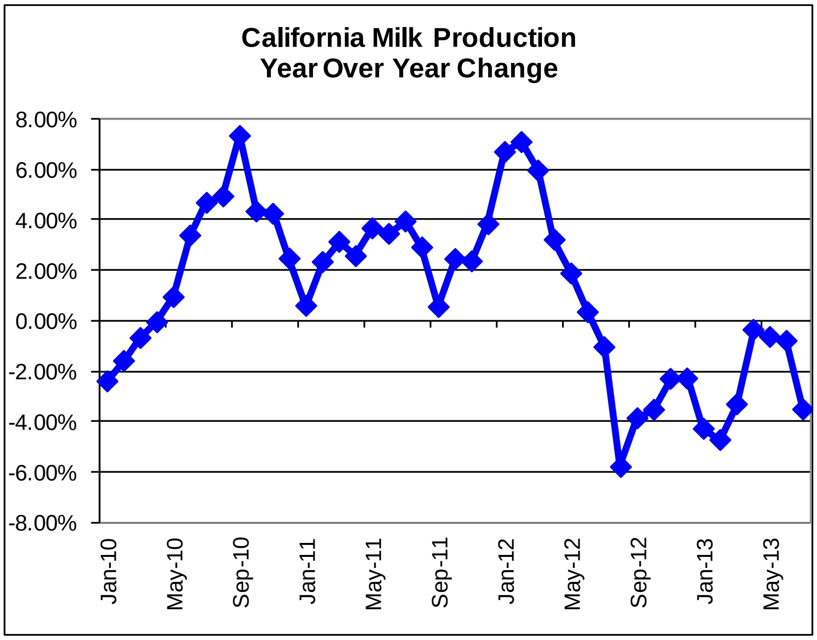


Source: USDA-NASS

We review 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 60262 of the Food and Ag Code).

At previous hearings, we testified that milk production is not necessarily a measure of the industry's health and that base programs have been put in place in the state to take care of potential plant capacity issues. Keeping a lower milk price in our state, we argued, would only contribute to the financial plight of dairy producers. This is exactly what happened. Unfortunately, looking at past hearing decisions, the Department does not seem overly concerned with the losses of dairy farms in the state of California so long as processors can procure enough milk. Looking at the Dairy Marketing Branch legislative charge, "It is the policy of the state to promote, foster and encourage the intelligent production and orderly marketing of milk necessary to its citizens in relation to demand", one could conclude milk production in the state is currently growing. After all, the population of California is not shrinking. However, a look at milk production data shows a completely different story. In fact, milk production in California has been declining for over a year now. Indeed, year-over-year production has been experiencing negative growth since July 2012. July 2013 milk production, the latest month of data available, was the lowest July production since July 2009. Figure 4 illustrates the trend.

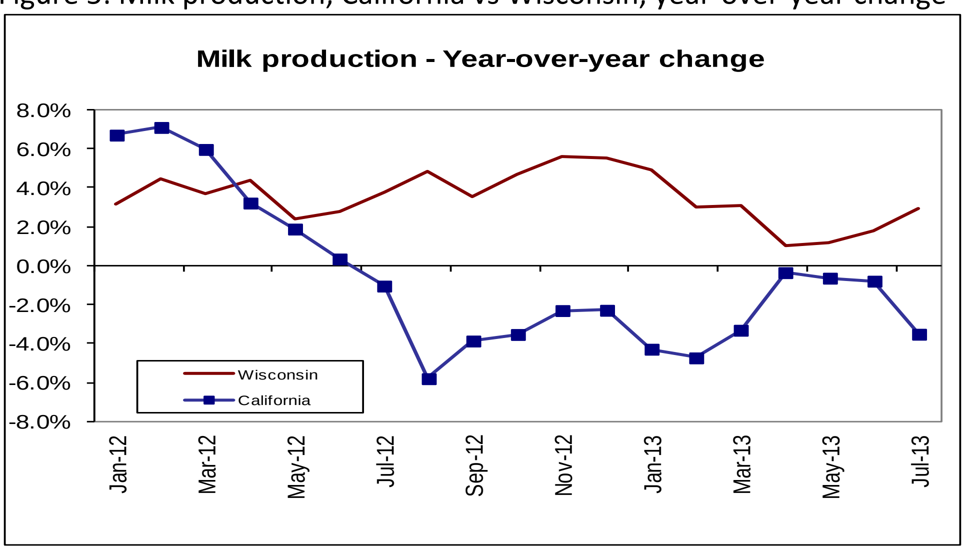
Figure 4: California milk production



Source: USDA - NASS

Comparing the milk production trend experienced in California with that experienced in other parts of the country shows disturbing results. More specifically, comparing the milk production in California to that of Wisconsin, where the Federal Order Class III is in effect and the farmer's milk price is connected to the market, is striking. While milk production in the number one dairy state has been declining, the number two dairy state's production has been thriving.

Figure 5: Milk production, California vs Wisconsin, year-over-year change



Source: USDA-NASS

Class 4b

The temporary increase proposed for Class 4b is to get to what the producer side of the industry has been advocating for almost three years: a more fair pool value from cheese making revenues.

The changes resulting from the May 31 -June 1, 2012 hearing and implemented on August 1, 2012 were a minimal improvement for producers: the whey value was now allowed to reach 75 cents instead of the previous 65 cents. However, while WUD appreciated the modification, we believe it still falls short of a fair value for whey in the Class 4b formula. While we understand the Secretary believes the dry whey issue shouldn't be the only factor to look at when providing price relief, WUD continues to believe the whey factor should more closely reflect the whey value generated by the current Class III formula and the market price for cheese. The difference between California's whey value and federal orders in 2012 averaged a staggering $1.69/cwt. California dairy families clearly need a better means to capture whey value.

We stressed the imperative of resolving this issue sooner rather than later and impressed upon the Secretary that waiting would not work. Our board was not going to give up on lost producer revenue and as you are aware decided to support legislation to fix that issue. In the meantime, we propose two separate changes as mentioned above. Those changes were agreed upon by the processor side of the industry as being reasonable. The agreement is outlined in the attached letter from Joe Lang, representing the Dairy Institute of California (see appendix B). The impact of our proposed change would result in an approximate 35 cents increase in the overbase price. While this is not enough to recoup the immense losses incurred in the recent past, it will not only help bridge the gap between cost of production and milk revenues; it will provide a much needed closer relationship between Class III and Class 4b prices. We would have rather asked for a lot more than this, but rarely does the processor and producer side of the industry come to agreement. If processors feel this is a viable alternative, we hope the Secretary will realize this is a workable and reasonable solution to the financial plight of California dairy families.

When looking at 2012 data, Federal Class III has averaged $1.91 per hundredweight higher than 4b. The deviation between Class III and 4b prices was caused by several factors. Notably, formula differences such as different price series (CME vs NASS), make allowances, yield and formula construct all contribute to the divergence. But the whey value is what creates the most variance between the two class prices and this is a significant concern to the members of WUD. According to our analysis, since April 2007, over 80% of the difference between Class 4b and Class III was attributable to the whey value.

More specifically, the average difference between the whey value in Class III and Class 4b since the beginning of the year has been $1.65 per hundredweight. With whey values that follow market movements in Class III and a sliding scale value in Class 4b capped at 75 cents per hundredweight, such a discrepancy is not surprising.

The concept of pooling was created to allow sharing of revenues among producers. This is what has allowed producers shipping to different plants to get the same price for the same commodity, regardless of where they ship their milk. In any given month, depending on where class prices settle, some plants need to pay more into the pool than the average overbase price, whereas some other months they pay less. To give an example, the first month of 2012, a producer shipping to a cheese plant got an overbase price of $15.55/cwt. The cheese plant had to contribute $13.42/cwt to the pool. Without the pool, the plant would have been required to pay the producer at least that minimum price of $13.42/cwt. In 2012, the 4b price was lower than the overbase price in 7 months. By not including a fair whey value in the Class 4b formula, Class 4b plants are not sharing into the pool like other classes are. Producers shipping to cheese plants benefit from higher blended prices from Class 1, 2, 3 and 4a when the Class 4b price is lower than the overbase, but the Class 4b plant does not share the full value of what it processes into the pool. In 2013, the overbase price has been higher than the Class 4b price every single month. It is time cheese processors start sharing a fair value with the pool.

Risk management

As mentioned above, margins at the dairy are still very fragile. The memory of the 2009 dairy crisis is still fresh in producer's minds. Waiting for good times does not suffice. 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. But it's not as simple as that. 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 California dairymen is tied to Class III. The difference between futures and cash prices is called basis. A hedge will never be perfect due to changes in the basis, which can be negative or positive. 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 gotten much larger due to higher whey values being reflected in Class III and the market, but not in the California milk price. Effectively, the issue of lower milk prices in California is exacerbated by the fact that the fixed 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 expected nor intended. Ironically, cheesemakers can use such tools but the farmers cannot since the farmers price was disconnected from the market by CDFA in 2007.

The unpredictability of the spread, due to the completely different structure of the whey value, makes it riskier for dairymen to hedge by preventing them from being able to determine their basis effectively. Looking back at historical relationships between prices received at the dairy and Class III (which is how one can determine the basis) is certainly not a good predictor of basis because of this disparity.

If the crisis is fresh in dairyman's mind, it's not very far from lenders' minds either. Risk management tools could be very useful for dairymen to show strong business plans to their bankers, reassuring them of less volatile margins. Lending standards have tightened and banks like to know where their borrower's bottom line will be. With all the dairy families being forced out of business, it is becoming less and less of an option.

Even processors recognize the importance of those tools and want producers to be able to use them effectively. Adjusting the whey factor to allow fluctuation with market prices would better enable California dairymen to utilize these risk management tools.

Authority

The Secretary has the legal authority to implement a temporary price increase according to the following additional code sections.

Section 61805 (especially paragraphs b) and d)) gives the Secretary authority to determine minimum prices to be paid to producers by handlers for market milk which are necessary due to varying factors of costs of production, health regulations, transportation, and other factors in the marketing areas of this state.

Section 61805.
The purposes of this chapter are to do all of the following:
(a) Provide funds for administration and enforcement of this chapter, by assessments to be paid by producers and handlers of market milk in the manner prescribed in this chapter.
(b) Authorize and enable the director to prescribe marketing areas and to determine minimum prices to be paid to producers by handlers for market milk which are necessary due to varying factors of costs of production, health regulations, transportation, and other factors in the marketing areas of this state. In determining minimum prices to be paid producers by handlers, the director shall endeavor under like conditions to achieve uniformity of cost to handlers for market milk within any marketing area. However, no minimum prices established or determined under this chapter shall be invalid because uniformity of cost to handlers for market milk in any marketing area is not achieved as a result of the minimum producer prices so established or determined.
(c) Authorize and enable the director to formulate stabilization and marketing plans, subject to the limitations prescribed in this chapter with respect to the contents of the stabilization and marketing plans, and to declare the plans in effect for any marketing area.
(d) Enable the dairy industry, with the aid of the state, to develop and maintain satisfactory marketing conditions, bring about and maintain a reasonable amount of stability and prosperity in the production of market milk, and provide means for carrying on essential educational activities.

Without a price increase, as outlined previously, the milk production in the state is jeopardized. According to Section 61802, it is the policy of the state to foster intelligent milk production therefore a price increase is not only recommended, it is warranted.

Section 61802.
(e) It is the policy of this state to promote, foster, and encourage the intelligent production and orderly marketing of commodities necessary to its citizens, including market milk, and to eliminate economic waste, destructive trade practices, and improper accounting for market milk purchased from producers.

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

Appendix A

Proposed Changes to Article III, Section 300.0(E) of the Stabilization and Marketing Plans for Northern California (Plan 59) and Southern California (Plan 74):

The minimum prices to be paid for components used for Class 4b shall be computed as follows, except as such formulas and procedures may be modified by Paragraph (H) of this Section:

(1) The Cheese hundredweight price shall be the price per hundredweight computed by the sum of the following:

(a) The price per hundredweight computed by the formula using the Cheddar cheese price, less an f.o.b. California price adjuster of two and fifty-two hundredths cents ($0.0252), less a Cheddar cheese manufacturing cost allowance of nineteen and eighty-eight hundredths cents ($0.1988), all multiplied by a yield factor of ten and two–tenths (10.2).

(b) The price per hundredweight computed by the formula using the butter price, less a manufacturing cost allowance of sixteen and thirty-five hundredths cents ($0.1635), less ten cents ($0.10), all multiplied by a yield factor of twenty-seven-hundredths (0.27).

(c) The price per hundredweight for the whey factor value, corresponding to the monthly average dry whey price, based on the following schedule:

Monthly Average Dry Whey Price ($/lb)	**Whey Factor Value ($/cwt.)**
< $0.25	$0.2500
≥ $0.25 and < $0.30	$0.3438
≥ $0.30 and < $0.35	$0.4375
≥ $0.35 and < $0.40	$0.5313
≥ $0.40 and < $0.45	$0.6250
≥ $0.45 and < $0.50	$0.7188
≥ $0.50 and < $0.55	$0.8125
≥ $0.55 and < $0.60	$0.9063
≥ $0.60	$1.0000

(2) For all milk fat, not less than the price per pound computed pursuant to Subparagraph (D)(1) of this Section.

(3) For all milk solids-not-fat, not less than the price per pound computed by the formula using the Cheese hundredweight price established pursuant to Subparagraph (E)(1) less the product of three and seventy–two hundredths (3.72) multiplied by the Class 4b fat price established pursuant to Subparagraph (E)(2), all divided by eight and eighty hundredths (8.80).

(4) The Cheddar cheese prices used in calculations pursuant this Paragraph shall be the simple average of the 40 pound block Cheddar cheese price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.

(5) The butter prices used in calculations pursuant this Paragraph shall be the simple average of the Grade AA butter price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.

(6) The dry whey prices used in calculations pursuant to this Paragraph shall be the simple average of the Dry Whey – West Mostly prices as published in Dairy Market News between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.

(7) In the event the Chicago Mercantile Exchange 40 pound block Cheddar cheese price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the cheese price used in the prior month's calculation of the Cheese hundredweight price.

(8) In the event that the Chicago Mercantile Exchange Grade AA butter price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the Grade AA butter price used in the prior month's calculation of the Cheese hundredweight price.

(9) In the event that the Dry Whey – West Mostly price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the Dry Whey – West Mostly price used in the prior month's calculation of the Cheese hundredweight price.

(10) For any month in which the Secretary implements the collection of security charges provided for in Chapter 2.5, Part 3, Division 21 of the Food and Agricultural Code, the minimum Class 4b price shall be increased by the following amounts:

(a) For milk fat, three and two-tenth mils ($0.0032) per pound.
(b) For milk solids-not-fat, one and three-tenths mils ($0.0013) per pound.

Proposed Changes to Article III, Section 300.0(H) of the Stabilization and Marketing Plans for Northern California (Plan 59) and Southern California (Plan 74):

The minimum prices for components used for Class 1, Class 2, Class 3, Class 4a, and Class 4b, as set forth respectively in Paragraphs (A), (B), (C), (D), and (E) of this Section, shall be increased:

(1) For the period July 1, 2013 to October 31, 2013 as described below:

(a) For Class 1 milk fat, three-tenths mils ($0.0003) per pound.

(b) For Class 1 milk solids-not-fat, two and three-tenths mils ($0.0023) per pound.

(c) For Class 1 milk fluid carrier, one-tenth mils ($0.0001) per pound.

(d) For Class 2 and 3 milk fat and milk solids-not-fat, four and one-tenth mils ($0.0041) per pound.

(e) For Class 4a and 4b milk fat, one and twenty-three hundredths cents ($0.0123) per pound.

(f) For Class 4a and 4b milk fat and milk solids-not-fat, one and twenty-three hundredths cents ($0.0123) per pound.

(2) For the period November 1, 2013 to October 31, 2014 as described below:

(a) For Class 4b milk solids-not-fat, five and twenty-eight hundredths cents ($0.0528) per pound.

(3) Any modifications to the Class 1 fat price resulting from this Paragraph shall not be included in the calculation of the Class 1 solids-not-fat and fluid carrier prices, as set forth in Paragraph (A) of this Section.

(4) Any modifications to the Class 4a component prices resulting from this Paragraph shall not be included in the calculation of the Class 2 and 3 component prices, as set forth, respectively, in Paragraphs (B) and (C) of this Section.

(5) Any modifications to the Class 4b fat price resulting from this Paragraph shall not be included in the calculation of the Class 4b solids-not-fat price, as set forth in Paragraph (E) of this Section.

Appendix B

SEPTEMBER 19, 2013

ATTACHMENT B

COPIES OF RECENT COMPLETE DAIRY DISPERSAL AUCTION ANNOUNCEMENTS

TURLOCK LIVESTOCK AUCTION YARD

MARKET REPORT

Tuesday, September 3, 2013

Receipts of 2483 Hd.

This Special Sale saw a good test on most classes of feeder cattle. Heavy Feeders showing the most advance with some 848 lb. Natural Angus Steers topping at $ 155.35. Holsteins steers and barren heifers steady with good demand. Weigh Cows and Bulls steady from a week ago.

Thanks again to all our patrons.

 # 1 Med. & Large Frame Steers

300-400 lbs. ... $ 170.00 - 199.00

400-500 lbs.... $ 155.00 - 199.00

500-600 lbs.... $ 145.00 - 186.00

600-700 lbs.... $ 135.00 - 161.00

700-800 lbs......$ 125.00 - 156.00

800-900 lbs..... $ 120.00 - 155.00

900-1000 lbs... $ No Test

 # 2 Med. & Large Frame Steers

300-400 lbs. ..$ 100.00 - 168.00

400-500 lbs....$ 100.00 - 154.00

Wednesday, August 21, 2013

Complete Dairy Dispersal

Market Report

Buyer activity was good for this herd sale. Considering body score and milk production the cows sold very well.

#1- 1st & 2nd Lactation Holsteins

$ 1175 - 1300.00

#2 - 1st - 3rd Lactation Holsteins

$ 850 - 1150.00

#1 - 1st Calf Springers

$ 1200 - 1450.00

#2 - 1st Calf Springers

$ 975 - 1175.00

#1 - 2nd-3rd Calf Springers

$ 1150 - 1300.00

Weigh Beef Cows

Top Yielding $ 76.00 - 90.00

Med Yielding $ 64.00 - 75.00

Friday, August 30, 2013

Receipts of 600 hd.

Happy Labor Day to all our friends and customers. Friday's sale had lighter test due to Holiday weekend. Springers softer due to volume and quality. Weigh cows and bulls steady on good fat cows and softer on lower end cows. Many thanks to all our buyers and consignors!

Dairy Replacements

#1 Hol Springers $ 1350 - 1475

#2 Hol Springers $ 1100 -1325

1 Jer Springers $ 1200 -1425

1 Jer x Springers $ 1100 -1350

 # 1 Hol Bred 6-7 mos. Heifers

NO TEST

 # 1 Hol Bred 5-6 mos. Heifers

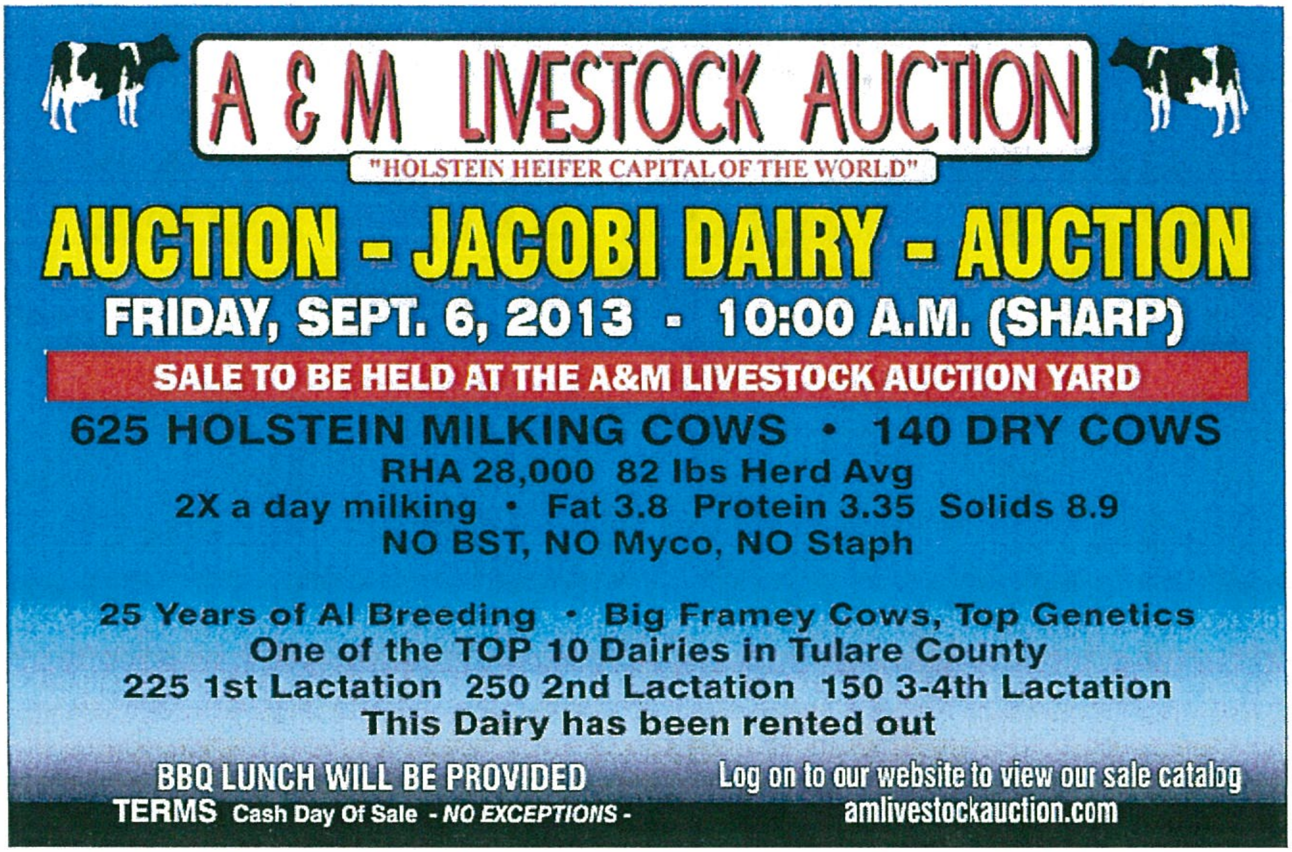
NO TEST

 # 1 Hol Bred 1-2 mos. Heifers

NO TEST

Holstein Open Heifers

Light Test


A & M LIVESTOCK AUCTION
"HOLSTEIN HEIFER CAPITAL OF THE WORLD"
AUCTION - JACOBI DAIRY - AUCTION
FRIDAY, SEPT. 6, 2013 - 10:00 A.M. (SHARP)
SALE TO BE HELD AT THE A&M LIVESTOCK AUCTION YARD
625 HOLSTEIN MILKING COWS • 140 DRY COWS
RHA 28,000 82 lbs Herd Avg
2X a day milking • Fat 3.8 Protein 3.35 Solids 8.9
NO BST, NO Myco, NO Staph
25 Years of AI Breeding • Big Framey Cows, Top Genetics
One of the TOP 10 Dairies in Tulare County
225 1st Lactation 250 2nd Lactation 150 3-4th Lactation
This Dairy has been rented out
BBQ LUNCH WILL BE PROVIDED
TERMS Cash Day Of Sale - NO EXCEPTIONS -
Log on to our website to view our sale catalog
amlivestockauction.com

Top Line #2

Formerly

M & A Dairy

Vern Mello & Xavier Avila
Caruthers, Ca

Complete Dairy Dispersal Auction

Monday September, 9 2013 - 11:00 AM

450 Cows

Approx. 270 Holstein Cows & 180 JerseyX Cows

60 % 1st & 2nd Lactation

150,000 S.C.C - Tested free for Myco & Staph

Fresh Dates & Pregnancy to be Announced.

Replacement Heifer Program to be sold in
Conjuction with our Special Holstein Heifers Auction
Wednesday September 4, 2013 - 1:00 PM
Featuring
300 Holstein & JerseyX Open & Pregnant Hefiers
From M & A Dairy along with
1000 Head Holsteins Open, Short Bred, & Springer Heifers

Peter Belezzuoli
(559) 816-2618
David Howze
(559) 816-2999

Sale Conducted at
OVERLAND STOCK YARD
10565 9th AVENUE
HANFORD, CA 93230
www.overlandstockyard.com
(559) 582-0404 fax (559) 582-6261

Dispersal on Sept 9 And Sept 4, 2013 at OSY

A & M LIVESTOCK AUCTION

"HOLSTEIN HEIFER CAPITAL OF THE WORLD"

ANNOUNCING THE COMPLETE HOLSTEIN MILKING AND HEIFER DISPERSAL

AUCTION - ROCK CREEK DAIRY - AUCTION

SATURDAY, SEPT. 14, 2013 - 10:00 A.M. (SHARP)

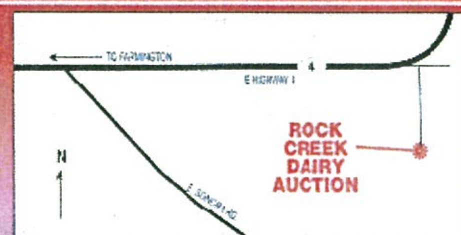
29770 EAST HWY 4, FARMINGTON, CA. 95230

AUCTION TO BE HELD ON THE FARM

1450 Milking and Dry Cows - 1600 Heifers of all ages
500 Heifers, Short bred to Springers
225 Hutches to running corrals - 650 1st Lactation 2 year olds
475 2nd Lactations Cows - Milking 2 times a day
This is a Closed Herd
The Rolling Herd Average is 26,460 , 3.6 butterfat,
and 3.2 Protein, 81 pound Herd Average
NO BST, NO Myco, NO Staph, SCC 140,000

Rock Creek Dairy has been breeding AI for 40 years,
mostly with Select Sires, ABS and Accelerated Bulls.
All records available.

This is a young, clean, good uddered herd that you will like.



BBQ LUNCH WILL BE PROVIDED

Log on to our website to view our sale catalog

amlivestockauction.com

TERMS Cash Day Of Sale - *NO EXCEPTIONS* -

TURLOCK LIVESTOCK AUCTION YARD

MARKET REPORT

Friday, September 6, 2013

Special Fresh Heifer Sale

Expecting 100 Top Holstein Fresh Heifers

ALSO SPECIAL CONSIGNMENT

32 Fancy Close-up Springers from the Michel Ranch Dairy

These heifers have High TPI and Net Merit Values and bred for reproductivity.

Saturday, September 21, 2013 at 9:00 am

Complete Dairy Dispersal

Frank J. Gomes Dairy

Gustine, Ca

1100 Holstein Milking & Dry Cows

82 lb. Herd Avg. - SCC's 150-170k - 28 years DHIA

Sale to be held at the dairy.

Regular Sales Schedule